

Equities

10 January 2012 | 33 pages

Housing sector

2012 investment strategy: Caution on slowing profit growth in new housing businesses

- **Conclusion** — We take a neutral sector stance for 2012. Despite our expectations of sustained profit growth for the five companies in our coverage during FY3/13, valuations for all are at historically low levels. On the other hand, we expect the profit impact of growth in new housing business revenues to slow, and with certain exceptions we think opportunities for share price appreciation will remain limited.
- **Order outlook** — We forecast 845,000 new housing starts in FY3/12 (+3.1% YoY), 858,000 in FY3/13 (+1.5%), and 882,000 in FY3/14 (+2.8%). The trend toward oligopolization in the rental housing market is likely to continue and we expect company orders to hold up well. Major players' share of the detached housing market will probably rise as well, but we expect order growth to be weaker than for rental housing and built-for-sale condos.
- **Margin outlook** — In new housing businesses, profit margins are likely to suffer at homebuilders from rising labor costs accompanying tighter supply/demand for construction workers and at housing equipment makers from deterioration in the channel mix as major homebuilders gain market share. As top-line growth will probably be slow, we think profit growth from higher revenues in new housing businesses is likely to slow.
- **Stock selection** — Our top pick for January–March is Daito Trust Construction. We expect upward revisions to full-year guidance when it announces Q3 results and feel a FY3/12E dividend yield of 4.5% is attractive. Looking toward full-year results in April–June, we highlight Toto. While we expect slower revenue growth in FY3/13, we anticipate sharply higher profits on cost cuts. In the second half of the year, we look for a turnaround in JS Group's share price. We think earnings visibility could improve on the end to the turmoil attending the merger of subsidiaries and the announcement of additional restructuring plans. We note that mid-sized homebuilders with substantial dependence on new-build detached housing and mid-sized housing equipment makers that have little room to reduce costs could reach earnings ceilings, and think strong share price performance from them is unlikely.

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Ticker	Rating		Target Price		Current Year Earnings Estimates		Next Year Earnings Estimates	
	Old	New	Old	New	Old	New	Old	New
1878	1	1	¥8,200	¥8,200	¥646	¥621	¥678	¥708
1925	2	2	¥1,020	¥1,020	¥45	¥22	¥97	¥101
5332	1	1	¥810	¥810	¥33	¥26	¥43	¥44
5938	1	1	¥2,200	¥1,900	¥125	¥98	¥128	¥124

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

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Outlook for new-construction housing starts

Conclusion

858,000 units (+1.5%) in FY3/13,
882,000 units (+2.8%) in FY3/14

We expect new-construction housing starts to total 845,000 units in FY3/12 (up 3.1% YoY), 858,000 units in FY3/13 (up 1.5%), and 882,000 units (up 2.8%) in FY3/14.

We think new-build housing starts will rise only slightly YoY in FY3/13. Although we think post-quake rebuilding demand will gradually emerge, we also think homebuying-support measures will be scaled back somewhat. We believe the YoY growth rate for housing starts will rise in FY3/14. Although the public's homebuying capacity could decline as a result of increases to rebuilding-related taxes eroding disposable income, we think rebuilding demand will emerge in earnest.

Consumption tax hike not in our outlook;
such a hike could lead to demand spike,
after which new build market could slip
into a long-term downtrend

There is significant opposition in both the ruling and opposition parties to the consumption tax hike provisions of the government's integrated social security and tax reform proposal, and the outlook for this provision coming to pass is highly unclear. We therefore have not factored a consumption tax increase into our forecasts. Even so, we think housing starts will probably enter into a long-term downtrend over the next several years as the rate of growth in the number of households slows and eventually starts to contract. If the consumption tax is increased, we think it will lead to a spike in demand, followed inevitably by a backlash, which could spell the "beginning of the end" for the new-build housing market.

Figure 1. New-build housing starts, actual and forecast

(FY, 1,000 units)	Built-to-order detached houses	Built-for-sale detached houses	Built-for-sale condos	Rental housing	Corporate housing	Total	(YoY)	Built-to-order detached houses	Built-for-sale detached houses	Built-for-sale condos	Rental housing	Corporate housing	Total
2001	377	121	223	442	10	1,173	2001	-13.9%	-5.4%	2.1%	5.8%	-8.4%	-3.3%
2002	366	117	198	455	10	1,146	2002	-3.1%	-3.2%	-11.0%	2.8%	-4.0%	-2.4%
2003	373	129	202	459	8	1,174	2003	2.1%	10.4%	2.0%	0.9%	-15.1%	2.5%
2004	367	139	207	467	9	1,193	2004	-1.6%	7.8%	2.5%	1.9%	16.2%	1.7%
2005	353	138	231	518	9	1,249	2005	-4.0%	-1.2%	11.2%	10.8%	-9.5%	4.7%
2006	356	138	242	538	9	1,285	2006	0.9%	0.4%	4.8%	3.9%	6.9%	2.9%
2007	312	121	160	431	10	1,036	2007	-12.3%	-12.5%	-34.0%	-19.9%	13.3%	-19.4%
2008	311	107	165	445	11	1,039	2008	-0.4%	-12.0%	3.1%	3.2%	7.5%	0.3%
2009	287	95	67	311	13	775	2009	-7.6%	-10.6%	-59.1%	-30.0%	19.3%	-25.4%
2010	309	113	98	292	7	819	2010	7.5%	19.0%	45.1%	-6.3%	-50.3%	5.6%
2011E	309	117	124	288	7	845	2011E	0.2%	3.2%	26.8%	-1.3%	0.0%	3.1%
2012E	311	119	136	285	7	858	2012E	0.6%	1.7%	9.7%	-1.0%	0.0%	1.5%
2013E	317	125	143	290	7	882	2013E	1.9%	5.0%	5.1%	1.8%	0.0%	2.8%

Source: MLIT, Citi Investment Research and Analysis.

Government policy and tax code

Most measures will continue on into 2012,
with some incentives being scaled back

New-construction housing starts rose YoY for five straight quarters (July-September 2010 through July-September 2011) thanks to the introduction of a series of measures aimed at stimulating demand for housing. Although the total amount of housing-related incentives will be somewhat smaller in 2012 than in 2011, the government—through the third supplementary budget for FY3/12 and the tax framework for FY3/13—has decided to extend or reintroduce a number of schemes that had been scheduled to expire in 2011, including Flat 35S (a support system for the acquisition of superior housing), the housing version of the eco-point system,

and expanded gift-tax exemptions. This extension of various policy measures and tax breaks should reduce the likelihood of their demand-boosting effect falling off suddenly.

Passage of long-delayed hike to inheritance tax likely

An increase to the inheritance tax was considered as part of the tax framework for FY3/12, but dysfunction in the Diet resulted in its passage being delayed. However, through the government's integrated social security and tax reform proposal, there is once again movement toward an inheritance tax hike. If the proposed legislation is approved, effective January 1, 2015, the basic exemption will be reduced to ¥30mn from ¥50mn, and the exclusion per lawful heir will be cut to ¥6mn from ¥10mn. Based on this, we calculate that in the case of land with an official land price of ¥100mn and an appraised price (for inheritance tax purposes) of ¥80mn being inherited by two heirs, the inheritance tax would rise to ¥4.7mn under the new system from ¥1.0mn under the current one. We think an increase in the inheritance tax would lead to increased apartment construction as people seek to reduce their taxes.

Figure 2. Major home-buying support measures

(CY)	2010	2011	2012	2013
Home loan deduction system (general homes)				
Maximum deduction (¥000)	5,000	4,000	3,000	2,000
Outline and notes	• 1% of the outstanding loan balance deductible from taxable income (income tax/municipal tax) each year over 10 years. • From 2011, the maximum deduction will be gradually lowered.			
Home loan deduction system (long-term superior-build homes, certified energy-saving homes)				
Maximum deduction (¥000)	6,000	6,000	4,000	3,000
Outline and notes	• 1.2% of the outstanding loan balance deductible from taxable income (income tax/municipal tax) each year over 10 years. • From 2012, the maximum deduction will be gradually lowered. • Only available for homes that meet certain criteria (durability, earthquake-proofing, floor area, energy-saving, etc).			
Flat 35S program				
Interest rate reduction (%)	1.0	1.0	0.3	0.3
Outline and notes	• Only available for homes that meet certain criteria (earthquake proofing, energy conservation, etc). • Discount interest rate for 10 or 20 years. • The rate discount is 0.7% for the first five years and 0.3% for the six years and out. • Program is scheduled to end in 10/2012.			
Expanded gift tax exemption cap				
Expanded gift tax exemption cap (¥000)	15,000	10,000	15,000	12,000
Outline and notes	• Limited to cases where the donation is used for a home acquisition; applies to donations from grandparents. • Exemption cap is reduced by 5 million yen for homes that don't meet certain criteria (energy saving or earthquake-proofing).			
Housing eco points				
Maximum support ('000 points)	300	300	--	--
Outline and notes	• A standard 300k points received for eco home new builds. • Points received for renovation depend on the construction. • Program ended in 7/2011 but restarted from 10/2011, and new one is scheduled to end in 10/2012.			

Source: Government data, Citi Investment Research and Analysis.

Homebuying affordability index

Together with policy and the tax code, a major factor determining housing demand

The rate of growth in the homebuying affordability index (derived by dividing the average amount of capital that can be raised by the average home price) has historically had a strong correlation with owner-occupied housing starts, and has therefore been, along with government policy and the tax code, a major determinant of housing demand. For example, homebuying affordability increased sharply following the collapse of Japan's Bubble Economy thanks to falling land prices and construction costs, along with low interest rates, and this led to an increase in owner-occupied housing starts. In the latter half of the previous decade, revisions to the Building Standards Act and a deteriorating employment environment led to a decline in owner-occupied housing starts, but this decline ceased in FY3/11 thanks

to an improvement in homebuying capacity, driven by low interest rates and falling construction costs.

Disposable income could fall slightly over the medium term

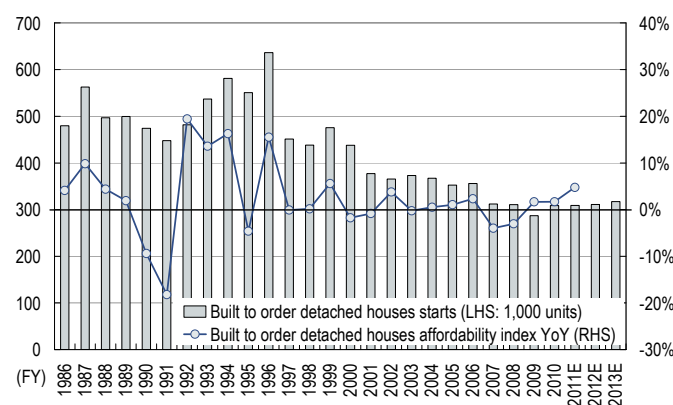
Given the turmoil in the financial markets triggered Europe's debt crisis, slowing overseas economies, and a persistently strong yen, it is hard to imagine the economy recovering in earnest in 2012. Our economics & rates strategy group projects that real GDP growth will remain lackluster in 2012, at 1.1%.

The residents' tax break for families with children under 16 will be abolished as of June 2012, and to help pay for post-quake reconstruction, income tax will be raised as of January 2013, followed by a hike to the residents' tax in June 2014. Consequently, unless one assumes an economic recovery, a decline in disposable income (i.e., a major factor behind the numerator of the homebuying capacity index calculation) seems probable.

