

## Equities

18 March 2011 | 6 pages

## Daikin Industries (6367)

## Alert: Updated thoughts

**Share price performance** – Today the share price jumped by 9% but it is still down by 11% since the close last Friday. Alongside MHI, which generates close to 10% of its orders from the nuclear business, Daikin was the worst performing name in our coverage over the past week.

**Risks and concerns** – Daikin has a chemical plant in Kashima, Ibaraki Prefecture but unlike other companies in the same area, the extent of the damage from the earthquake was minimal. It has three other chemical plants in Osaka, China and the US. As Japan accounts for more than 40% of total global a/c production, yen strength is a potential drag on earnings. We estimate that for each ¥1 move against the US\$ and € on an annual basis, OP is affected by ¥0.6bn and ¥0.5bn, respectively. However, we think that it is unfair to highlight Daikin as one of the most affected Japan manufacturers. Domestic sales of air conditioners could be affected from here depending on consumer psychology and electricity supply, but among makers of consumer white goods we doubt whether Daikin is alone in facing this threat. Moreover, 2/3 of total a/c sales are overseas. Then there is the lingering question about Goodman Global, and the risk of equity dilution on a potential high priced acquisition.

**What is (still) good** – Daikin has two a/c factories in Japan, and both are in the west (near Kyoto and Osaka) and neither was damaged by the quake. Approx 45% of all a/c production and 2/3 of all a/c sales are outside of Japan. We believe the impact of the quake should do nothing to divert the company from its goal of becoming the top global a/c supplier over the next five years. Some of this growth may come from M&A, and with more than three months since news of the Goodman deal first appeared in the Nikkei we think that some of the risks of equity dilution are probably in the price.

Daikin Industries (6367.T; ¥2,205; 2M)

## ■ Company Update

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

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## Daikin Industries

### Valuation

We use a PER of 15x our FY3/12 EPS estimate to arrive at our target price. According to CIRA's global equity strategy team, the average global PER for 2011 is 12.4x and 13.8x for Japan. The average PER for global industrials is 13.8x for 2011. We believe Daikin deserves a certain premium given its global credentials and the scope for overseas growth. However, we struggle to justify paying much more of a premium given that Daikin is only expected to generate an OPM in FY3/12 of 8.0%, compared to the average for the Japanese machinery sector of 9%; and the average for names in our core coverage of 15.5%. Historically, its OPM peaked in FY3/08 at 10%, the same level as the machinery sector; its FY3/12E RoE of 11% is below the global industrial average of 14%; and with a net debt equity ratio of 43% at the end of Sep-10, its balance sheet is not as strong as some of the other global blue chip names in the Japanese machinery sector, such as Fanuc and SMC.

Applying our fair value PER of 15x to our EPS forecast for FY3/12, our base year, we arrive at our ¥3,150 and round this up to a target price of ¥3,200.

### Risks

Factors that could cause the shares to fail to reach our target price include 1) a slowdown in global economic activity in general but more specifically in the three main A/C markets of Japan, Europe and China; 2) continued euro depreciation; 3) higher raw material prices for copper, aluminum and steel; 4) further downward pressure on ASPs for A/Cs; and 5) an accident at one of its chemical plants.

Conversely, upside risks for the shares are mainly macro factors including 1) stronger-than-projected global GDP growth; 2) a faster-than-expected pickup in European growth; 3) a rebound in the property market in China's main cities; 4) significant yen weakness, especially against the euro; and 5) growing interest in companies with environmental credentials. If these or other factors manifest themselves to a greater extent than we have anticipated, the share price may differ from our target price.

We rate the shares Medium Risk (M) based on their three-year historical volatility, which places them in the sixth through ninth deciles in terms of share price risk compared with our coverage universe.

## Appendix A-1

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Analyst: Graeme McDonald  
Covered since July 8 2010

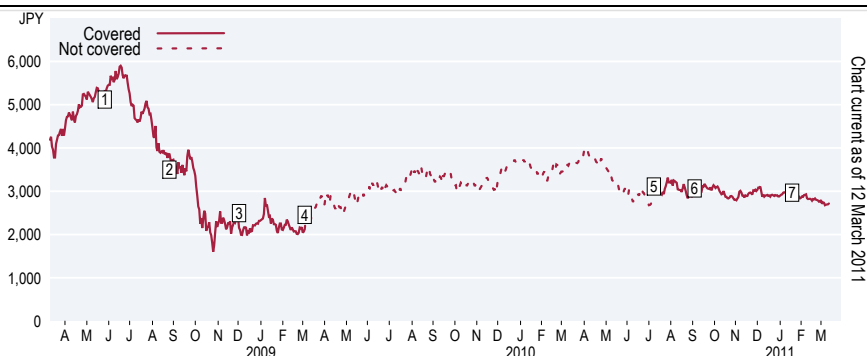


Chart current as of 12 March 2011

	Date	Rating	Target Price	Closing Price
1	27-May-08	2M	*5,300	5,310
2	26-Aug-08	2M	*4,300	3,870
3	2-Dec-08	2M	*2,300	2,155

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	4-Mar-09	Coverage terminated		
5	8-Jul-10	2M	*3,000	2,957
6	3-Sep-10	2M	*3,100	2,971

	Date	Rating	Target Price	Closing Price
7	19-Jan-11	2M	*3,200	2,907

Rating/target price changes above reflect Eastern Standard Time

### Daikin Industries (6367)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Graeme McDonald  
Covered since July 8 2010

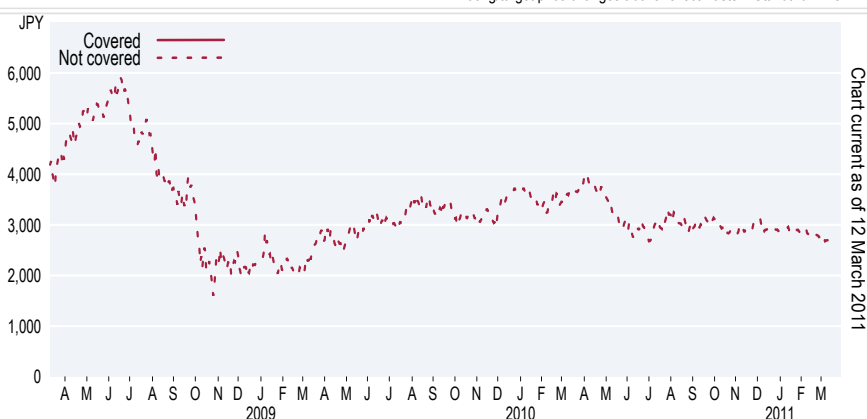


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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
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45%	44%	40%	0%	44%	0%

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