

## Self-help in Japan

### Japanese companies breaking free of the cycle

- **Macro versus micro** — The market's weakness since the start of 2014 has been driven largely by global macro uncertainties. However, the sell-off has masked a continued improvement in corporate profitability in Japan. Japan continues to enjoy stronger profit momentum than other regions, with just-completed Q3 results season once more surprising to the upside. In his February 10 report [Japan Equity Strategist - October-December results: Earnings strong, unlike market](#), Kenji Abe noted that positive surprises outweighing negatives by a ratio of 2:1. We believe that as macro uncertainties settle down, investor focus will return to the powerful micro story building in Japan. To this end we asked our analysts to identify the companies in their coverage that they see as taking the greatest steps to grow irrespective of the macro environment, or where they believe substantial change in the business model has yet to be recognized fully by the market.
- **Will 2014 be a year of change?** — In his December 10 report [Japan Equity Strategist - 2014 outlook: Year One of a change in management thinking](#), Mr. Abe predicts that this will be the year when investors start to discern a change in management thinking in Japan, with a greater focus on investment return and in unlocking value. PM Abe is also looking to promote this change in the so-called 'third arrow' of Abenomics, which creates top-down pressure on management to change. In our view, the newly-introduced JPX-Nikkei 400 and the launch of NISA investment accounts are evidence of government intent. Many of Japan's leading companies are already changing swiftly and we expect to see the market reward those companies that change the most, a phenomenon we have been witnessing globally.
- **Four categories of change** — A look at our list suggests that the companies split into four categories: Radical Restructurers (i.e., companies implementing or planning to implement far-reaching structural reforms), Global Growers (i.e., companies looking to expand globally via M&A, etc.), Only Ones (i.e., companies with high market shares and unique products), and Shrinkers and Hikers (i.e., companies that plan significant share buybacks and/or dividend hikes). We believe this area in particular is where Japan could see significant change over the next few years.
- **Key companies in each category** — Radical Restructurers include Hitachi (continuing with far-reaching structural reforms including offloading non-core business and group restructuring) and Nidec (key earnings driver is steadily shifting to automotive and general industrial motors from HDD motors). Global Growers, on the other hand, include Nippon Paint (to take majority stakes in its Asia JVs with Wuthelam, working to transform itself into the No. 4 paint maker globally with sales of ¥500bn) and M3 (plans to launch Internet services for physicians in China, having done so in Europe and the US). The Only Ones category includes Toray, which is managing to turn fibers into a high-growth business despite the area being considered as mature and commoditized. Finally, Shrinkers and Hikers include Lixil (has a clear focus on shareholders, has hiked DPS for the first time in 11 years), Omron (also focused on shareholders, aiming for a dividend payout of 25% or more), and Asahi Group Holdings (taking an aggressive approach to shareholders' return in 2013-2015, aims for a total payout of 50% or more via share buybacks and dividends).

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

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| Sector name  | Lead Analyst       | e-mail address   | Company                         | RIC  | Rating | Current Price<br>(Feb 19, ¥) | Market cap |
|--|--------------------|--|---------------------------------|------|--------|------------------------------|------------|
| Auto & Machinery/Capital Goods                                     |                    |  |                                 |      |        |                              |            |
| Automobiles, Tires   | Arifumi Yoshida    | <a href="mailto:arifumi.yoshida@citi.com">arifumi.yoshida@citi.com</a>       | Honda Motor                     | 7267 | 1      | 3,754                        | 6,765,805  |
|  |                    |  | Fuji Heavy Industries           | 7270 | 1      | 2,783                        | 2,171,827  |
| Auto Parts   | Manabu Hagiwara    | <a href="mailto:manabu.hagiwara@citi.com">manabu.hagiwara@citi.com</a>       | Denso                           | 6902 | 1      | 5,356                        | 4,267,053  |
|  |                    |  | Stanley Electric                | 6923 | 1      | 2,332                        | 392,902    |
| Machinery, Capital Goods   | Graeme McDonald    | <a href="mailto:graeme.mcdonald@citi.com">graeme.mcdonald@citi.com</a>       | Kubota                          | 6326 | 1      | 1,430                        | 1,795,938  |
|  |                    |  | Omron                           | 6645 | 1      | 4,270                        | 939,901    |
|  | Lucy Liu           | <a href="mailto:lucy.liu@citi.com">lucy.liu@citi.com</a>                     | DMG Mori Seiki                  | 6141 | 1      | 1,650                        | 178,531    |
| Lifestyle  |                    |  |                                 |      |        |                              |            |
| Food & Beverages, Household<br>& Personal Care                     | Nobuyoshi Miura    | <a href="mailto:nobuyoshi.miura@citi.com">nobuyoshi.miura@citi.com</a>       | Asahi Group Holdings            | 2502 | 1      | 2,603                        | 1,203,193  |
|  |                    |  | Japan Tobacco                   | 2914 | 1      | 3,344                        | 6,077,854  |
| Pharmaceuticals  | Hidemaru Yamaguchi | <a href="mailto:hidemaru.yamaguchi@citi.com">hidemaru.yamaguchi@citi.com</a> | M3 Inc.                         | 2413 | 2      | 306,000                      | 493,757    |
|  |                    |  | Takeda Pharmaceutical           | 4502 | 2      | 4,823                        | 3,807,609  |
| Transportation   | Akira Funae        | <a href="mailto:akira.funae@citi.com">akira.funae@citi.com</a>               | Yamato Holdings                 | 9064 | 1      | 2,067                        | 865,956    |
|  |                    |  | ANA Holdings                    | 9202 | 2      | 224                          | 781,400    |
| Retail   | Masataka Kunito    | <a href="mailto:masataka.kunito@citi.com">masataka.kunito@citi.com</a>       | Fast Retailing                  | 9983 | 2      | 35,720                       | 3,639,841  |
| Materials  |                    |  |                                 |      |        |                              |            |
| Chemicals, Fibers, Glass, Paint                                    | Takao Kanai        | <a href="mailto:takao.kanai@citi.com">takao.kanai@citi.com</a>               | Asahi Kasei                     | 3407 | 1      | 741                          | 1,035,495  |
|  |                    |  | Sumitomo Chemical               | 4005 | 1      | 427                          | 697,940    |
|  | Atsushi Ikeda      | <a href="mailto:atsushi.ikeda@citi.com">atsushi.ikeda@citi.com</a>           | Toray Industries                | 3402 | 1      | 712                          | 1,159,851  |
|  |                    |  | Nippon Paint                    | 4612 | 1      | 1,508                        | 393,178    |
| Cement, Steel  | Tatsuro Ochi       | <a href="mailto:tatsuro.ochi@citi.com">tatsuro.ochi@citi.com</a>             | Nippon Steel & Sumitomo Metal   | 5401 | 1      | 306                          | 2,792,191  |
|  |                    |  | Kobe Steel                      | 5406 | 2      | 143                          | 429,171    |
| Oil, Electric Power, Gas,<br>Trading Companies                     | Takashi Miyazaki   | <a href="mailto:takashi.miyazaki@citi.com">takashi.miyazaki@citi.com</a>     | Mitsui & Co.                    | 8031 | 1      | 1,579                        | 2,881,920  |
|  |                    |  | Mitsubishi Corp.                | 8058 | 1      | 1,999                        | 3,294,531  |
| Technology, Media, Telecom   |                    |  |                                 |      |        |                              |            |
| Consumer Electronics,<br>Semiconductors, Industrial<br>Electronics | Kota Ezawa         | <a href="mailto:kota.ezawa@citi.com">kota.ezawa@citi.com</a>                 | Hitachi                         | 6501 | 1      | 812                          | 3,821,504  |
|  |                    |  | NEC                             | 6701 | 1      | 309                          | 808,055    |
| Electronic Components  | Tsubasa Sasaki     | <a href="mailto:tsubasa.sasaki@citi.com">tsubasa.sasaki@citi.com</a>         | Fujitsu General                 | 6755 | 1      | 1,091                        | 110,402    |
|  |                    |  | Ibiden                          | 4062 | 1      | 2,034                        | 276,590    |
| Precision Instruments, SPE   | Yuta Fukasawa      | <a href="mailto:yuta.fukasawa@citi.com">yuta.fukasawa@citi.com</a>           | Nidec                           | 6594 | 1      | 12,140                       | 1,658,306  |
|  |                    |  | Fujifilm Holdings               | 4901 | 1      | 2,914                        | 1,369,284  |
| Games, Internet, IT Services,<br>Leisure                           | Masahiro Shibano   | <a href="mailto:masahiro.shibano@citi.com">masahiro.shibano@citi.com</a>     | Konica Minolta                  | 4902 | 1      | 1,076                        | 552,644    |
|  |                    |  | Sega Sammy Holdings             | 6460 | 1      | 2,280                        | 543,690    |
| Media, Internet, Telecom   | Soichiro Fukuda    | <a href="mailto:soichiro.fukuda@citi.com">soichiro.fukuda@citi.com</a>       | Namco Bandai Holdings           | 7832 | 1      | 2,313                        | 494,299    |
|  |                    |  | Dentsu                          | 4324 | 1      | 3,980                        | 1,124,638  |
|  | Hideki Takoh       | <a href="mailto:hideki.takoh@citi.com">hideki.takoh@citi.com</a>             | SoftBank                        | 9984 | 2H     | 7,666                        | 9,011,852  |
| Financial & Housing/Construction                                   |                    |  |                                 |      |        |                              |            |
| Banks, Brokers, Insurance  | Hironari Nozaki    | <a href="mailto:hironari.nozaki@citi.com">hironari.nozaki@citi.com</a>       | Sumitomo Mitsui Financial Group | 8316 | 1      | 4,837                        | 6,450,843  |
|  |                    |  | Mizuho Financial Group          | 8411 | 1      | 218                          | 5,153,477  |
| Housing, Construction  | Shusuke Terada     | <a href="mailto:shusuke.terada@citi.com">shusuke.terada@citi.com</a>         | Daito Trust Construction        | 1878 | 1      | 9,630                        | 752,956    |
|  |                    |  | LIXIL Group                     | 5938 | 2      | 2,910                        | 821,043    |