A risk over time, even if low interest rates and falling land prices offset lower income for now

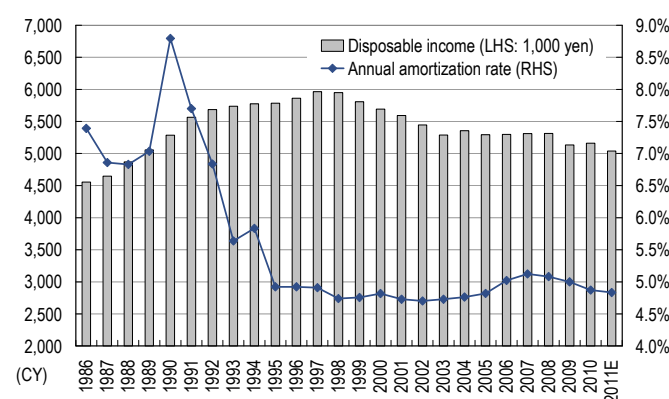
Although disposable income has been trending downward since the latter half of the 1990s, low interest rates and falling land prices have helped prop up homebuying capacity since the latter half of the previous decade. Since mortgage rates and land prices are still trending downward, we think falling disposable income is not likely to lead to an erosion of homebuying capacity for the time being. However, with interest rates running out of room to decline further, we think that if the decline in incomes is not arrested, it could serve to depress housing demand.

Figure 3. Owner-occupied housing starts and homebuying affordability index growth rate



Note1: The homebuying affordability index growth rate is advanced by one year.
Note 2: The method for calculating the homebuying affordability index is as follows:
Homebuying affordability index = amount of capital that can be raised / home price
The home price growth rate is based on the growth rates for official land prices and the construction cost deflator (housing) and a weighted average of 40% land acquisition costs and 60% construction costs
Amount of capital that can be raised = personal funds + the amount that can be borrowed
Personal funds = savings – life insurance – debt
Disposable income x 0.25 = amount that can be borrowed x yearly payment rate
The yearly payment rate is based on the weighted average of the JHFA's basic rate and private-sector home loan variable rates (using a 30-year loan period).
Source: MLIT, MIAC, BoJ, Japan Housing Finance Agency (JHFA), Citi Investment Research and Analysis.

Figure 4. Disposable income and yearly payment rate



Note: The yearly payment rate is based on the weighted average of the JHFA's basic rate and private-sector home loan variable rates (using a 30-year loan period).
Source: MIC, BoJ, JHFA, Citi Investment Research and Analysis.

Post-quake recovery and reconstruction demand

Over 1mn homes damaged

The damage to the housing stock from the Tohoku earthquake (as of December 30, 2011) was as follows: 127,000 homes totally destroyed, 232,000 partially destroyed, and 653,000 partially damaged. In each category, the number of homes is greater it was in the 1995 Kobe earthquake. In value terms, we estimate the amount of damage to the housing stock from the Tohoku earthquake at ¥5trn-¥6trn.

Figure 5. Disaster damage: Great Hanshin earthquake and eastern Japan earthquake compared

	Great Hanshin earthquake	Eastern Japan Earthquake (as of 12/30/2011)					
		Total	Iwate	Miyagi	Fukushima	Other	3 prefecture ratio
Fully collapsed houses (bldg.)	104,906	127,185	20,184	82,754	19,770	4,477	96.5%
Half collapsed houses (bldg.)	144,274	231,888	4,552	129,212	61,749	36,375	84.3%
Partly collapsed houses (bldg.)	390,506	652,631	7,316	211,305	141,922	292,088	55.2%
Public buildings (bldg.)	1,579	49,634	4,148	27,818	1,116	16,552	66.7%
Other buildings (bldg.)	40,917						
Burned down houses (bldg.)	7,036	281	15	135	80	51	81.9%
Partly burned down houses (bldg.)	96						
Fatalities (person)	6,434	15,844	4,667	9,506	1,605	66	99.6%
Disappeared (person)	3	3,451	1,368	1,861	218	4	99.9%

Source: Cabinet Office, National Police Agency, Citi Investment Research and Analysis.

Rebuilding demand of 150,000-200,000 housing units

In the three Tohoku prefectures (Iwate, Miyagi, and Fukushima), over 100,000 evacuees households are currently living in temporary housing or private rental housing deemed to be temporary housing (Figure 6). Moreover, nearly 90,000 people (equivalent to around 35,000 households) are either evacuees living temporarily with friends or family, or have left the three Tohoku prefectures and are now living in private rental housing or public housing. Including these people brings the total number of evacuees to around 140,000 households. We believe some portion of the partially destroyed and partially damaged homes will be replaced, and we estimate rebuilding demand will amount to 150,000-200,000 housing units.

Preparations for rebuilding homes in the affected areas will take some time

However, rebuilding homes in the area affected by the Tohoku earthquake will in many cases require moving people en masse to high ground, and the urban planning, land acquisition, and land development processes will all take a certain amount of time. Miyagi Prefecture aims to build a total of 12,000 housing units for disaster victims by 2015. However, we believe only 2.5% of this figure will be ready in 2012, and that the vast majority of completed housing units will not be ready until 2013 and later (Figure 8).

Rebuilding demand likely to start emerging in earnest in 2013

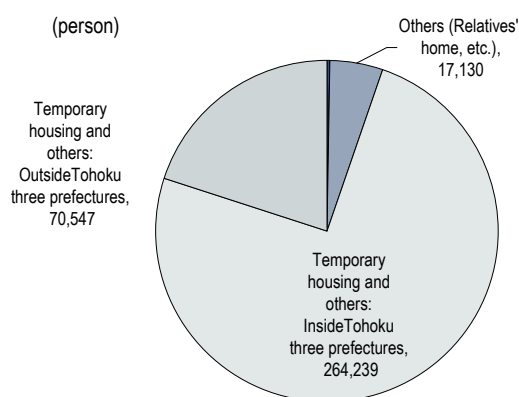
Immediately following the 1995 Kobe earthquake, new-build housing starts in Hyogo Prefecture (the main area affected by the quake), increased much more sharply than the national average. In contrast, a little more than nine months have passed since the Tohoku earthquake, yet housing starts in the three Tohoku prefectures remain low. Given this, we project that rebuilding demand will boost new-construction housing starts as follows: 5,000 units in FY3/12, 10,000 units in FY3/13, 45,000 units in FY3/14, and over 100,000 units in FY3/15 and beyond.

Figure 6. Temporary housing occupancy in the three Tohoku prefectures

Occupied units	Temporary housing	Private rental housing	Public housing and others	Others	Total
Iwate	13,984	3,364	174	816	18,338
Miyagi	22,095	25,662	--	--	47,757
Fukushima	16,226	23,822	392	--	40,440
Total	52,305	52,848	566	816	106,535

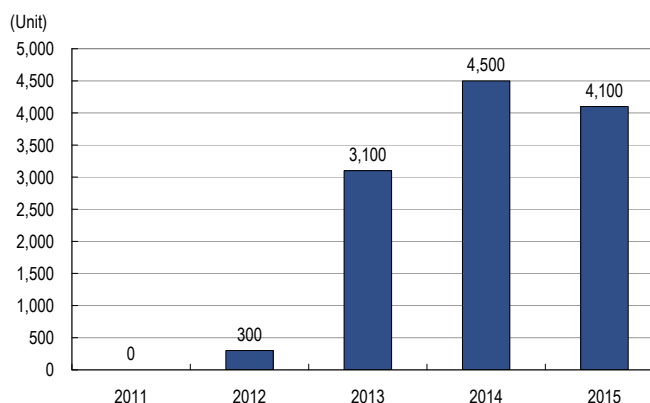
Note: Temporary housing figures are as of December 2011, all other figures are as of October-November 2011.
Source: Prefectural government materials, Citi Investment Research and Analysis.

Figure 7. Number of Tohoku earthquake evacuees nationwide: Evacuees total 330,000 individuals, 140,000 households



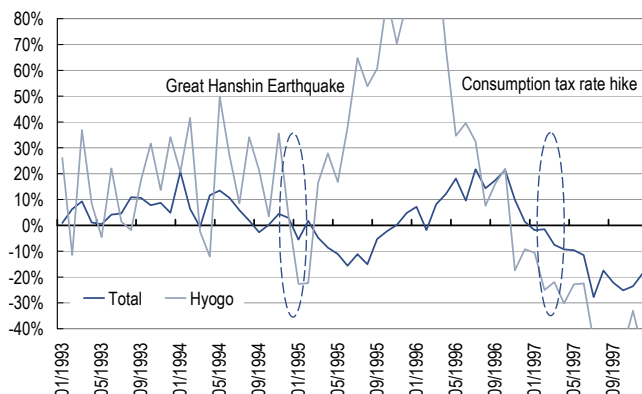
Note: As of December 15, 2011.
Source: Reconstruction Headquarters in Response to the Great East Japan Earthquake, Citi Investment Research and Analysis.

Figure 8. Miyagi Prefecture's plan for providing public housing to disaster victims: Only 2.5% of total to be supplied in 2012



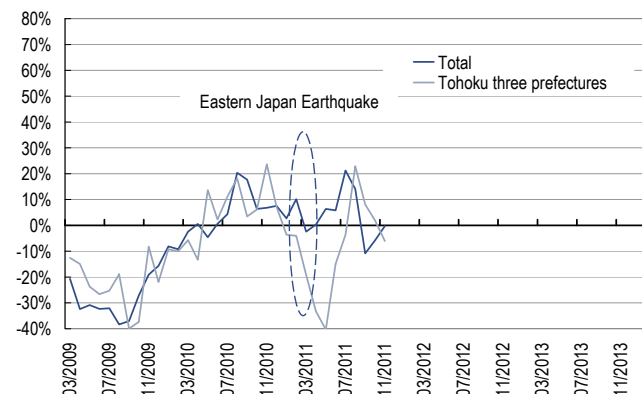
Source: Miyagi Prefecture, Citi Investment Research and Analysis.

Figure 9. YoY growth in new-construction housing starts before and after 1995 Kobe earthquake: Housing starts grow much faster than national average in affected area following the earthquake



Source: MLIT, Citi Investment Research and Analysis.

Figure 10. YoY growth in new-construction housing starts before and after Tohoku earthquake: Housing starts remain low in affected area



Note: The three Tohoku prefectures are Iwate, Miyagi, and Fukushima.
Source: MLIT, Citi Investment Research and Analysis.

Order outlook

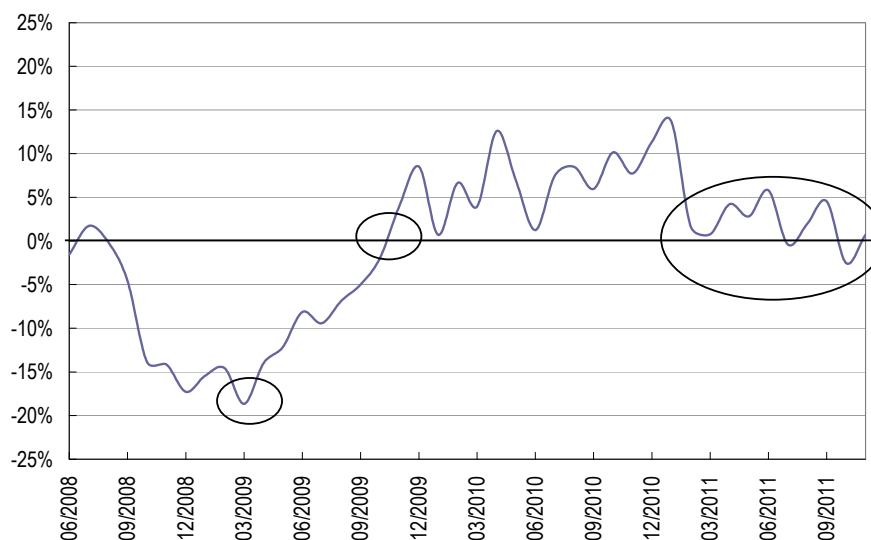
Orders growth at the majors flat YoY recently

At the eight major integrated housing companies, YoY orders growth began contracting more slowly in April 2009, turned positive for the first time in 15 months in November of that year, and subsequently trended steadily higher. However, starting in 2011 and continuing now, YoY order growth has been flat. This is attributable to a high YoY hurdle, depressed consumer sentiment following the Tohoku earthquake, and the housing version of the eco-point system and the Flat 35S scheme ending temporarily or being downscaled at the end of July and September 2011, respectively.

