

# LIXIL Group (5938)

## Results: Q3 results somewhat negative, Lixil expects fall into the red overseas

- Citi's Take** — Q3 OP was ¥25bn (+3% YoY), below our forecast of ¥30bn. We get the sense that domestic sales growth was sluggish relative to new housing starts. The market has high expectations for overseas operations, but while Lixil had expected FY3/14 overseas OP of ¥1.7bn it now anticipates an operating loss due to deterioration in profitability for some large projects at Permasteelisa. Lixil revised up slightly for full-year RP and NP in light of equity in earnings and gains on the sale of idle assets and marketable securities. It also announced a dividend hike, to ¥55 from ¥50.
- What drove the numbers** — OP rose ¥700mn YoY, which primarily breaks down to 1) +¥8.3bn from C-30 project-related efforts, 2) +¥4.9bn from increased revenue, 3) -¥6.8bn from business environment factors (forex, material costs, etc.), and 4) -¥6.7bn from structural reform costs (personnel, etc.).
- What this means for full-year earnings** — Full-year OP guidance is ¥70bn. Looking at assumptions underlying this forecast we believe that domestic sales are in line with initial plan (the market share is lower than expected although market growth is higher), while domestic prices are ahead of plan (thanks to new products and careful order selection in building sashes), domestic costs are in line with plan (C-30 savings are ahead of expectations, but so is the negative impact of yen weakness), and overseas earnings are behind plan (due to unprofitable projects at Permasteelisa).
- Implications** — We think results could be somewhat negative for the shares. In light of the contribution to earnings from Grohe starting in FY3/15 (not factored into our forecasts), we do not believe valuations look overly stretched.

(¥bn)	Sales	OP	RP	NP
Q3 Actual	420.0	25.0	27.1	19.1
Q3 Citi Research E	430.0	30.0	30.0	18.0
Q1-Q3 A	1,161.6	50.9	56.1	36.9
Progress vs new CoE (%)	72.6	72.7	78.5	82.9
FY3/14 CoE old	1,600.0	70.0	70.0	41.0
FY3/14 CoE New	1,600.0	70.0	71.5	44.5
FY3/14 Consensus	1,601.0	72.8	74.1	42.6

Note: If the company has revised its forecasts along with results this will not be reflected in the table below.  
Source: Company data, Citi Research, Bloomberg for consensus estimates.

Consol.	Sales		OP			RP		NP		EPS	PE
	¥M	YOY (%)	¥M	YOY (%)	OPM(%)	¥M	YOY (%)	¥M	YOY (%)	¥	X
3/12A	1,291,396	6.3	17,915	-55.7	1.4	16,125	-58.8	1,868	-88.2	6	411.9
3/13A	1,436,395	11.2	50,485	181.8	3.5	53,063	229.1	21,347	nm	73	36.4
3/14CE	1,600,000	11.4	70,000	38.7	4.4	70,000	31.9	41,000	92.1	141	18.9
3/14E	1,609,500	12.1	76,200	50.9	4.7	79,000	48.9	43,700	104.7	150	17.8
3/15E	1,731,100	7.6	85,500	12.2	4.9	85,900	8.7	44,700	2.3	154	17.4
3/16E	1,778,400	2.7	90,800	6.2	5.1	91,700	6.8	48,200	7.8	166	16.1

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

<b>Neutral</b>	<b>2</b>
Price (31 Jan 14)	¥2,671
Target price	¥2,500
Expected share price return	-6.4%
Expected dividend yield	1.9%
<b>Expected total return</b>	<b>-4.5%</b>
Market Cap	¥776,582M
	US\$7,611M

### Price Performance (RIC: 5938.T, BB: 5938 JP)



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## LIXIL Group

### Valuation

Our target price of ¥2,500 is the product of our end-FY3/14 BPS forecast of ¥2,225 and a target PBR of about 1.1x (derived by dividing average FY3/15E-FY3/16E RoE of 6.9% by a 6.0% cost of equity).

For cost of equity we adopt 6.0% (the reciprocal, or earnings yield, of the average forward PER for TOPIX over the last six months). We then adjust this based on an individual company's financial risk, share price volatility, and growth potential. In our view Lixil is in the middle of the sector in terms of both financial risk and share price volatility, and given its high exposure to the domestic new build business growth potential cannot be said to be high. Therefore, we use 6.0% for Lixil, in line with the sector benchmark.

### Risks

Downside risks to our share price include 1) far smaller progress in cost cutting than we expect; 2) the top-line undershooting our expectations due to a slowdown in new housing starts or further prolongation of the confusion resulting from the merger of subsidiaries; 3) high material prices (aluminum, copper); and 4) uncertainty caused by a rush into M&A.

Upside risks include 1) higher profits than we forecast and 2) major business portfolio restructuring via M&A. If the rate of revenue growth from the domestic renovation business remained below company plan it is possible Lixil could implement further cost cutting.

If these factors manifest themselves differently than we have anticipated, the share price may vary from our target price.

## Appendix A-1

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Analyst: Shusuke Terada  
Covered since April 6 2011



	Date	Rating	Target Price	Closing Price
1	6-Apr-11	*1M	*2,600	2,082
2	18-May-11	1M	*2,700	2,057
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*1	2,700	2,031

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	15-Nov-11	1	*2,200	1,546
6	10-Jan-12	1	*1,900	1,475
7	15-Mar-12	1	*2,200	1,691
8	22-May-12	1	*2,000	1,460

	Date	Rating	Target Price	Closing Price
9	12-Feb-13	1	*2,300	1,959
10	2-Apr-13	1	*2,100	1,767
11	13-May-13	*2	*2,500	2,467

Rating/target price changes above reflect Eastern Standard Time

### LIXIL Group (5938)

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

Analyst: Shusuke Terada  
Covered since April 6 2011



	Date	Rating	Target Price	Closing Price
1	26-Apr-11	*ADD MP	-	1,902
2	14-Sep-11	*REM MP	-	1,990

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	8-May-12	*ADD MP	-	1,519
4	14-Sep-12	*REM MP	-	1,788

	Date	Rating	Target Price	Closing Price
5	27-Sep-12	*ADD MP	-	1,858
6	13-Nov-12	*REM MP	-	1,671

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