Source: Citi Research, Powered by DataCentral<sup>1</sup>

For further writing on the subject of self-help and other themes, please see:

[Equity Strategy: Self Help - Sometimes, Doing It Yourself Matters More](#) (October 14, 2013)

[European Portfolio Strategist - Help Yourself](#) (April 11, 2013)

[Citi Global THEME book - February 2014](#) (February 2014)

<sup>1</sup> Citi Research's proprietary database, dataCentral, sources data from Citi Research estimates, published company data, Thomson Reuters, DataStream, and IBES.

## Reasons for change at Japanese companies

### Abenomics to eliminate six key problems

Japanese corporate managers have long said that the business environment is unfavorable for Japanese companies. They tend to bring up six problems in particular: the strong yen, high corporate tax rates, delays in establishing FTAs with trading partners, tight labor regulations, tight environmental regulations, and high electricity costs. Abenomics has taken on these issues, with some success.

The yen has depreciated more than 25%, and the corporate tax will be reduced as the special tax for reconstruction is going to be eliminated from FY2014. In addition, the Abe administration has decided to take part in TPP negotiations, and it has said it plans to revise the Worker Dispatch Law. Screening necessary to restart nuclear reactors in Japan is progressing, as are negotiations to import cheap shale gas.

### Improving corporate governance is a key theme

Abenomics is not only expected to eliminate the six problems noted above, but also to help improve corporate governance. Japan Revitalization Plan announced by the Abe Cabinet in June 2013 included six items designed to change management thinking in Japan (Figure 1).

Many have expressed doubts about the 'third arrow' of Abenomics and PM Abe's growth strategy. However, measures to improve corporate governance are steadily being enacted. The JPX-Nikkei 400 was announced in November 2013, with its calculation beginning in January 2014. In addition, an expert panel issued a recommendation in November 2013 suggesting that the GPIF invest in more risk assets. What is more, revisions to the Company Law were enacted in the current Diet session that require companies that lack external directors to explain why this is, and a draft of the Japanese version of the Stewardship Code has been issued (it is expected to be finalized in February after public comments have been gathered).

Figure 1. Six measures in the growth strategy designed to change management thinking

| Measures for changing how management thinks   | Progress   |
|---|--|
| 1) Making external directors part of listing requirements on Japan's securities exchanges and creating an index of stocks that are well-regarded in terms of profitability and management | The JPX-Nikkei 400 was announced by the Japan Exchange Group, the TSE, and the Nikkei in November 2013. Calculation began from January 2014.   |
| 2) Having a panel of experts consider measures to improve return on long-term investment in equities by public pension funds and other bodies   | In November an expert panel recommended revision to the public pension system's focus on JGBs in investing, and suggested a greater allocation to risk assets.   |
| 3) Considering efforts to promote business restructuring to correct the issue of low-margin businesses sitting neglected for long periods of time   | Legislation to improve Japan's industrial competitiveness was passed in an extraordinary session of the Diet. The ruling coalition has hammered out an outline for tax reform that includes tax breaks.                                |
| 4) promoting the introduction of external directors via changes to corporate law  | While the government has put off mandating external directors, it will require companies that do not have them to explain why, and we believe it will revisit making external directors mandatory in two years.                        |
| 5) Creating a Japanese version of the Stewardship Code  | A panel of experts convened by the FSA is put together a Japanese version by year-end and will be finalized in February after public comments have been gathered.  |
| 6) Measures to enliven the financial and capital markets (financial growth strategy)  | The FSA and MoF have convened an expert panel to take up the question of how to enliven the financial and capital markets. They will continue to develop concrete measures in 2014. Private pension reform is to be discussed as well. |

Source: Office of the Prime Minister, MoF, Citi Research.

### RoE a key criterion in calculating the JPX-Nikkei 400

The JPX-Nikkei 400 has adopted three-year average RoE as a key criterion for stock selection. The GPIF is considering using the new index as a benchmark for some of its passively managed assets, and there have been repeated proposals to develop and ensure the spread of related products as part of the financial growth strategy. We think it is also possible that ETFs based on the new index could be subject to BoJ purchasing operations. The government seems to want to brand the JPX-Nikkei 400 as comprising companies with high and stable RoE, and give support to their share prices.