Orders could grow faster than the market thanks to rising market share

We think new-build housing starts will gradually rise starting in 2012 thanks to the continuation of homebuying-support measures and the emergence of rebuilding demand. Moreover, we think the major housing companies could see their orders grow faster than the market thanks to market share gains.

Figure 11. Average YoY growth in orders at eight major housing companies



Note: The eight major housing companies are Misawa Homes, Mitsui Home, Sumitomo Forestry, PanaHome, Daiwa House Industry, Sekisui House, Asahi Kasei, and Sekisui Chemical.

Source: Company data, Citi Investment Research and Analysis.

Owner-occupied homes: Prefab ratio rising on the disaster

The ratio of owner-occupied (i.e., subcontracted single-family housing) home starts accounted for by prefab housing (a proxy for the majors' market share) trended downward in the latter half of 2010 owing to a rebound in overall owner-occupied home starts. However, as happened following the January 1995 Kobe earthquake, the prefab ratio began rising gradually following the March 2011 eastern Japan earthquake. We expect this ratio to continue increasing gradually, given that 1) as a result of supply-chain disruptions following the earthquake, differences emerged among homebuilders in terms of their ability to secure construction materials and construction workers; and 2) consumers have become more focused on quake-resistance, making them more likely to go with the majors.

Rental housing: Contracts underwriting vacancy risk a structural advantage for the majors

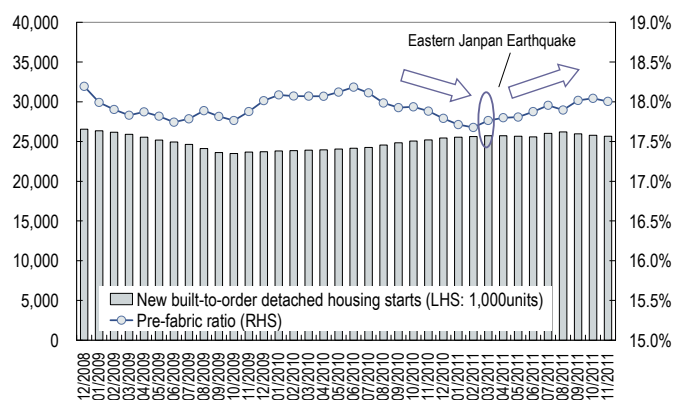
Over the past 10 years, the major housing companies have achieved a virtually uninterrupted increase in their share of the rental housing market by leveraging their superior capital and creditworthiness to sign contracts with apartment owners promising to pay a certain amount of rent for unoccupied units, thereby underwriting the owner's vacancy risk. Recently, Leopalace21 (which is highly dependent on

corporate tenants and single-person tenants) has sharply reduced the number of units it supplies, having been buffeted by the decline in the number of non-regular employees at manufacturing companies since 2008 (a consequence of the financial crisis). However, four other companies (Daito Trust Construction, Daiwa House Industry, Sekisui House, and Token) are steadily securing orders.

Condominiums: Number of suppliers limited

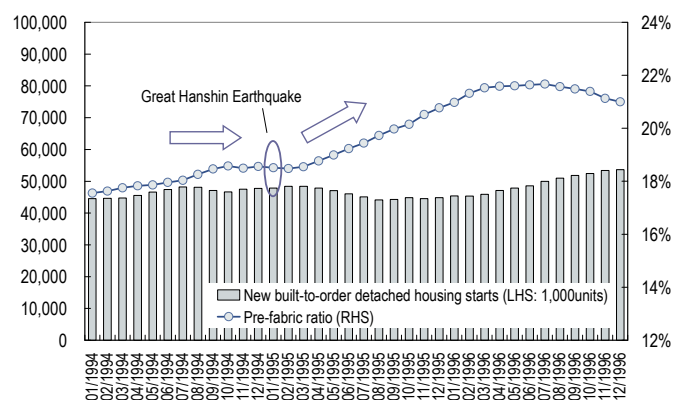
The total volume of condominiums supplied fell from 167,000 units in 2005 to 85,000 in 2010, or to roughly half the recent peak. We attribute this to a large number of developers like Anabuki Construction and Japan General Estate being forced out of the market as a result of tighter lending stances toward the real estate industry in the wake of the financial crisis of 2008-2009. This has enabled major developers belonging to large corporate groups to reap survivor benefits, and amid a tight supply/demand environment these companies are enjoying strong condominium sales.

Figure 12: Prefab owner-occupied ratio (2008-2011)



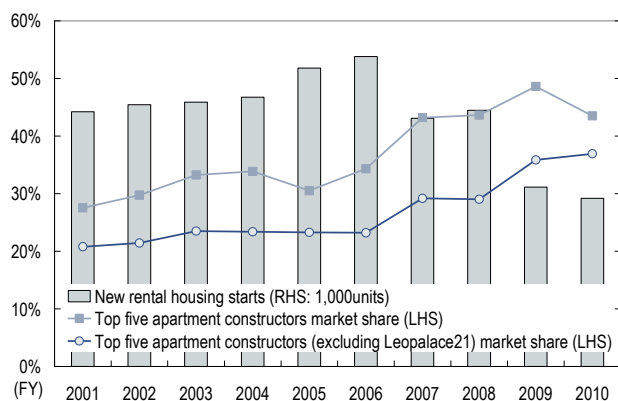
Note: 12MMA for all figures.
Source: MLIT, Citi Investment Research and Analysis.

Figure 13: Prefab owner-occupied ratio (1994-1996)



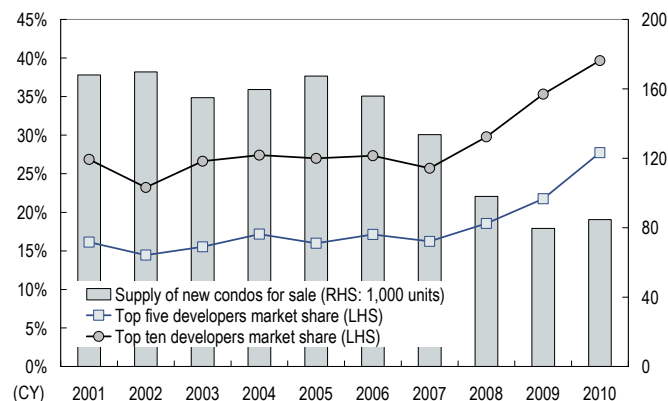
Note: 12MMA for all figures.
Source: MLIT, Citi Investment Research and Analysis.

Figure 14: Share of apartment sales volume



Note: Top five firms are Daito Trust Construction, Daiwa House Industry, Sekisui House, Token and Leopalace21.
Source: MLIT, Citi Investment Research and Analysis.

Figure 15: Share of built-for-sale condo supply volume



Source: Real Estate Economic Institute, Citi Investment Research and Analysis.

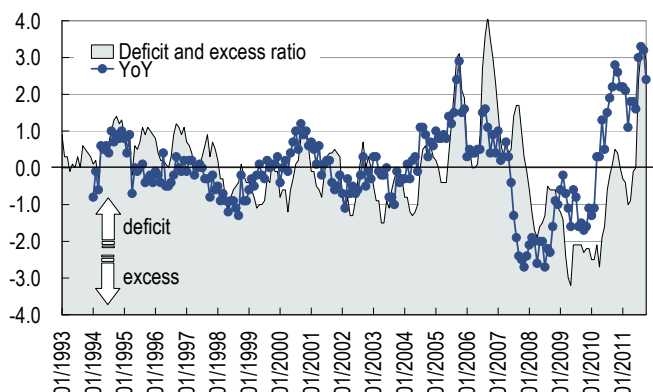
Profit margin outlook

Housing manufacturers: Tight supply/demand for labor

For housing manufacturers, rising labor costs (a reflection of tight supply/demand for labor) is one reason for the rising costs at their contract homebuilding businesses. The supply/demand balance for both skilled and general construction workers has remained tight ever since the real estate boom of the middle of the preceding decade. This is attributable to a structural factor—the aging of the workforce and a decline in the number of young people entering these trades—as well as to a decline in the number of housing suppliers (a reflecting of the steep decline in real estate investment since 2008) and an increase in demand as a result of the 2011 eastern Japan earthquake.

As a result, unit prices for outsourced construction at the housing manufacturers are up by as much as 10% YoY. Generally, the cost structure of contract homebuilding operations is as follows: materials costs 30%, building costs 30%, and other expenses 10%, with the remaining 30% booked as profits. The rise in building costs could depress profit margins by 2%-3%, in our view.

Figure 16. Skilled construction worker surplus/shortage ratio (%): 6-category aggregate

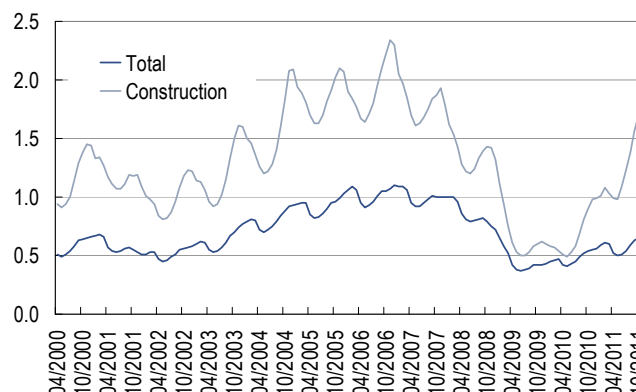


Note 1: Surplus/shortage ratio: (number of workers sought but not secured – number of workers secured but not needed) / (number of workers secured + number of workers sought but not secured)

Note 2: The six job categories are concrete mold maker (civil engineering), concrete mold maker (construction), plasterer, rigger, reinforcing-bar placer (civil engineering), reinforcing-bar placer (construction).

Source: MLIT, Citi Investment Research and Analysis.

Figure 17. Jobs-to-applicants ratio (x)

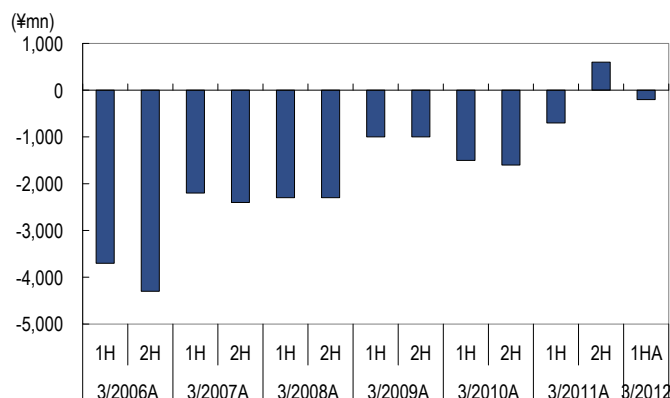


Source: MLHW, Citi Investment Research and Analysis.

Housing equipment manufacturers: Channel mix could deteriorate

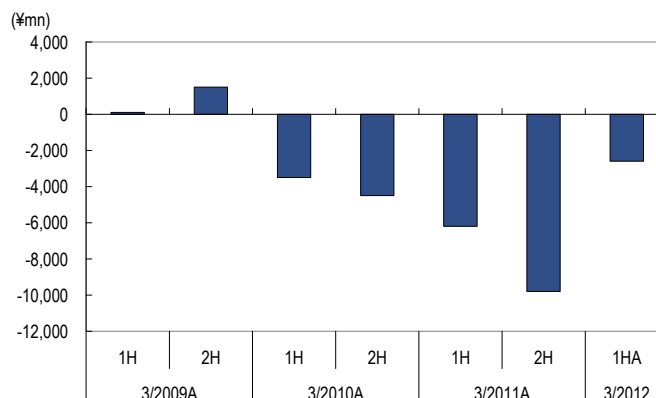
Housing equipment manufacturers like Toto and JS Group have in the past struggled with sharply lower selling prices squeezing profits. Recently, however, they have made progress in reducing the number of parts per finished good and in streamlining their product lineups, and by introducing new products with lower CoGS ratios have succeeded in offsetting the profit-reducing effects of falling prices and the encroachment of low-end products. However, if the major housing manufacturers continue to increase their market shares as outlined earlier, we think channel-mix deterioration could increase the CoGS ratios of the equipment makers.

Figure 18. Toto: Profit impact of fluctuations in selling prices



Source: Company data, Citi Investment Research and Analysis.

Figure 19. JS Group: Profit impact of fluctuations in selling prices



Source: Company data, Citi Investment Research and Analysis.

Stock selection

Favor those companies with profit drivers other than top-line growth in new housing construction

In the housing sector, where companies' business structures are diversifying and there is a dearth of semi-macro indicators of the type that help determine the direction of sector share prices, there is a strong correlation between the period earnings of a company and its share price.

However, with top-line growth gradually slowing and amid the aforementioned CoGS-boosting factors, we think the profit growth attained through higher revenues will slow. For that reason, we think the companies whose share prices will go up in 2012 will be those who have profit drivers other than top-line growth in new-construction housing.

Daito Trust and Toto in first half, JS Group in second half

Our top pick for January-March is Daito Trust. Given that the gross margin on construction and construction orders were higher than expected in H1, we think the company will increase full-year guidance when it reports Q3 earnings. Given the strength of orders we believe the order backlog at end-FY3/12 will be up ¥88.9bn YoY, contributing to higher sales and profits, as well as a higher dividend, in FY3/13. We also think the company's share of the rental housing market will continue to rise over the medium term.

In April-June (i.e., results season), our focus will be on Toto. Thanks to efforts to lower purchasing costs, a reorganization of domestic manufacturing bases, and an increased ratio of new-product sales, we think costs could decline by a total of ¥18.1bn over the three years spanning FY3/12-FY3/14. We think there will be growing interest in the potential for significant profit growth in FY3/13, and along with this a rise in the share price.

For the second half of the year, we think JS Group looks promising. The slump in earnings is making it difficult for the share price to rise, a situation we think will continue. However, thanks to several catalysts, we think the share price will trend higher from mid-year onward. Such catalysts include 1) all of the negative incentives being out once the impact of the Thai floods is ascertained and the company lowers full-year guidance (March-April), 2) the company issuing FY3/13 guidance involving sharply higher profit thanks largely to reduced costs on the C-30 Project (May), and 3) the announcement of additional restructuring aimed at accelerating workforce reduction and increasing the ratio of overseas manufacturing (July-September).

Little investment appeal among mid-sized companies

Mid-size housing manufacturers are highly dependent on new-build detached housing operations, while mid-sized housing equipment makers have little room for cost cutting. We think earnings are approaching a peak for both types of companies, so we see little reason to expect their stocks to perform well.

Figure 20. Housing sector: October–December results preview

Code	Company	Q3 results release date	Investment rating	Share price 01/06/2012 (¥)	Share price performance			FY10 Q3OP Actual (¥bn)	FY11 H3OP	
					1month	3month	6month		CIRA E (¥bn)	YoY (%)
1878	Daito Trust Construction	02/03	1	6,860	1.2%	-6.3%	-3.9%	11.1	13.1	18.4%
1925	Daiwa House Industry	02/10	2	927	-0.2%	-5.5%	-10.2%	25.0	30.0	20.0%
1928	Sekisui House	12/08	2	686	1.8%	-4.9%	-10.0%	2.9	17.2	496.4%
5332	TOTO	01/31	1	601	-1.5%	-11.6%	-3.7%	8.6	9.0	4.5%
5938	JS Group	02/06	1	1,448	-2.8%	-31.2%	-28.1%	19.5	17.8	-8.7%

Code	Company	Company E (¥bn)	CIRA E (¥bn)	FY11 OP IFIS Consensus (¥bn)			Possibility of upward revision	Possibility of surprise	FY11 PER CE (X)	FY12 PER CIRA E (X)
				Average	Upper	Lower				
1878	Daito Trust Construction	80.0	88.2	83.4	88.2	80.6	↑ ↑	↑	11.5	9.7
1925	Daiwa House Industry	110.0	111.2	110.8	112.0	110.0	--	--	17.9	9.2
1928	Sekisui House	68.0	73.0	70.1	75.0	62.0	NM	NM	13.1	10.2
5332	TOTO	20.0	19.2	19.8	20.5	19.0	--	--	17.1	13.8
5938	JS Group	42.0	34.6	39.3	42.0	34.9	↓	↓	14.8	11.7

Note 1: Our assessments of the possibility of revisions to full-year plans and of surprises are for the Q3 results announcements. ↑ indicates upward revisions or positive surprises. ↓ indicates downward revisions or negative surprises. Number of arrows indicates our assessment of the likelihood.

Note 2: Sekisui House has a January year-end, so its Q3 numbers are actuals.

Source: Company data, IFIS, Citi Investment Research and Analysis.

Figure 21. Housing sector valuations

	Share price (¥) 1/6/12	Target Price (¥)	PER(X)				ROE(%)				PBR(X)			
			FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E
1878 Daito Trust	6,860	8,200	17.9	11.0	9.7	9.3	19.5%	34.5%	32.8%	29.2%	4.13	3.40	2.87	2.47
1925 Daiwa House	927	1,020	19.7	41.3	9.2	8.9	4.4%	2.0%	8.9%	8.6%	0.85	0.84	0.79	0.74
1928 Sekisui House	686	760	15.2	12.1	10.2	9.3	4.2%	5.1%	5.8%	6.1%	0.63	0.61	0.58	0.56
5332 Toto	601	810	40.4	23.3	13.8	11.2	2.8%	4.9%	8.0%	9.2%	1.17	1.14	1.07	1.00
5938 JS Group	1,448	1,900	26.1	14.8	11.7	9.0	3.0%	5.2%	6.3%	7.8%	0.78	0.76	0.73	0.70
	Rating	ETR	OP(¥mn)				PCFR(X)				Div. yield(%)			
			FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E
1878 Daito Trust	1	23%	73,767	88,200	93,000	96,900	16.8	10.5	9.3	9.0	3.3%	4.5%	5.2%	5.4%
1925 Daiwa House	2	12%	87,697	111,200	110,300	115,100	7.5	9.1	5.0	4.8	2.2%	2.7%	3.2%	3.3%
1928 Sekisui House	2	14%	56,354	73,000	81,100	88,400	9.9	8.2	7.2	6.6	3.1%	2.9%	3.8%	4.1%
5332 Toto	1	36%	14,014	19,200	24,900	30,100	8.3	7.5	5.6	5.0	1.7%	1.7%	2.3%	2.8%
5938 JS Group	1	34%	40,409	34,600	67,000	75,800	7.9	6.2	5.4	4.6	2.8%	2.8%	3.5%	4.1%
	M-Cap. (¥bn)	M-Cap. (\$bn)	EV / EBITDA(X)				Net Debt Equity ratio (X)							
			FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E				
1878 Daito Trust	553	7.18	6.07	4.92	4.25	3.63	-0.44	-0.58	-0.71	-0.82				
1925 Daiwa House	556	7.22	5.01	4.27	4.23	4.05	0.39	0.43	0.43	0.43				
1928 Sekisui House	464	6.03	6.03	5.53	4.84	4.31	0.08	0.16	0.13	0.10				
5332 Toto	223	2.90	5.73	5.30	4.00	3.40	0.15	0.18	0.10	0.05				
5938 JS Group	453	5.89	6.80	7.55	5.05	4.56	0.25	0.30	0.27	0.26				
			EPS(¥)				BPS(¥)				DPS(¥)			
			FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E	FY2010A	FY2011E	FY2012E	FY2013E
1878 Daito Trust			384.3	620.9	707.7	738.7	1,663	2,016	2,388	2,773	229	310	354	369
1925 Daiwa House			47.1	22.5	100.7	104.4	1,096	1,098	1,174	1,248	20	25	30	31
1928 Sekisui House			45.0	56.7	67.4	73.7	1,091	1,132	1,177	1,223	21	20	26	28
5332 Toto			14.9	25.8	43.6	53.6	514	529	561	600	10	10	14	17
5938 JS Group			55.5	97.9	123.6	160.4	1,850	1,909	1,981	2,081	40	40	50	60

Note: Expected total return is the difference between the share price and our target price, plus the dividend yield. EV/EBITDA multiple = (market cap + interest-bearing debt – cash and deposits – marketable securities – held-for-investment securities) / (OP + depreciation + interest and dividends received).

Source: Company data, Citi Investment Research and Analysis.

Company Focus

- Company Update
- Estimate Change

Buy	1
Price (06 Jan 12)	¥6,860
Target price	¥8,200
Expected share price return	19.5%
Expected dividend yield	4.5%
Expected total return	24.1%
Market Cap	¥544,037M
	US\$7,081M

Price Performance (RIC: 1878.T, BB: 1878 JP)



Daito Trust Construction (1878)

Buy: Near-term top pick in light of expectations for upward revisions and the high dividend yield

- **Conclusion** — Daito Trust is our near-term top pick. The shares have been trading water recently as investors reacted unfavorably to the absence of upward revisions at the Q2 results announcement and the FY3/12E dividend yield is 4.8%. However, we expect upward revisions to the full-year plan at Q3 results given the gross margin in the construction segment and the order overshoot at H1. We model a ¥88.9bn YoY increase in the order backlog at end-FY3/12, thanks to strong orders, and see this contributing to higher revenues, profits, and dividends in FY3/13. We also think that growth in market share in the leasing market will be sustained over the medium term. We fine-tune our forecasts on changes in the corporate tax rates. We maintain our target price.
- **Q3 preview** — We model sales of ¥264.3bn (up 12% YoY) and OP of ¥13.1bn (up 18%). We expect the gross margin in the construction segment to deteriorate 1.3ppt to 36.1% on rising construction unit prices but think that growth in completed construction value and improvement in occupancy rates in the real estate segment will drive profit growth. Good order momentum continues, with December orders (announced January 7) amounting to ¥59.8bn (up 12%), ahead of high year-ago levels. October–December cumulative orders amounted to ¥150.8bn (up 16%), a record high for the quarter.