**Japanese society to demand change in management thinking as the number of individual investors expands**

In our view, the government isn't the only body that will demand change in management thinking; Japanese society is likely to demand change as well. In the past, the main demand on corporate managers from Japanese society was maintaining employment, with expanding corporate value to reward those who had taken on risk and invested capital a secondary concern (please see our November 12, 2013 report [Japan Equity Strategist - Japanese companies more focused on employment than investment return . . .](#)). To change this we have long thought there need to be a larger cohort of individual investors who benefit directly from expansion in corporate value. The launch of NISA in January 2014 and the increasing use of defined contribution pension plans is likely to increase the ranks of individual investors (please see our January 16 report [Japan Equity Strategist - Japanese stewardship code and financial growth strategy](#)). As such, we think that Japanese society will start to demand not only maintaining employment but also expanding corporate value from corporate managers.

**2014 likely to be "Year One" of a change in management thinking**

Given these changes, we think corporate management is likely to change as well. As such, we have argued that 2014 will be "Year One" of a change in management thinking in Japan (please see our December 10, 2013 report [Japan Equity Strategist - 2014 outlook: Year One of a change in management thinking](#)). In collaboration with our fundamental analysts, in this report we create a list of companies that are making changes such as restructuring their business portfolios, implementing strategic M&A, and/or significantly expanding shareholders' return.

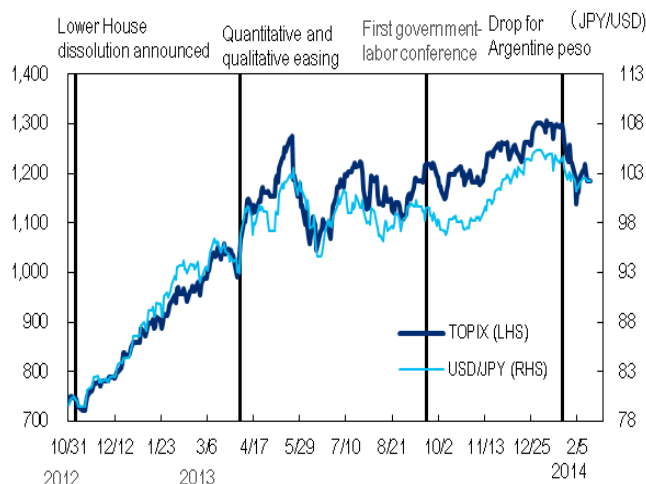
**Japanese earnings are firm, unlike the market**

Japanese equities have fallen sharply since January 2014 (Figure 2). We believe this has been due to factors like sharp declines for EM currencies and weakness for US economic figures stemming from severe winter weather (Figure 3). Although Japanese equities have been weak, Japanese corporate earnings have been steadily improving, and earnings momentum continues to be better than in other regions. Japan leads major regions in consensus EPS growth for 2014, and it is the only region with a revision index in positive territory (Figures 4, 5).

**Once the market calms down then companies implementing changes are likely to benefit**

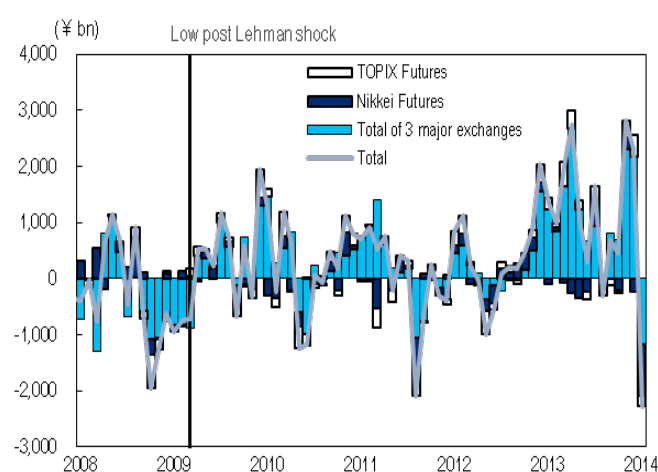
Once the market calms down we think investors are likely to shift their attention back to corporate fundamentals. We think the companies that are working to enact "self-help" kinds of change could benefit once this shift has been made.

Figure 2. TOPIX and ¥/\$ rate



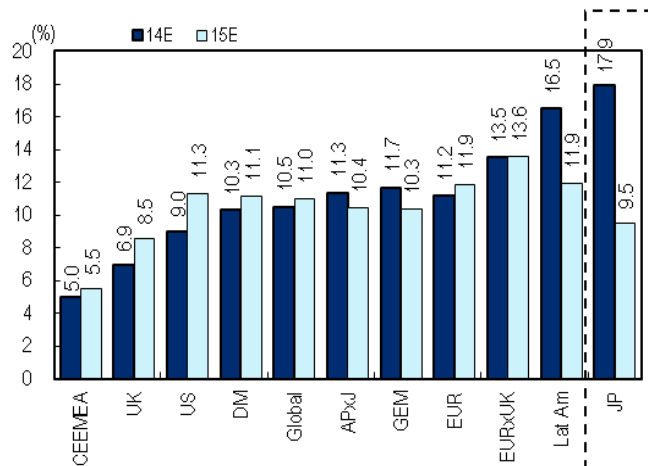
Source: Datastream, Citi Research.

Figure 3. Investment in Japanese equities by foreign investors



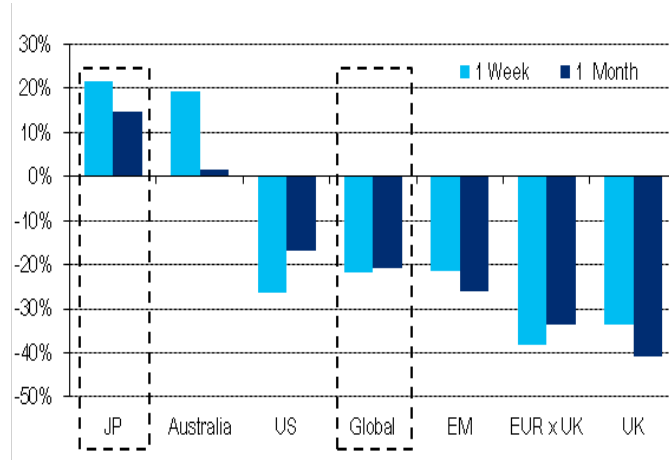
Source: Astra Manager, Citi Research.

Figure 4. Forecast EPS growth by region in 2014 and 2015



Source: Worldscope, MSCI, Factset, Citi Research.

Figure 5. Revision index by region



Source: MSCI, Factset, Citi Research.