Consol.	Sales		OP			RP		NP		EPS	PE
	¥M	YOY (%)	¥M	YOY (%)	OPM(%)	¥M	YOY (%)	¥M	YOY (%)	¥	X
3/10A	972,616	1.9	71,127	1.0	7.3	76,663	3.6	45,353	7.7	386	17.8
3/11A	1,001,169	2.9	73,767	3.7	7.4	78,005	1.8	43,151	-4.9	384	17.9
3/12CE	1,075,950	7.5	80,000	8.4	7.4	81,300	4.2	48,000	11.2	595	11.5
3/12E	1,087,400	8.6	88,200	19.6	8.1	89,500	14.7	52,050	20.6	646	10.6
3/12RE	1,087,400	8.6	88,200	19.6	8.1	89,500	14.7	50,050	16.0	621	11.0
3/13E	1,197,500	10.1	93,000	5.4	7.8	94,500	5.6	54,650	5.0	678	10.1
3/13RE	1,197,500	10.1	93,000	5.4	7.8	94,500	5.6	57,050	14.0	708	9.7
3/14E	1,266,300	5.7	96,900	4.2	7.7	98,600	4.3	57,050	4.4	708	9.7
3/14RE	1,266,300	5.7	96,900	4.2	7.7	98,600	4.3	59,550	4.4	739	9.3

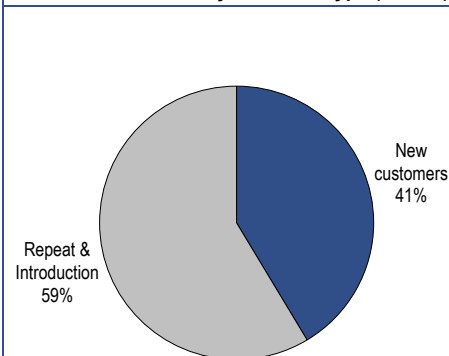
A: Actuals, E: CIRA Ests, CE: Company Ests, RE: CIRA Revised Ests, CRE: Company Revised Ests, NA: Not Available, NM: Not Meaningful

Investment Dashboard

Reasons to Buy

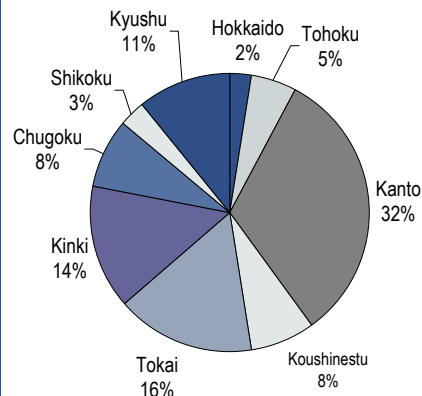
- Earnings and defensiveness are outstanding in an opaque external environment and we see relative investment appeal increasing
- We see construction orders growing stably up ahead on growth in the number of marketing people. We also expect the decline in the gross margin to be moderate
- Losses may continue in real estate but the impact on consolidated earnings is not great
- The medium-term plan contains a strong commitment from the management team to repay borrowings while maintaining a payout ratio of 50%. We see little chance of a change in capital policies even after the retirement of Chairman Katsumi Tada. The current dividend yield (FY3/12E) is just under 5%

Construction orders by customer type (FY3/11)



Source: Company data.

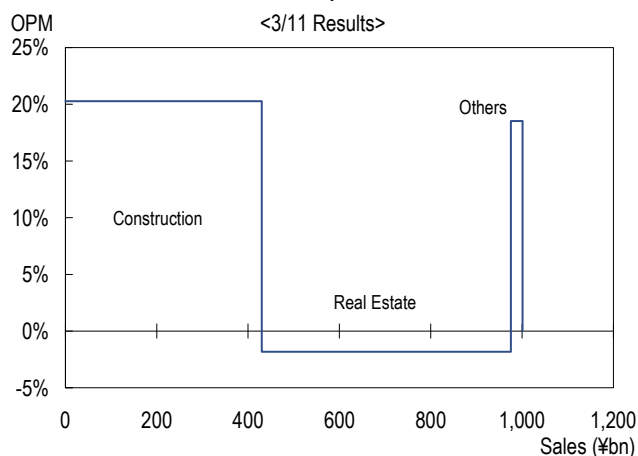
Construction orders by region (FY3/11)



Source: Company data.

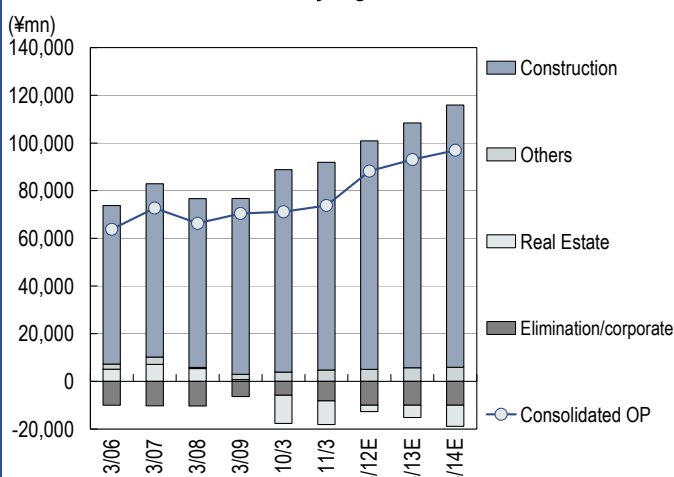
Business portfolio

<3/11 Results>



Note: Not including elimination/corporate
Source: Company data.

OP by segment

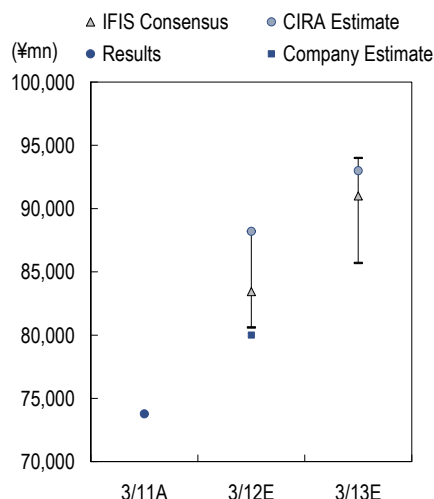


Source: Company data, Citi Investment Research and Analysis.

Alternate scenario: A more bearish case

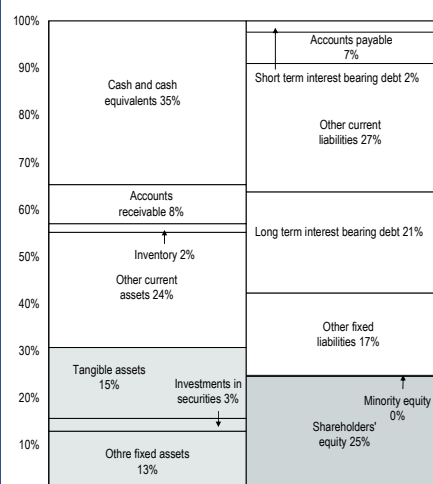
- The gross margin in construction could deteriorate more than we expect on surging material and external construction costs
- Construction orders could fall short of our expectations on less landowner enthusiasm to save tax or a hardening of lending attitudes by financial institutions
- Daito Trust could struggle with tenant leasing on deterioration in the employment environment or slack efforts to bolster brokerage, leading occupancy rates in real estate to come in short of our expectations
- In this case, we would lower our earnings forecasts and target multiple and derive a theoretical share price of ¥7,200

OP forecast comparison



Source: Company data, IFIS (January 7), CIRA.

Balance sheet (end-FY3/11)



Source: Company data.

Company Focus

- Company Update
- Estimate Change

Neutral	2
Price (06 Jan 12)	¥927
Target price	¥1,020
Expected share price return	10.0%
Expected dividend yield	2.7%
Expected total return	12.7%
Market Cap	¥536,546M
	US\$6,983M

Price Performance (RIC: 1925.T, BB: 1925 JP)



Daiwa House Industry (1925)

Neutral: Core operations firm but dearth of catalysts

■ **Conclusion** — Earnings have been firm recently but given that the drivers of earnings growth to date are likely to slow in FY3/13 and out—housing on deterioration in detached housing profitability, development on gains-on-sale shortfalls, and overseas on weakness in the Chinese real estate market—we doubt there will be a catalyst for the righting of undervaluation near term. We revise our forecasts on changes in the corporate tax rate. Daiwa House revised down its FY3/12 NP target on December 16 to ¥30bn from ¥47.5bn. We maintain our target price.

■ **Q3 preview** — We model sales of ¥430.4bn (up 4% YoY) and OP of ¥30bn (up 20%). We expect higher revenues and earnings in the commercial facilities and business & corporate facilities segments, in part on contributions from post-quake reconstruction demand, to drive earnings.

■ **Post-employment benefits** — We think around ¥40bn in nonoperating expenses that are not factored into the company plan are likely to be booked in FY3/12 due to increases in post-employment benefit expenses resulting from changes in the discount rates. While this is a technical accounting factor, the envisioned losses are considerable and we think this will be one factor keeping a lid on share price gains until it is clarified. The discount rate will be decided based on the 20-year JGB as of end-March, so we do not expect downward revisions at the Q3 results announcement and do not regard the negative newsflow as having been exhausted.

Consol.	Sales		OP			RP		NP		EPS	PE
	¥M	YOY (%)	¥M	YOY (%)	OPM (%)	¥M	YOY (%)	¥M	YOY (%)	¥	X
3/10A	1,609,883	-4.8	62,714	-14.8	3.9	60,036	50.6	19,113	358.3	33	28.1
3/11A	1,690,151	5.0	87,697	39.8	5.2	79,049	31.7	27,267	42.7	47	19.7
3/12CE	1,800,000	6.5	110,000	25.4	6.1	99,000	25.2	47,500	74.2	82	11.3
3/12CRE	1,800,000	6.5	110,000	25.4	6.1	99,000	25.2	30,000	10.0	52	17.9
3/12E	1,803,600	6.7	111,200	26.8	6.2	60,200	-23.8	26,000	-4.6	45	20.6
3/12RE	1,803,600	6.7	111,200	26.8	6.2	60,200	-23.8	13,000	-52.3	22	41.3
3/13E	1,850,300	2.6	110,700	-0.4	6.0	112,400	86.7	56,100	115.8	97	9.6
3/13RE	1,845,800	2.3	110,300	-0.8	6.0	112,000	86.0	58,300	348.5	101	9.2
3/14E	1,917,300	3.6	115,300	4.2	6.0	113,700	1.2	58,000	3.4	100	9.3
3/14RE	1,916,500	3.8	115,100	4.4	6.0	113,500	1.3	60,400	3.6	104	8.9

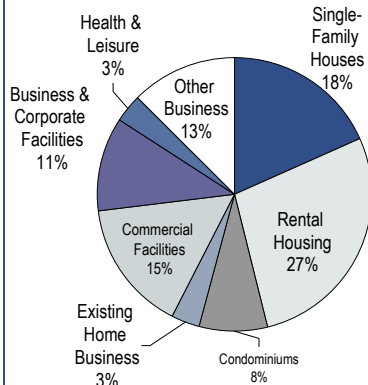
A: Actuals, E: CIRA Ests, CE: Company Ests, RE: CIRA Revised Ests, CRE: Company Revised Ests, NA: Not Available, NM: Not Meaningful

Investment Dashboard

Reasons for our Neutral rating

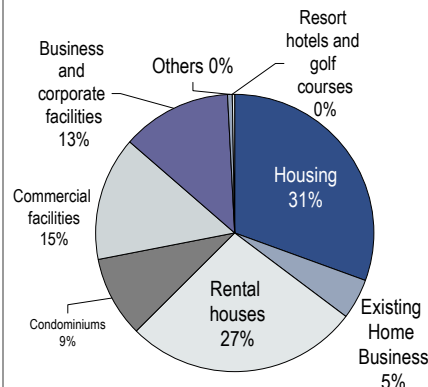
- As we have been pointing out, the good news is likely to have been priced in already
- A certain lack of visibility has emerged on the earnings drivers hitherto, with margins deteriorating in single-family houses, sales slowing in built-for-sale condominium projects in China, and a lack of visibility on the booking of gains on sales of properties in commercial facilities
- Valuations are lower than in past years and versus peers, so we feel downside is limited. We do not foresee real upside over the near term, however, in light of slowing earnings growth momentum moving forward

Consolidated sales breakdown (FY3/11)



Source: Company data.

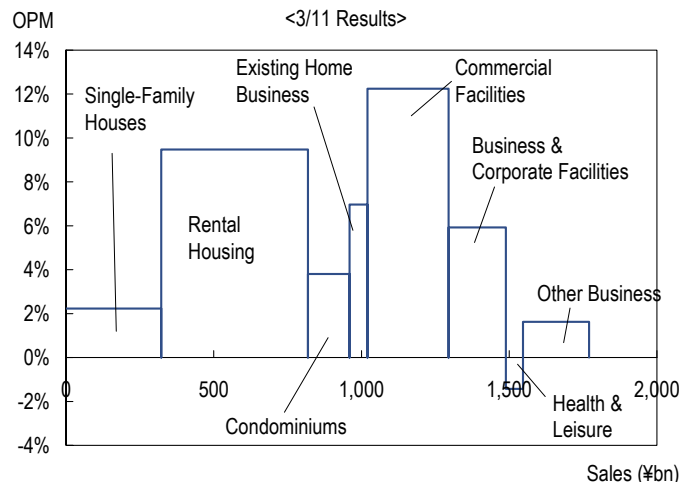
Parent sales breakdown (FY3/11)



Source: Company data.

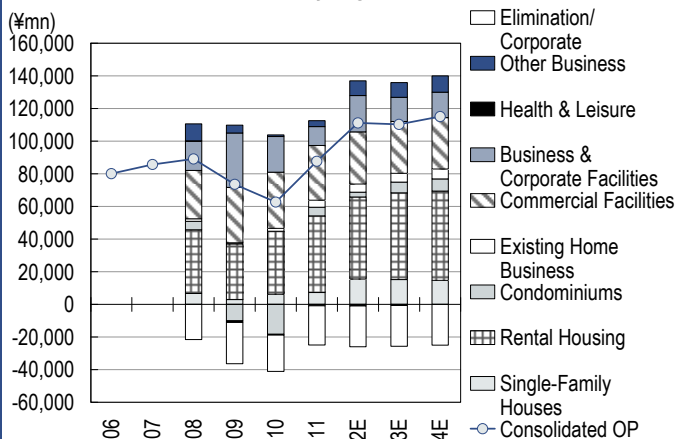
Business portfolio

<3/11 Results>



Note: Not including elimination/corporate
Source: Company data.

OP by segment

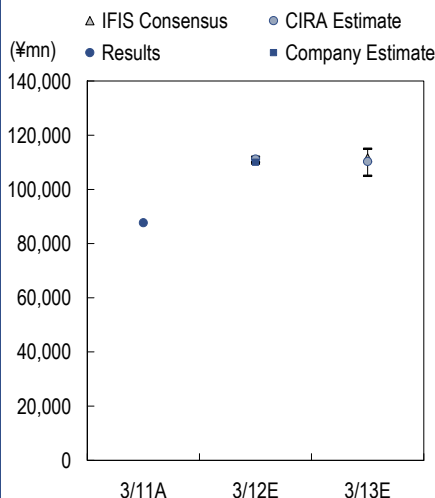


Source: Company data, Citi Investment Research and Analysis.

Alternate scenario: A more bullish case

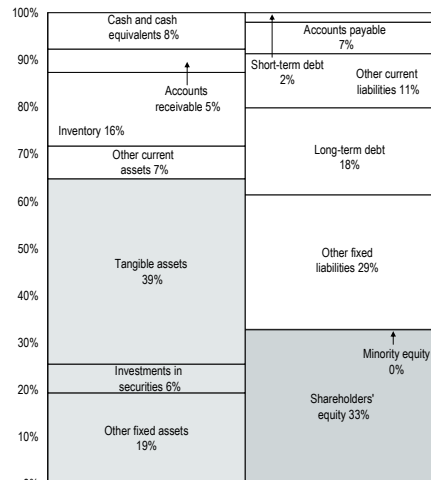
- Earnings in the single-family house and rental housing segment exceeding expectations on an upturn in the external environment thanks to policy support and post-quake reconstruction demand and on growth in market share on a beefed up sales force
- Gains on sales exceeding our expectations on the listing of Daiwa House REIT in FY3/13 as the real estate trading market picks up and contributing to a rise in valuations for Daiwa House, which behaves much like a real estate stock
- Profitability on Suzhou and Dalian projects improves thanks to a swift change in direction by the Chinese government in favor of housing policy easing
- If these factors emerged, we would raise our target multiple and our forecasts and derive a theoretical share price of ¥1,100

OP forecast comparison



Source: Company data, IFIS (January 7), CIRA.

Balance sheet (end-FY3/11)



Source: Company data.

Company Focus

- Company Update
- Estimate Change

Buy	1
Price (06 Jan 12)	¥601
Target price	¥810
Expected share price return	34.8%
Expected dividend yield	1.7%
Expected total return	36.4%
Market Cap	¥205,524M
	US\$2,675M

Price Performance (RIC: 5332.T, BB: 5332 JP)



TOTO (5332)

Buy: Still expecting earnings surge in FY3/13 even if remodeling demand takes a breather

- **Conclusion** — We expect a slight undershoot to Toto's full-year OP target on an undershoot in sales in the domestic remodeling segment. However, we think that Toto can reach its target of ¥18.1bn in cost cut benefits in the three years between FY3/12 and FY3/14, on campaigns to cut purchasing costs, the reorganization of domestic production facilities, and a rise in the sales weighting for new products. We expect the shares to advance in the full-year results reporting season of April–June, when we foresee investors paying increasing attention to the likely surge in earnings in FY3/13. We fine-tune our forecasts on changes in the corporate tax rate. We maintain our target price.
- **Q3 preview** — We model sales of ¥118.7bn (up 3% YoY) and OP of ¥9.0bn (up 4%). We see higher revenues in the domestic new housing segment and cost cuts contributing to earnings growth. Toto is anticipating H2 sales growth of 6% in the domestic remodeling segment but we think it is likely to undershoot plan in Q3 on slumping business sentiment and a lack of skilled craftspeople.

Consol.	Sales		OP			RP		NP		EPS	PE
	¥M	YOY (%)	¥M	YOY (%)	OPM(%)	¥M	YOY (%)	¥M	YOY (%)	¥	X
3/10A	421,929	-9.2	6,589	0.4	1.6	7,339	23.6	878	nm	3	237.4
3/11A	433,557	2.8	14,014	112.7	3.2	13,855	88.8	5,115	482.6	15	40.5
3/12CE	460,000	6.1	20,000	42.7	4.3	20,500	48.0	12,000	134.6	35	17.1
3/12E	458,600	5.8	19,100	36.3	4.2	19,500	40.7	11,400	122.9	33	18.0
3/12RE	458,900	5.8	19,200	37.0	4.2	19,600	41.5	8,800	72.0	26	23.3
3/13E	471,200	2.7	25,600	34.0	5.4	26,100	33.8	14,800	29.8	43	13.9
3/13RE	468,900	2.2	24,900	29.7	5.3	25,400	29.6	14,900	69.3	44	13.8
3/14E	482,700	2.4	30,600	19.5	6.3	31,100	19.2	17,900	20.9	52	11.5
3/14RE	481,200	2.6	30,100	20.9	6.3	30,600	20.5	18,300	22.8	54	11.2

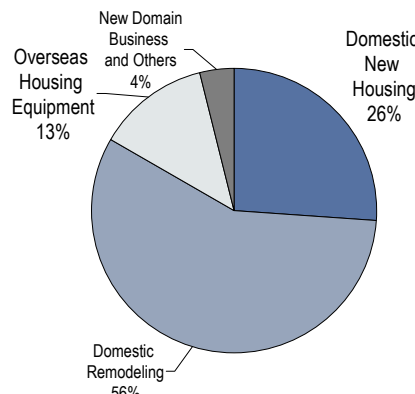
A: Actuals, E: CIRA Ests, CE: Company Ests, RE: CIRA Revised Ests, CRE: Company Revised Ests, NA: Not Available, NM: Not Meaningful

Investment Dashboard

Reasons to Buy

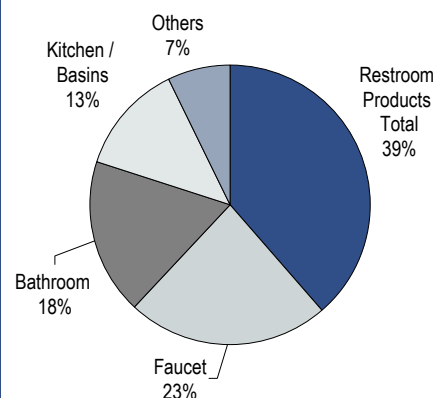
- We are optimistic about a big surge in earnings, as we anticipate ¥18.1bn in profit contributions from the Cost Reduction program between FY3/12 and FY3/14
- We expect domestic demand to hold up well for both new housing and remodeling
- We think Toto's Chinese operations will be able to deliver stable earnings even up ahead, when Chinese real estate conditions go through the worst of the contraction
- We model RoE of 8.0% in FY3/13 and 9.2% in FY3/14. As we think the valuation premium the shares have been awarded in the past is likely to persist, we conclude that they are undervalued at the current price

Consolidated sales breakdown (FY3/11)



Source: Company data.

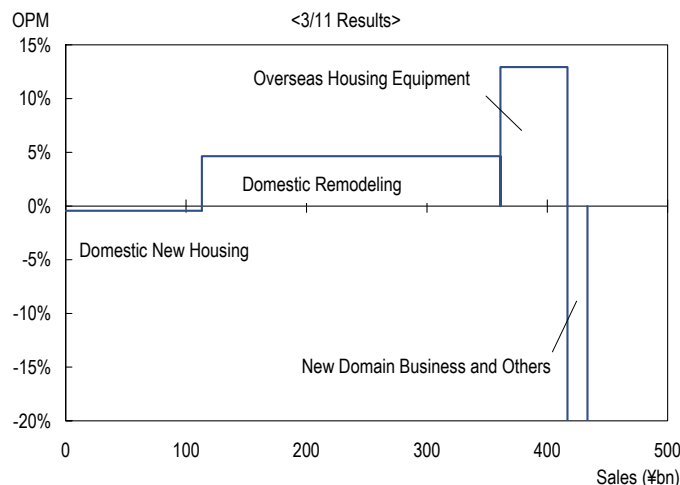
Domestic sales breakdown (FY3/11)



Source: Company data.

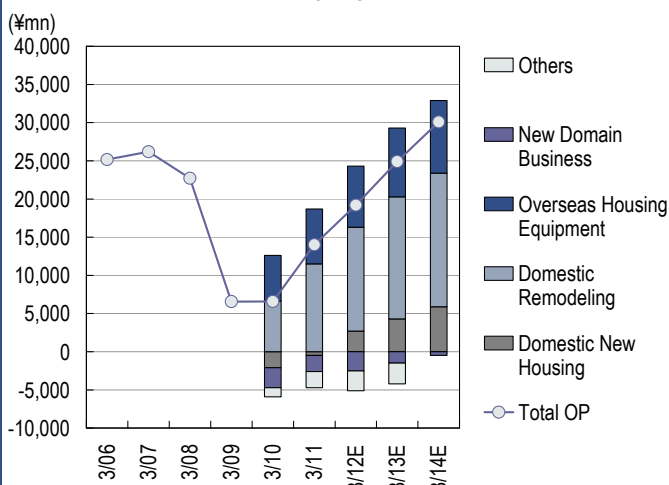
Business portfolio

<3/11 Results>



Source: Company data.