## Auto & Machinery/Capital Goods

### Automobiles, Tires

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#### Honda Motor (7267)

|                     |  |
|---------------------|--|
| Change Thesis       | Honda has finally reworked its power train based on the Earth Dreams Technology tech strategy. By combining an established package with a new power train, Honda has generated a number of hits since the N-Box launch. Moving forward the company will roll out the new Fit series globally. We think upfront investment will remain high through FY3/15, but we look for this to bear fruit from FY3/16. |
| Company Description | The world leader in motorcycles. In autos, Honda is strong in packaging and leading technology. The firm is shifting its focus to developing markets from North America.   |
| Key Reports         | <a href="#">Honda Motor (7267) - FY3/15 guidance merits caution, but reiterating Buy on expectations for FY3/16</a> (February 12, 2014)<br><a href="#">Honda Motor (7267) - Q3 in line with market expectations, brings some hope</a> (January 31, 2014)   |

#### Fuji Heavy Industries (7270)

|                     |  |
|---------------------|--|
| Change Thesis       | We believe brand value and market share will continue to improve in North America. Going forward the key issues are improving dealer quality, increasing production capacity, launching a new model Legacy better attuned to local needs, and launching a new version of EyeSight. Competition is heating up in the North American market, and we think FHI is rare in that it should be able to keep both incentives and inventory low. With an increasing focus among consumers on safety, we believe FHI will be able to stand firm thanks to its impressive safety reputation. |
| Company Description | A high-earnings niche player focused on developed markets. Known for impressive safety performance. Its marketing strategy is another strength.  |
| Key Reports         | <a href="#">Fuji Heavy Industries (7270) - Top automaker pick: Forecasting sustained margin improvement</a> (February 12, 2014)<br><a href="#">Fuji Heavy Industries (7270) - Q3 in line with market expectations; solid results</a> (February 4, 2014)  |

### Auto Parts

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#### Denso (6902)

|                     |   |
|---------------------|---|
| Change Thesis       | We think increasingly strict regulations in developed markets will act as a tailwind for Denso, which makes AEB systems and components that contribute to greater fuel efficiency. More auto-related products are becoming commoditized as demand in emerging markets expands, but Denso is ahead of the curve with its introduction of "cost half" products and its standardizing parts that can be used by different models. Right now earnings are firm as sales are expanding steadily to non-Toyota customers, particularly in components that contribute to greater fuel efficiency and car air conditioners (an area of strength for Denso). We look for sales of "cost half" products to rise in China from FY3/15. |
| Company Description | A Toyota-related parts supplier and one of the big three global parts makers. Has the top share globally for products like heat exchangers.   |
| Key Reports         | <a href="#">Auto parts sector - Q3 results: Tough going overall</a> (February 3, 2014)<br><a href="#">Auto parts: Update on eight Toyota affiliates - Prefer the majors, upgrading Toyota Industries to Buy</a> (October 25, 2013)  |

#### Stanley Electric (6923)

|                     |  |
|---------------------|--|
| Change Thesis       | Stanley boasts high earnings thanks to its thorough profit management. Efforts began last summer to increase productivity at a problem plant in Michigan. We believe benefits from these efforts will emerge gradually between now and FY3/15 H1. Auto headlights are increasingly shifting to LED, and we think the company is aiming to bring in more added value than from previous products via in-house production. There were 20 models using LED headlights as of end-May 2015, and right now we understand this number has increased to 44 models. |
| Company Description | An independent parts maker that focuses on automotive lights. In 2012 we estimate its share of the global headlight market was about 10%.  |
| Key Reports         | <a href="#">Stanley Electric (6923) - Upgrading to Buy: Strong near-term earnings momentum and big beneficiary of shift to LED lights</a> (February 17, 2014)<br><a href="#">Stanley Electric (6923) - Q3 in line with market expectations</a> (January 29, 2014)  |



## Machinery, Capital Goods

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### Kubota (6326)

|                     |   |
|---------------------|---|
| Change Thesis       | Kubota is the top ag equipment supplier in Japan and one of the top ag equipment suppliers in Asia, but only ranks #4 globally with significant gaps in its product portfolio. To rectify this, the company aims to enter the market for large-sized dry-field tractors, which, just for the 120-180 HP category, is estimated to be worth ¥700bn. According to the FAO, there is 4x more land devoted to dry-field farming worldwide than to paddy fields. As a first step Kubota is building a new factory in Northern France with plans to ship 3,000 units by 2017. However, the CEO also says that M&A remains an option to boost its presence in this category. |
| Company Description | Kubota is a leading supplier of ag equipment, engines and compact construction equipment. In Q1-Q3 Japan comprised 40% of sales followed by North America (25%); Asia (20%); and Europe (12%). Some 70% of manufacturing is located in Japan.   |
| Key Reports         | <a href="#">Kubota (6326) - Another upward revision, but what's left in store for next year?</a> (February 7, 2014)<br><a href="#">Kubota (6326) - Dealer meeting in Kyoto</a> (January 15, 2014)   |

### Omron (6645)

|                     |  |
|---------------------|--|
| Change Thesis       | Omron is set to generate record high profits this year and is committed to keeping shareholder returns high on the agenda with a minimum payout ratio of 25%. At the same time management is looking for possible deals to bolster growth in its health care and industrial automation businesses, but it says that if the trigger is not pulled it will look to return capital to shareholders. The next medium-term plan to be announced in April will attach greater importance to RoIC which should reach 11% this year. |
| Company Description | Omron is a conglomerate manufacturing a broad range of components and end-products mainly for industrial customers. Japan makes up c45% of sales followed by Greater China (19%), Europe (14%), and the Americas (13%).  |
| Key Reports         | <a href="#">Omron (6645) - Sensing an opportunity</a> (February 4, 2014)<br><a href="#">Omron (6645) - Results First Impressions — Positive</a> (January 30, 2014)   |

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### DMG Mori Seiki (6141)

|                     |  |
|---------------------|--|
| Change Thesis       | Past M&A involved firms such as DIXI Machine, Tobler, and Magnescale, but since 2009 the company has been expanding its alliance with DMG and now has a c25% stake in that company. In October 2013, the company changed its name to DMG Mori Seiki and integrated its global sales network. Going forward it will work to unify machines and systems, use each other factories, and set up a joint venture by 2020. Overseas production has accelerated with factories starting up in North America in 2012 and in Tianjin in October 2013. |
| Company Description | Machine tool major specializing in lathes and machining centers. Forging stronger ties with industry peer Gildemeister (Germany)   |
| Key Reports         | <a href="#">DMG Mori Seiki (6141) - Q3 results negative but on period slippage, we expect claw-back in Q4</a> (February 12, 2014)<br><a href="#">Machine tool sector - Makino Milling our top pick on domestic, aircraft-related order growth</a> (November 20, 2013)  |



## Lifestyle

### Food & Beverages, Household & Personal Care

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#### Asahi Group Holdings (2502)

|                     |  |
|---------------------|--|
| Change Thesis       | The domestic business environment is favorable. Consumption is shifting to top brands and up-trading, trends that bode well for the brand leader Super Dry. The business is growing more stable, and management plans to accelerate shareholder returns in 2013-2015. The plan is to boost the total payout ratio to over 50%, including dividends and buybacks. Taxes look likely to be lowered on regular beer and raised on "new genre" beers, which would be a big boost for Asahi's earnings. |
| Company Description | Japanese largest beer company. Its Super Dry brand commands 24% of the domestic market. Asahi is also fourth domestically in soft drinks.  |
| Key Reports         | <a href="#">Asahi Group Holdings (2502) - Q4 results negative; excessive pessimism unwarranted</a> (February 12, 2014)<br><a href="#">Asahi Group Holdings (2502) - Our top sector pick for 2014</a> (January 6, 2014)   |

#### Japan Tobacco (2914)

|                     |  |
|---------------------|--|
| Change Thesis       | JT's earnings remain strong overseas, helped by an improving product mix in Russia and growing volumes in Turkey among other countries. In Russia, we are seeing consumers trading up from low-end brands, to middle-tier and sub-premium price bands, which is a tailwind for JT. Cigarette prices are lower in Japan than other developed nations, so there is ample scope for price hikes. We forecast an FY3/14 operating margin of 27.0%, a roughly 8ppt improvement from three years ago. In addition, JT intends to raise its dividend payout ratio to 50% by FY3/16. |
| Company Description | JT is the world's third largest tobacco company. It has the No. 1 share in Japan and the No. 5 share in Russia, the world's second-largest market.   |
| Key Reports         | <a href="#">Japan Tobacco (2914) - JTI's new CEO commits to double-digit FY12/14 EBITDA growth</a> (January 31, 2014)<br><a href="#">Japan Tobacco (2914) - Q3 in line with market expectations, shares likely to bottom</a> (January 30, 2014)  |