OP by segment

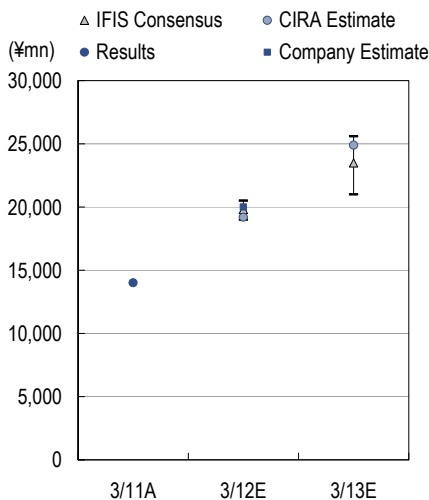


Source: Company data, Citi Investment Research and Analysis.

Alternate scenario: A more bearish case

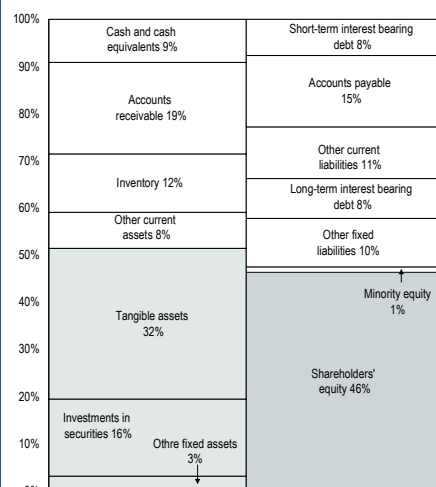
- Domestic demand undershoots our expectations on turmoil in global finance and a downturn in consumer sentiment on plans to hike various taxes
- Margin improvement is only modest due to slow progress in cutting costs and rising personnel costs in overseas operations
- If these risks materialize, we would lower our target multiple and earnings forecasts and derive a theoretical share price of ¥660

OP forecast comparison



Source: Company data, IFIS (January 7), CIRA.

Balance sheet (end-FY3/11)



Source: Company data.

Company Focus

- Company Update
- Target Price Change
- Estimate Change

Buy	1
Price (06 Jan 12)	¥1,448
Target price	¥1,900
from ¥2,200	
Expected share price return	31.2%
Expected dividend yield	2.8%
Expected total return	34.0%
Market Cap	¥416,637M
	US\$5,422M

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



JS Group (5938)

Buy: Expecting the shares to rise from around mid-year as visibility on the earnings recovery improves

- **Conclusion** — We revise down our earnings forecasts as the Thai floods hit earnings more than we had expected and as we revise our new housing start assumptions. We lower our target multiple to FY3/13E EV/EBITDA of 6.0x from 6.5x in response to weak near-term earnings and cut our target price to ¥1,900 from ¥2,200. However, we expect the shares to rise from around mid-year on improved visibility for an earnings recovery on an end to the turmoil resulting from the merger of subsidiaries and the announcement of additional restructuring plans, so we maintain our Buy rating.
- **Q3 preview** — We model sales of ¥350.4bn (up 10% YoY) and OP of ¥17.8bn (down 9%). While we expect the high revenue growth rate to continue on contributions from the newly consolidated subsidiaries Kawashima Selkon Textiles, Hivic, and Shanghai Melte Curtain Wall, we expect earnings to be down YoY for the third quarter in a row, hit by the Thai floods and weak market share in kitchen operations.
- **Thai plant** — The company said on January 5 that the Thai plant, which had been damaged by the floods, had already restarted production of some components and that production of final products was scheduled to resume in March. It expects inventory levels to recover to pre-flood levels by around April. However, the cost of substitute production in Japan has ballooned by more than initially expected and we now expect the FY3/12 negative earnings impact to be around ¥8bn-¥10bn, ahead of the ¥2.5bn-¥3.0bn we had previously calculated.
- **Share price outlook** — We expect the shares to continue to find upside hard to come by due to near-term earnings weakness. However, we foresee upward share price momentum building from mid-year on the following catalysts: 1) an exhaustion of the bad news when JS Group revises down for the full year when the impact of the Thai floods has been ascertained (March-April), 2) the announcement of guidance for a surge in FY3/13 earnings on contributions from C-30 Project cost cuts (May), and 3) the announcement of additional restructuring, involving expedited personnel cuts and rises in the overseas sales weighting (July–September).

Consol.	Sales		OP			RP		NP		EPS	PE
	¥M	YOY (%)	¥M	YOY (%)	OPM(%)	¥M	YOY (%)	¥M	YOY (%)	¥	X
3/10A	982,606	-6.1	25,983	1.5	2.6	27,857	25.6	-5,331	nm	-19	nm
3/11A	1,214,939	23.6	40,409	55.5	3.3	39,160	40.6	15,779	nm	55	26.1
3/12CE	1,340,000	10.3	42,000	3.9	3.1	42,000	7.3	36,000	128.2	125	11.6
3/12E	1,341,100	10.4	40,300	-0.3	3.0	40,300	2.9	35,900	127.5	125	11.6
3/12RE	1,338,200	10.1	34,600	-14.4	2.6	34,600	-11.6	28,200	78.7	98	14.8
3/13E	1,568,100	16.9	71,300	76.9	4.5	71,300	76.9	36,800	2.5	128	11.3
3/13RE	1,544,100	15.4	67,000	93.6	4.3	67,000	93.6	35,600	26.2	124	11.7
3/14E	1,624,800	3.6	79,300	11.2	4.9	79,500	11.5	46,500	26.4	161	9.0
3/14RE	1,604,700	3.9	75,800	13.1	4.7	76,000	13.4	46,200	29.8	160	9.0

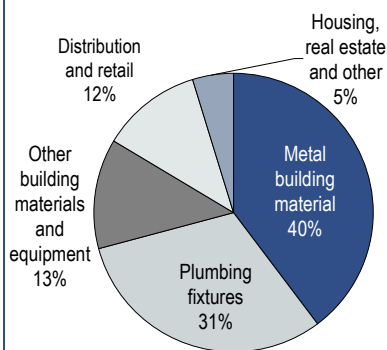
A: Actuals, E: CIRA Ests, CE: Company Ests, RE: CIRA Revised Ests, CRE: Company Revised Ests, NA: Not Available, NM: Not Meaningful

Investment Dashboard

Reasons to Buy

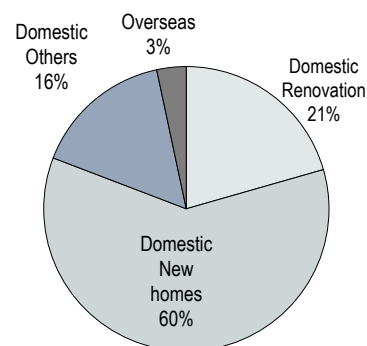
- Many of the products whose sales slowed due to the disaster and mergers have already recovered sales momentum. The housing market is also firm, thanks to policy support and post-quake reconstruction demand
- One-off factors such as merger expenses and disaster-related costs will drop out in FY3/13. Meanwhile, JS Group is making steady progress with big cost-cutting measures thanks to the C-30 Project and cost cuts have not ceased to operate as an earnings driver
- Even given that market expectations of the management team were dashed by downward revisions just over three months after the announcement of the period-start plan, current valuations are low

Consolidated sales breakdown (FY3/11)



Source: Company data.

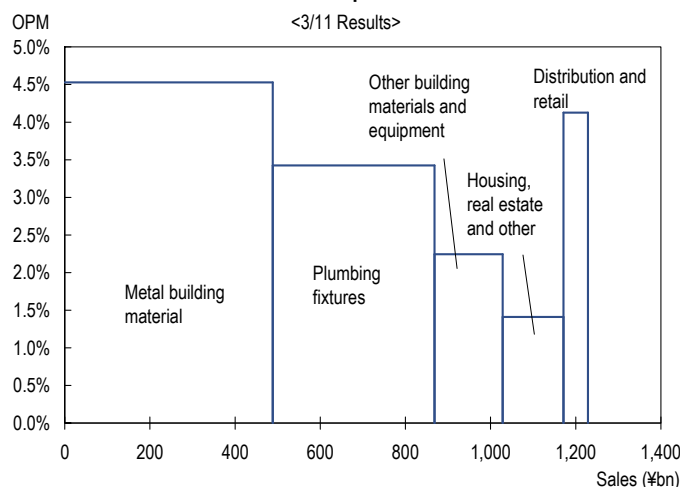
Consolidated sales breakdown (FY3/11)



Source: Company data.

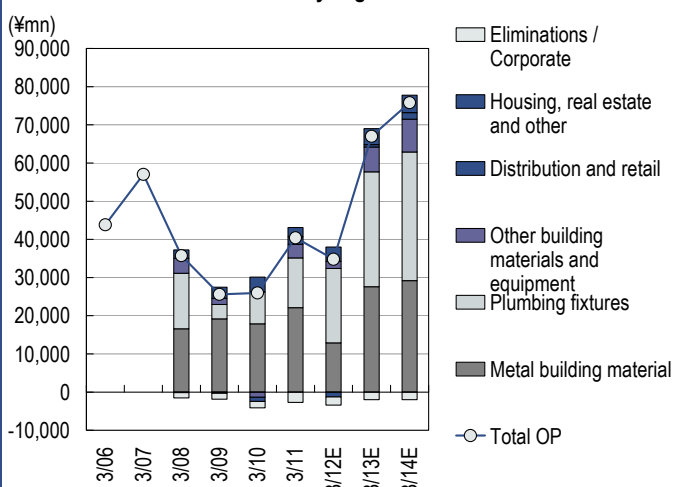
Business portfolio

<3/11 Results>



Note: Not including elimination/corporate
Source: Company data.

OP by segment

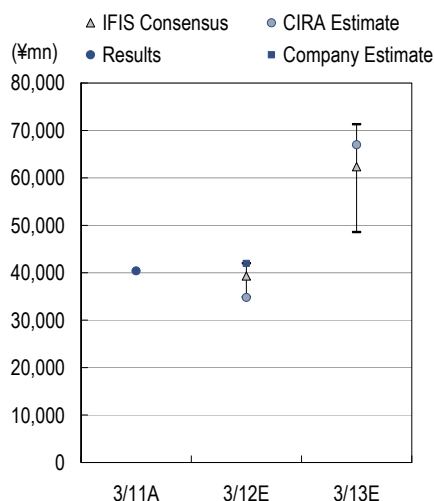


Source: Company data, Citi Investment Research and Analysis.