### Pharmaceuticals

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#### M3 Inc. (2413)

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| Change Thesis       | M3 established a highly profitable business with drug makers as its customers, by using the Internet for marketing and promotional activities for ethical pharmaceuticals and ramping up its "MR-kun" marketing support services. Subsequently it expanded into subcontracted clinical trials for drug makers and operations that leverage its access to doctors, such as support for doctors who want to change jobs, and has been taking advantage of M&A and tie-ups. It is also pushing the deployment of these businesses overseas and following launches in Europe and the US, has started offering services for doctors via the Internet in China. It is very quick to expand new businesses and into new geographies and growth remains high. |
| Company Description | M3 established the first Internet portal for doctors to access. It covers more than 80% of doctors in Japan.  |
| Key Reports         | <a href="#">M3 Inc. (2413) - Q3 results positive</a> (January 24, 2014)<br><a href="#">M3 Inc. (2413) - Revising forecasts in light of H1 results</a> (October 30, 2013)  |

#### Takeda Pharmaceutical (4502)

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| Change Thesis       | Takeda developed blockbusters in fields such as diabetes and hypertension in the 1990s and grew in Japan on its marketing muscle and overseas on co-marketing arrangements. However, Takeda subsequently struggled as new drug development stagnated and it was beset by drugs going off-patent. It then acquired US biopharmaceutical firm Millennium and Nycomed, which is strong in emerging markets and pushed the globalization of its R&D and sales networks. In the course of this, the management team was also globalized, at a speed unprecedented in Japan. In April, Takeda plans to welcome a Frenchman recruited from GSK of the UK as its new president. The company is in our view entering a new growth stage as it pushes cost cuts and the development of new drugs continues. |
| Company Description | Takeda is a major drug maker. It developed blockbusters in the 1990s and grew. As drugs came off-patent, it is aiming to recover growth potential through M&A and cost cuts.  |
| Key Reports         | <a href="#">Takeda Pharmaceutical (4502) - Q3 results positive</a> (February 5, 2014)<br><a href="#">Takeda Pharmaceutical (4502) - Downgrading to Neutral: TAK-875 sayonara a setback</a> (January 7, 2014)  |

## Transportation

Akira Funae [akira.funae@citi.com](mailto:akira.funae@citi.com)

### Yamato Holdings (9064)

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| Change Thesis       | We expect stable growth for the delivery business via e-commerce market expansion, but increased cargo also means increased costs. In its new medium-term plan, Yamato aims for network innovation, greater automation, and IT system improvements via its value networking concept. In addition, it intends to expand high value-added services and accelerate profit growth in non-delivery businesses. In addition, the company aims to improve capital efficiency, bringing RoE of above 9% in FY3/16, and we expect it to grow more aggressive on shareholders' return. |
| Company Description | Domestic leader in parcel delivery with overwhelming strength in its pick-up and delivery network and in delivery quality. Aggressive management aiming for logistics innovation.  |
| Key Reports         | <a href="#">Yamato Holdings (9064) - Upgrading to Buy: Focus switching from rising costs to bigger profits and capital policy</a> (February 17, 2014)<br><a href="#">Yamato Holdings (9064) - Medium-term business plan unveiled</a> (January 23, 2014)  |

### ANA Holdings (9202)

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| Change Thesis       | In its new medium-term plan, ANA intends to grow profits by reforming its cost structure, optimizing supply on domestic routes, and expanding overseas routes leveraging Haneda. Over the next three years ANA intends to cut ¥84bn in costs in an attempt to bring costs to global levels. Also, ANA now intends to reduce supply on domestic routes, where competition is heating up, while also working toward rate revisions based on a careful focus on margins. At the same time, ANA plans aggressive expansion for overseas routes. It hopes to attract premium passengers and boost its market share leveraging Haneda's advantages. |
| Company Description | One of Japan's two majors, with top share on domestic routes. It aims to grow by expanding overseas routes, diversifying its business portfolio, and investing strategically in Asia.   |
| Key Reports         | <a href="#">ANA Holdings (9202) - Much to like in new plan, but results will be what count</a> (February 14, 2014)<br><a href="#">Airline sector - Q3 results in line at JAL, higher than expected at ANA; JAL's dividend cut moderately negative</a> (January 31, 2014)  |

## Retail

Masataka Kunito [masataka.kunito@citi.com](mailto:masataka.kunito@citi.com)

### Fast Retailing (9983)

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| Change Thesis       | In September 2005, founder Tadashi Yanai returned to the helm of Fast Retailing. He reformed the business structure, strategy, product development and other aspects of the business. In FY8/10, five years after returning as CEO, OP had grown 2.3x to ¥132.3bn. The focus on functionality in clothes designed for everyday wear helped differentiate the company from other makers of fast fashion and drove overseas expansion, particularly in Asia. Steady efforts to boost penetration of the Uniqlo brand overseas since 2001 and rising per-store earnings should support high sales and profit growth going forward. |
| Company Description | Fast Retailing is the fourth-largest SPA (specialty retailer of private brand apparel) retailer in the world, in terms of sales. The store-opening pace for its Uniqlo brand, particularly in Asia, is accelerating.  |
| Key Reports         | <a href="#">Fast Retailing (9983) - FY8/14 Q1 results positive</a> (January 9, 2014)<br><a href="#">Fast Retailing (9983) - Initiating coverage: Can "changing clothes" change the world?</a> (December 10, 2013)   |

# Materials

## Chemicals, Fibers, Glass, Paint

Takao Kanai [takao.kanai@citi.com](mailto:takao.kanai@citi.com)

### Asahi Kasei (3407)

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| Change Thesis       | Asahi Kasei has been pushing a policy of selectivity and focus, concentrating on competitive business units. It decided to halt domestic ethylene facilities and plans to restructure commoditized products. In contrast, it has positioned medical, environment & energy, and housing & lifestyle as growth fields, and in 2012 acquired Zoll for \$2.2bn. Zoll is growing sales by an annual 15%-20%, centered on its proprietary LifeVest product, and we expect it to start contributing to profits in FY3/15. Asahi Kasei is also pushing its SL 200 Project, which aims at cost savings companywide of ¥20bn in FY3/14-FY3/15. |
| Company Description | Asahi Kasei is a world leader in areas including acrylonitrile and electronic compasses. Zoll's LifeVest is also a unique product. In housing, too, the company is a domestic major.   |
| Key Reports         | <a href="#">Asahi Kasei (3407) - Q3 results in line with market expectations</a> (February 5, 2014)<br><a href="#">Integrated chemicals sector restructuring - Sumitomo Chemical our top pick on reform benefits</a> (January 9, 2014)   |

### Sumitomo Chemical (4005)

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| Change Thesis       | Sumitomo Chemical decided to halt domestic ethylene and derivative operations. It also plans to restructure caprolactam and other loss-making businesses. In commodity petrochemicals, production is being concentrated in Singapore and Saudi Arabia. Sumitomo Chemical has positioned three specialty businesses—polarizing films and other information electronics, herbicides and other agrochemicals, and pharmaceuticals—as growth fields and is concentrating resources on them. The balance sheet deteriorated on aggressive investment but Sumitomo Chemical plans to reduce its ¥1.1trn in interest-bearing debt to under ¥900bn by FY3/16. Petro Rabigh is set to make a real profit contribution, on changes to arrangements and stabilization of operating rates. |
| Company Description | Sumitomo Chemical is the global number two in polarizing film and the global number nine and Japan number one in agrochemicals. It is the only Japanese chemical firm with a big facility in Saudi Arabia.   |
| Key Reports         | <a href="#">Sumitomo Chemical (4005) - Buy: 3 specialty segments driving earnings, Rabigh to contribute</a> (February 14, 2014)<br><a href="#">Sumitomo Chemical (4005) - Q3 results in line with market expectations</a> (January 31, 2014)   |

Atsushi Ikeda [atsushi.ikeda@citi.com](mailto:atsushi.ikeda@citi.com)

### Toray Industries (3402)

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| Change Thesis       | The fiber segment, which before the global financial crisis generated OP of around ¥20bn (OPM of 3%), has turned into a cash-cow—we model FY3/14 OP of ¥55bn (operating margin over 7%). This is seen generally as a mature and commoditized industry, where many Western and Japanese firms have shrunk or closed their operations; the keen insight and execution abilities of past Toray managers thus stands out. In carbon fiber, where the global number two and three firms are struggling and in the red, we model an FY3/14 operating margin of 16%, far ahead of peers. Up ahead, we foresee annual growth of 20% continuing on applications such as aircraft and fuel cell tanks, where the barriers to entry are formidable. |
| Company Description | Toray is one of the world's leading makers of high-performance apparel fiber and carbon fiber. We also see considerable potential in lithium-ion battery separators and water treatment films.   |
| Key Reports         | <a href="#">Toray Industries (3402) - New medium-term plan</a> (February 17, 2014)<br><a href="#">Toray Industries (3402) - Q3 results in line with expectations</a> (February 6, 2014)  |

### Nippon Paint (4612)

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| Change Thesis       | Nippon Paint will take a majority stake in the Asian JVs with Wuthelam and transform itself into a global paint major, ranked number four in the world, with sales of around ¥500bn. We think the JV businesses have the potential to grow by double digits annually and that the longer-term earnings expansion story has materialized. We believe margins are set to improve substantially as Nippon Paint deploys the cost-cutting expertise it has amassed in Japan laterally in Asia. We forecast that the consolidated pre-goodwill OPM will rise to 19% in FY3/16 from 1% in FY3/09. We expect to see a more proactive line on shareholder returns such as via share buybacks. |
| Company Description | Nippon Paint is Japan's leading integrated paint maker. It is strong in automotive paint and is expanding its market share in construction paint, too, on the launch of strategic products.   |
| Key Reports         | <a href="#">Nippon Paint (4612) - Response to investor questions on Wuthelam tie-up</a> (February 10, 2014)<br><a href="#">Nippon Paint (4612) - Q3 results positive, domestic auto paint overshooting</a> (February 3, 2014)   |

## Cement, Steel

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### Nippon Steel & Sumitomo Metal (5401)

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| Change Thesis       | NSSM's scenario for change encompasses 1) building the world's leading cost competitiveness and 2) uncovering new demand for high-end steel in growth markets overseas. Since its merger in October 2012, NSSM has been working to concentrate production at its most efficient plants by FY3/16 and aims to cut costs by ¥200bn. It aims to double production capacity to 19mn MT in the overseas growth markets for autos of the US and China by leveraging its world-leading technological capabilities and by entering alliances with overseas majors. It plans to maximize margins with the highest ASPs and lowest production costs. |
| Company Description | The world's largest high-end steelmaker, headed to be the world leader in cost-competitiveness post integration.   |
| Key Reports         | <a href="#">Nippon Steel &amp; Sumitomo Metal (5401) - Q3 results positive, cost control shines through</a> (January 30, 2014)<br><a href="#">Head-to-Head: POSCO vs NSSM - Is the era of POSCO as Asia's undisputed #1 coming to an end?</a> (October 4, 2013)  |

### Kobe Steel (5406)

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| Change Thesis       | Kobe Steel's scenario for change calls for revitalizing its steel business by boosting competitiveness. Kobe Steel's production costs are ¥10,000-¥12,000/MT higher than NSSM, which has concentrated output at a massive 5,000m <sup>3</sup> blast furnace facility, and JFE Holdings, which has better facilities. Kobe Steel has raised ¥100bn and is investing this in its Kakogawa steelworks where production will be concentrated following the closure of the Kobe works. We expect in FY3/17, Kobe Steel will match its peers in cost competitiveness and enjoy substantial earnings improvement. |
| Company Description | A specialist in niche high-end steel, it aims invest intensively to radically reform its inferior cost structure competitiveness by small-lot production and antiquated facilities.  |
| Key Reports         | <a href="#">Kobe Steel (5406) - Q3 results positive but less undervalued on financing</a> (February 4, 2014)<br><a href="#">Japanese steel - Is the market too focused on China, missing Japan's recovery?</a> (April 3, 2013)   |

## Oil, Electric Power, Gas, Trading Companies

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### Mitsui & Co. (8031)

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| Change Thesis       | Mitsui & Co. announced that it would buy back 2.2% of shares outstanding on February 5. Its decision to do so ahead of the announcement of the new medium-term plan in May came as a surprise and the market reacted positively. The company plans to aim to turn FCF positive in the next medium-term plan. We think this decision took into account concerns of a decline in RoE on the introduction of IFRS and the needs of the market. We expect investment and financing in metal resources to decline in FY3/15 and out, sense visibility on FCF turning positive is good, and expect to see additional shareholder returns as FCF turns positive. |
| Company Description | By NP, Mitsui & Co. ranks as Japan's second largest trading company. In resources, its production volumes of iron ore and crude/gas are considerable, while non-resource operations are relatively weak.  |
| Key Reports         | <a href="#">Mitsui &amp; Co. (8031) - Q3 positive, prelude to RoE improvement?</a> (February 5, 2014)<br><a href="#">Trading companies - 2014 H1 outlook: Expecting yield-driven catch-up</a> (November 28, 2013)   |

### Mitsubishi Corp. (8058)

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| Change Thesis       | In the new medium-term plan, announced last June, Mitsubishi Corp. says it would aim to turn FCF positive by managing cash flow by business unit and focusing on reshuffling its asset portfolio. We like the changes at the company we saw immediately after the plan was announced and indeed Mitsubishi Corp. generated positive FCF of ¥51.7bn in April-December, versus negative FCF of ¥248.3bn in the year-ago period. We think the shares can advance further in FY3/15 if cash flow creation moves for the sale of equity to the sale of businesses and if the dividend is kept flat or hiked. |
| Company Description | By NP, Mitsubishi Corp. ranks as Japan's largest trading company. In resources, it produces a lot of coking coal, while in non-resources, it is strong in machinery and lifestyle businesses.   |
| Key Reports         | <a href="#">Mitsubishi Corp. (8058) - Q3 positive – new guidance looks conservative</a> (February 4, 2014)<br><a href="#">Trading company sector - Market too cautious, we stay buyers</a> (June 11, 2013)  |

## Technology, Media, Telecom

### Consumer Electronics, Semiconductors, Industrial Electronics

Kota Ezawa [kota.ezawa@citi.com](mailto:kota.ezawa@citi.com)

#### Hitachi (6501)

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|---------------------|--|
| Change Thesis       | Wide-ranging restructuring is ongoing, with Hitachi selling non-core businesses, increasing stakes in subsidiaries in core businesses, reorganizing businesses within the group, and reforming the cost structure (Smart Transformation Project). Hitachi sold HGST and reduced its equity stake in Renesas Technology. It also moved its air-conditioner and thermal power businesses off the consolidated books, made Hitachi Medico a wholly owned subsidiary, and merged Hitachi Metal and Hitachi Cable. We expect the Smart Transformation Project to squeeze out another ¥100bn in cost cut benefits in FY3/15, as in FY3/14. |
| Company Description | Hitachi is one of the world's leading conglomerates, with a presence in information and telecoms, social infrastructure, construction equipment, high-performance materials, distribution, and finance.  |
| Key Reports         | <a href="#">Hitachi (6501) - Reiterating our Buy rating: MHPS profit growth story unchanged</a> (February 13, 2014)<br><a href="#">Hitachi (6501) - Q3 results positive</a> (February 4, 2014)   |

#### NEC (6701)

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| Change Thesis       | NEC has carved out consumer and hardware businesses, which have been designated non-core operations, and we think the structural transformation is entering its final stages. It spun out its semiconductor subsidiary as Renesas Electronics and has even removed it from its roster of equity-method affiliates. It has also sold its mobile phone sales and ISP businesses and almost completed its voluntary withdrawal from smartphone operations. |
| Company Description | NEC is one of Japan's leading communication and information firms, with a presence in both IT and telecoms  |
| Key Reports         | <a href="#">NEC (6701) - Q3 results positive, better-than-expected improvement in operating environment</a> (January 30, 2014)<br><a href="#">NEC (6701) - Upgrading to Buy: Overlooked beneficiary of Japan's recovery</a> (January 22, 2014)  |

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#### Fujitsu General (6755)

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| Change Thesis       | On October 25, 2013, Fujitsu General announced its first share buybacks, purchasing up to 4.4mn shares at a cost of up to ¥4.9bn, equivalent to 4% of shares outstanding. The goal was enhancement of shareholder returns. Additional measures have yet to be announced; however, we look forward to enhanced shareholder returns such as share buybacks and a boosted dividend payout as cash flow from the air-conditioning business bolsters its financial standing. We would consider the 4% dividend yield at Electrolux and other European home appliance makers to be an appropriate benchmark (Fujitsu General's dividend yield is 1%). |
| Company Description | Fujitsu General is an electronic equipment maker that focuses on air-conditioners and wireless disaster management systems.   |
| Key Reports         | <a href="#">Fujitsu General (6755) - Positive Q3 results, strength for IT &amp; electronic devices</a> (January 24, 2014)<br><a href="#">Fujitsu General (6755) - Still a Buy: Looking more attractive after Q2 results</a> (November 15, 2013)   |

## Electronic Components

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### Ibiden (4062)

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| Change Thesis       | The impressive technological competitiveness garnered from PC packaging substrates is also well received in smartphone and tablet PC products, and the earnings driver is shifting from PCs to mobile device products. We think Ibiden's market share will rise given the increasing use of ABF in FC-CSP substrates. In PCBs we look for the company to overcome upfront investment and benefit from increasing adoption in mid-range smartphones over the medium term. Furthermore, demand for large DPFs is expected to rise with the advent of new regulations. Ibiden is, in our view, able to benefit from technological advancement in mobile devices and growth in the automotive market. |
| Company Description | Global leader in substrate technologies. Likely to benefit most from use of cutting-edge substrate technology in mid-range products.  |
| Key Reports         | <a href="#">Ibiden (4062) - Q3 results positive, but outlook not too rosy</a> (February 4, 2014)<br><a href="#">Packaging substrate industry - Technological progress to eliminate growth uncertainty</a> (September 12, 2013)  |

### Nidec (6594)

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| Change Thesis       | The earnings driver is shifting steadily from HDD motors to motors for automotive and general industrial machinery applications. Thanks to impressive foresight the company has been moving forward with M&A in these two areas for some time and is now reaping synergy benefits. It is also moving into new fields in (non-HDD) small motors and has positioned small precision motors as a cash cow. Given management's ability to push its businesses forward and its global cost cutting capabilities we anticipate strong growth not swayed by macroeconomic trends. |
| Company Description | Has the top share globally in small precision motors. Growing its presence in automotive and general industrial motors thanks to M&A synergies.  |
| Key Reports         | <a href="#">Nidec (6594) - Q3 results positive— improved growth visibility</a> (January 22, 2014)<br><a href="#">Nidec (6594) - Turning into a one-stop motor shop</a> (July 23, 2013)   |

## Precision Instruments, SPE

Masahiro Shibano [masahiro.shibano@citi.com](mailto:masahiro.shibano@citi.com)

### Fujifilm Holdings (4901)

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| Change Thesis       | The COO Shigehiro Nakajima, who took office in June 2012, has worked to shift Fujifilm to a greater focus on profitability and self-reliance, reduce inventory in an effort to improve cash flow, and boost asset efficiency. We think the firm's direction will become even clearer in the next medium-term plan scheduled to be announced in autumn 2014. In shareholders' return the company is focused on dividends, but share buybacks are possible too. For FY3/14 the company plans to hike its dividend ¥10 to ¥50/share, and we expect ¥50/share or more from FY3/15 as well. |
| Company Description | Fujifilm's core areas are office equipment and FPD materials, and it is working to expand in medical products and devices and industrial materials as well.  |
| Key Reports         | <a href="#">Fujifilm Holdings (4901) - Maintaining Buy: Steady earnings improvement in progress*</a> (February 10, 2014)<br><a href="#">Fujifilm Holdings (4901) - Q3 in line with market but big FCF improvement</a> (January 30, 2014)   |

### Konica Minolta (4902)

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| Change Thesis       | Revisions to the holding company system in April 2013 have sped up decision-making, and the company has also accelerated withdrawal from unprofitable businesses (it wound down the HDD glass substrate business at end-2013 and expects to wind down the mobile phone camera module business in mid-2014). At the end of January 2014 KMH announced a share buyback (maximum of 3.8% of outstanding shares). A new president will take office in April, and we think adoption in the JPX-Nikkei 400 will mean continued aggressiveness in balance sheet management in order to boost RoE. |
| Company Description | Focuses on office equipment, and is working to quickly exit unprofitable businesses while also expanding industrial materials.   |
| Key Reports         | <a href="#">Konica Minolta (4902) - Growing focus on RoE improvement, shareholders' return</a> (February 13, 2014)<br><a href="#">Konica Minolta (4902) - Positive—announces buyback, aims to improve RoE</a> (January 30, 2014)   |



## Games, Internet, IT Services, Leisure

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### Sega Sammy Holdings (6460)

|                     |   |
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| Change Thesis       | Under the leadership of CEO Hajime Satomi, the company is working to enter the domestic casino market. Sammy Sega aims to dramatically expand its earnings base by, for instance, acquiring a majority stake in an existing player. Casino legislation has been submitted to the Diet and we think it is likely to be approved in mid-2014, which locations and operators being decided in 2015. Outside Japan, the company is entering the South Korean casino mark, plans to supply gaming equipment to casinos in Asia, and thus boost its exposure to the casino business over the longer-term. |
| Company Description | Number one maker of pachislo machines, recently strengthening capabilities in native apps for smartphones   |
| Key Reports         | <a href="#">Sega Sammy Holdings (6460) - Q3 results in line with market expectations</a> (February 7, 2014)<br><a href="#">Global Gaming - Rising Sun to Outshine Vegas; Japan Set to Launch Casinos</a> (August 20, 2013)  |

### Namco Bandai Holdings (7832)

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| Change Thesis       | Namco Bandai's leading IP such as Naruto, One Piece, and Gundam are widely recognized throughout Asia, but up to now it has not been able to monetize this awareness (Asia accounted for just 4% of total sales in FY3/13). During 2014, however, Namco Bandai plans to roll out the PC browser game Naruto Online in China, which it jointly developed with Tencent, China's largest online game company. If the title proves to be a success, we think development in Asia of PC/mobile games that leverage its powerful IP will accelerate. |
| Company Description | Namco Bandai's has built a business model that uses leading IP in multiple product areas. Its exposure to the domestic market is high, and overseas expansion is an issue.   |
| Key Reports         | <a href="#">Namco Bandai Holdings (7832) - Q3 results in line with market expectations</a> (February 5, 2014)<br><a href="#">Social game industry - Focal points for native apps in 2014</a> (December 19, 2013)   |

## Media, Internet, Telecom

Hideki Takoh [hideki.takoh@citi.com](mailto:hideki.takoh@citi.com)

### Dentsu (4324)

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| Change Thesis       | Dentsu's domestic market share was 24% in 2012. It has a particularly dominant share of the TV ad market at 38%. Compared with its overseas peers, however, it was slow to expand overseas. However, Dentsu plans to ramp up its overseas strategy with acquisition of Aegis (ranked No. 8 globally in gross profit in 2012). In the 2013 gross profit rankings, Dentsu came in first at the parent level and fifth as a group. In October-December 2013, overseas markets accounted for 47% of companywide gross profit. |
| Company Description | Japan's largest full-service advertising agency in terms of both sales and gross profit. Overseas expansion has accelerated in recent years via M&A.  |
| Key Reports         | <a href="#">Dentsu (4324) - Q3 in line, steady progress with profit growth overseas</a> (February 13, 2014)<br><a href="#">Dentsu (4324) - Medium-term growth scenario remains intact; reiterate Buy rating</a> (June 6, 2013)  |

### SoftBank (9984)

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| Change Thesis       | Softbank is engaged in a wide array of services in the telecom (mobile, fixed-line, ADSL) and Internet (portal sites, social games, EC) fields. Softbank entered the domestic telecom market with the acquisitions in 2004 of the former Japan Telecom and in 2006 of the former Vodafone Japan. Since 2013 it has made Sprint Corp., BrightStar, GungHo Online Entertainment, and Supercell into subsidiaries. It intends to accelerate overseas expansion by strengthening its infrastructure and content. In October-December 2013, we surmise overseas markets accounted for c48% of companywide sales |
| Company Description | Offers a wide array of services in the telecom and Internet fields via proactive M&A.  |
| Key Reports         | <a href="#">SoftBank (9984) - Q3 results above expectations</a> (February 12, 2014)<br><a href="#">Sprint &amp; T-Mobile US - Consolidation May Turn Into a Marathon Instead of a Sprint</a> (December 16, 2013)   |



## Financial & Housing/Construction

### Banks, Brokers, Insurance

Hironari Nozaki [hironari.nozaki@citi.com](mailto:hironari.nozaki@citi.com)

#### Sumitomo Mitsui Financial Group (8316)

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| Change Thesis       | SMFG used to focus on domestic operations, but it is quickly ramping up its overseas business. It is currently working to expand its revenue bases in North America, Europe, and Asia by acquiring aircraft leases in Europe, embarking on a capital tie-up in Indonesia with BTPN, and acquiring FHC (financial holding company) status in the US. The key going forward is expanding risk appetite in Japan and overseas. |
| Company Description | SMFG focuses on bank operations, but it is a financial conglomerate that engages in a wide range of businesses, including brokerage and consumer finance operations.  |
| Key Reports         | <a href="#">Bank sector - Some negatives in Q3 results</a> (January 29, 2014)<br><a href="#">Financial sector outlook 2014 - When the wild things wake...</a> (January 6, 2014)   |

#### Mizuho Financial Group (8411)

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| Change Thesis       | While Mizuho has built itself into a key megabank in Japan, it has lagged behind other groups in terms of profitability, efficiency, and governance. It has integrated group banks in an effort to catch up, and it is also engaged in dramatic reform of its organizational operations via measures like shifting to a company with committees system in order to improve governance. Yasuhiro Sato has decided to step down as president of Mizuho Bank and devote himself to his role as president of the holding company. We believe this will result in enhanced strength for the overall group. |
| Company Description | Mizuho is a financial group encompassing banking, brokerage, and trust operations. Organizational restructuring is starting to pick up via moves like integrating group banks.  |
| Key Reports         | <a href="#">Financial sector - Q3 results in line with market expectations</a> (January 31, 2014)<br><a href="#">Financial sector outlook 2014 - When the wild things wake...</a> (January 6, 2014)   |

### Housing, Construction

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#### Daito Trust Construction (1878)

|                     |  |
|---------------------|--|
| Change Thesis       | DTC has clearly demonstrated a shareholder-focused management style. In a rare move, the company discussed efficient capital management at its Q3 results briefing. For example, ¥43bn in tenant deposits posted to cash in Q2 have been converted to cash in trust. The market could react positively should the company exhibit more effective utilization of its abundant financial resources moving forward. In addition, while we anticipate a restart of share buybacks from FY3/16, we note an earlier restart is possible. |
| Company Description | Japan's No. 1 rental housing maker in terms of both annual construction volume and total units under management.   |
| Key Reports         | <a href="#">Daito Trust Construction (1878) - Staying Buy: Slow but steady profit growth likely to continue</a> (February 12, 2014)<br><a href="#">Daito Trust Construction (1878) - Q3 in line with market expectations, margin deterioration continues</a> (January 31, 2014)  |

#### Lixil Group (5938)

|                     |  |
|---------------------|--|
| Change Thesis       | Lixil has clearly demonstrated a shareholder-focused management style. In FY3/14 it has decided to raise its DPS from ¥40 a year earlier to ¥55, the first increase in eleven years. In addition, its previous dividend payout target was at least 30% of EPS, but this has been raised to at least 30% of EPS before goodwill depreciation. Lixil holds teleconferences for foreign investors on which President Yoshiaki Fujimori presents in English, and it is focused on communicating with both domestic and overseas investors. |
| Company Description | Japan's largest housing equipment maker. It has grown its business significantly via M&A both in Japan and overseas.   |
| Key Reports         | <a href="#">LIXIL Group (5938) - Q3 results somewhat negative, Lixil expects fall into the red overseas</a> (February 3, 2014)<br><a href="#">LIXIL Group (5938) - Announcement of effective upward revision to payout ratio somewhat positive</a> (September 17, 2013)  |

## Appendix A-1

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