Alternate scenario: A more bearish case

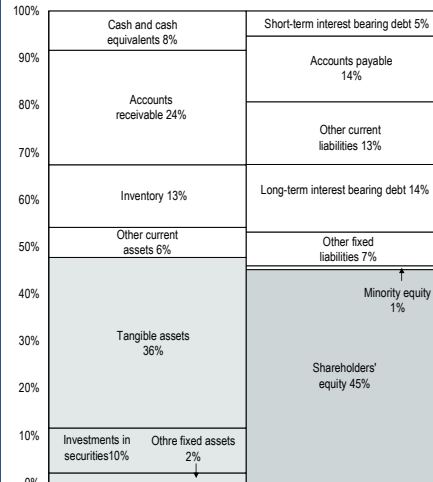
- Cost cuts during the course of the new medium-term management plan significantly undershooting our expectations
- The top-line missing our assumptions due to a slowdown in new housing starts and further prolongation of the turmoil stemming from subsidiary mergers
- Surging prices of materials such as aluminum and copper
- Lack of visibility on a potentially hasty M&A strategy
- If the above concerns emerge, we would lower our target multiple and earnings forecasts, derive a theoretical share price of ¥1,700, and downgrade to Neutral

OP forecast comparison



Source: Company data, IFIS (January 7), CIRA.

Balance sheet (end-FY3/11)



Source: Company data.

Daito Trust Construction

Investment strategy

We rate the shares of Daito Trust Construction Buy (1), with a target price of ¥8,200. With the external environment uncertain, we think the firm's earnings and share price defensiveness stand out, giving it relatively high investment appeal.

We think construction orders will continue to expand steadily due to an increase in sales representatives. At the same time, the decline in gross margin should be modest. While real estate is likely to remain in the red, this should have little impact on consolidated earnings. When announcing a new medium-term plan, management expressed a strong commitment to maintaining a dividend payout ratio of 50% while also paying down debt. We think there is little likelihood of a change in capital policy even after Chairman Katsumi Tada steps down. The dividend yield is currently 4%+ on our FY3/12 forecasts.

Valuation

We base our ¥8,200 target price on an FY3/13E PER of 12x. PER is closely correlated with monthly orders, and the ten-year range is 10x-20x. We think orders will rise to record levels going forward due to an increase in the sales force. However, we use a target PER at the low end of the historical range because of the temporary increase in borrowings and the halt to share buybacks equivalent to 30% of NP.

Risks

Risks associated with our target price include 1) surging materials costs and outsourced construction expenses resulting in greater-than-expected deterioration in the construction gross margin, 2) construction orders falling below our expectations on less tax-saving ardor among landowners and a hardening of lending attitudes by financial institutions, and 3) struggles with tenant leasing on deterioration in the employment environment and weak measures to bolster tenant placement resulting in the real estate segment occupancy rate undershooting our expectations.

If the above risk factors prove to be graver than we anticipate, the shares may not reach our target price.

Daiwa House Industry

Investment strategy

We rate the shares of Daiwa House Neutral (2) with a target price of ¥1,020.

The good news that we have discussed previously looks to be largely priced in. Valuations continue to look undemanding, but for the shares to appreciate further, we think profit growth needs to exceed market expectations. However, taking into consideration profit deterioration in single-family housing and the slowing pace of sales at condo projects in China, as well as a lack of visibility as to the recording of gains on property sales in commercial facilities, we expect earnings momentum to slow. We expect a -0.8% OP decline in FY3/13 and just 4.4% growth in FY3/14.

Valuation

We use adjusted EV/EBITDA to value the two housing majors. We calculate this as (market cap + interest-bearing debt - cash on hand - marketable securities and investment securities)/(OP + depreciation + interest and dividend revenue).

We adopt EV/EBITDA for two reasons: 1) it measures real profit generating capabilities as it strips out the impact on profits of extraordinary gains and losses and 2) it reduces the impact of different accounting standards for things like retirement benefits.

We set a target price of ¥1,020. Given the drop in valuations for the Japanese market as a whole and the likelihood of a profit growth slowdown, we base our target price on an FY3/13E EV/EBITDA of 4.5x, a discount to the company's historical range (5.0x-9.0x).

Risks

Upside risks to our target price include 1) improvement in external conditions due to factors such as government support measures and reconstruction demand, and an expanded sales force contributing to higher market share, leading to better-than-expected earnings in detached housing and rental housing; 2) stepped-up activity in the real estate trading market resulting in greater-than-expected sales gains after a listing of Daiwa House REIT next year and contributing to higher valuations for Daiwa House as a high-quality real estate stock; and 3) the shift to a more accommodative real estate policy in China in the near term, improving the profitability of projects in Suzhou and Dalian.

Downside risks include 1) a collapse in real estate prices, resulting in lower-than-expected external sales of development projects; 2) a lack of recovery in housing prices, keeping margins for the built-for-sale land and condominium businesses flat; 3) prolonged order weakness for commercial and business & corporate facilities as companies remain cautious about capex; and 4) a reduced earnings contribution from the overseas operations on a slowdown in the Chinese housing market.

If the impact of any of these factors is larger than we expect, the share price could diverge from our target price.

TOTO

Investment strategy

We rate the shares of Toto Buy (1), with a ¥810 target price (EV/EBITDA multiple of 5.0x, target price based on FY3/13E).

There are three reasons for our Buy rating: 1) we look for significant profit growth, as we anticipate a ¥18.1bn boost from cost reductions during FY3/12-FY3/14; 2) we look for domestic demand to be solid in both new construction and remodeling; and 3) we think the firm's China operations can secure stable earnings even with the worst likely to come for the Chinese real estate market.

We think RoE can reach 8.0% in FY3/13 and 9.2% in FY3/14. As we expect the valuation premium seen in the past to remain in place moving forward, we think the shares currently look undervalued.

Valuation

We use EV/EBITDA ((market cap + interest-bearing debt - cash and deposits - marketable securities - held-for-investment securities)/(OP + depreciation + dividends and interest received)) as our target multiple in valuing the two housing equipment makers.

The main reason we use EV/EBITDA is that we can strip out losses in a given fiscal year due to cost cutting. We think it unlikely that the market will react negatively due to downward pressure on short-term earnings stemming from structural reforms and thus see no reason to reflect losses in our target price. We also see EV/EBITDA as appropriate as it allows us to compare the two firms directly having accounted for differences in depreciation costs stemming from different business portfolios.

Our target price for Toto is ¥810. Given the fall in valuations on the Japanese equities market as a whole, we use an EV/EBITDA multiple of 5.0x (FY3/13E basis), the low end of the historical range (5.0x-10.0x).

Risks

We see the following as risks that could cause the share price to diverge from our target price: 1) domestic new housing starts that are lower than we expect; 2) slowing renovation demand in Japan due to deteriorating consumer sentiment; 3) a fall in sales prices on intensifying price competition with peers; 4) a lack of overall cost cutting; 5) the adjustment in Chinese real estate prices impacting housing demand, resulting in slower housing equipment demand; and 6) a market share decline in China due to offensives by competitors.

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

JS Group

Investment strategy

We rate the shares of JS Group Buy (1) with a ¥1,900 target price (based on an FY3/13E EV/EBITDA of 6.0x).

Sales momentum for most products that lost market share due to the earthquake and the integration has already started to recover. The housing market is also firm, thanks to government support and reconstruction demand. We also expect the one-offs of merger expenses and disaster-related expenses to drop out in FY3/13 and thereafter. Meanwhile, the C-30 Project, a giant cost-cutting program, is going smoothly, and is continuing to function as an upward earnings driver. Even given the loss of confidence in management caused by downward revisions to FY3/12 forecasts only just over three months after they were announced, we think valuations are low.

Valuation

We use EV/EBITDA ((market cap + interest-bearing debt - cash - marketable securities and investment securities)/(OP + depreciation + dividends and interest received)) as our target multiple in valuing the two housing equipment makers.

The main reason we use EV/EBITDA is that we can strip out losses in a given fiscal year due to cost cutting. We think it unlikely that the market will react negatively due

downward pressure on short-term earnings stemming from structural reforms and thus see no reason to reflect losses in our target price. We also see EV/EBITDA as appropriate as it allows us to compare the two firms directly having accounted for differences in depreciation costs stemming from different business portfolios.

Our target price for JS Group is ¥1,900. Given the drop in valuations for the Japanese market as a whole and likely earnings weakness short term, we base our target price on an FY3/13E EV/EBITDA of 6.0x (below the bottom of the company's historical range of 7.0x-12.0x).

Risks

We see the following as risks that could cause the share price to diverge from our target price: 1) cost cutting as part of the new medium-term plan being far smaller 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.

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

Sekisui House

Investment strategy

We rate the shares of Sekisui House Neutral (2) with a target price of ¥760. We think earnings are likely to continue improving in FY1/12 and out on a turn to the black for condos and overseas operations, so share price performance could be firm in the short term. However, growth in the earnings contribution from detached housing and rental housing is likely to be sluggish, and we also do not expect significant gains on sales in the urban redevelopment business. As a result, FY1/13 RoE is likely to be only in the 5%-6% range, so valuations do not look particularly low. Uncertainty about the China business continues to weigh on the shares, and we see little that is likely to drive valuations upward in any real sense.

Valuation

We use adjusted EV/EBITDA to value integrated housing makers. We calculate this as (market cap + interest bearing debt - cash on hand - marketable and investment securities)/(OP + depreciation + interest and dividend income).

We adopt EV/EBITDA for two reasons: 1) it measures real profit strength as it strips out the impact of extraordinary losses and 2) it reduces the impact of different accounting standards for things like retirement benefits.

We derive our ¥760 target price by applying an EV/EBITDA of 5.5x (Sekisui House has a 10-year range of 5.0x-9.0x) to our FY1/13 estimates.

Risks

Upside potential to our target price could come from 1) higher-than-expected new housing starts, 2) earlier-than-expected margin improvement on accelerated condominium inventory disposal, 3) higher-than expected gains on external sales of real estate development projects, and 4) earnings from overseas operations contributing faster than we expected.

Downside risks to our target price are 1) a larger-than-expected increase in materials and labor outsourcing costs; 2) lower-than-expected new housing starts, 3) rapid Chinese real estate market deterioration, giving rise to losses on built-for-sale condo projects.

If impacts from the above factors are larger than we expect, the share price could stay above or below our target price.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Daito Trust Construction (1878)

Ratings and Target Price History Fundamental Research

Analyst: Shusuke Terada

Covered since December 16 2009



	Date	Rating	Target Price	Closing Price
1	16-Dec-09	*1M	*5,600	4,420
2	24-Feb-10	1M	*5,300	4,335
3	9-May-10	1M	*6,200	5,080

* Indicates change

	Date	Rating	Target Price	Closing Price
4	21-Feb-11	1M	*8,100	7,110
5	24-May-11	1M	*7,500	6,500
6	8-Jul-11	1M	*8,000	7,220

	Date	Rating	Target Price	Closing Price
7	7-Aug-11	1M	*8,200	6,970
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*1	8,200	7,300

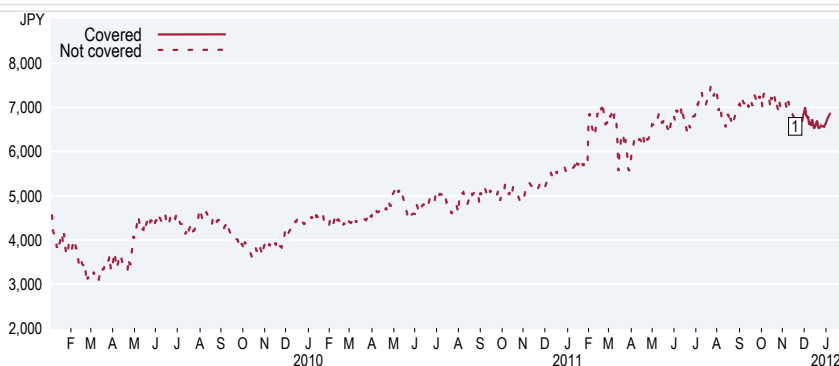
Rating/target price changes above reflect Eastern Standard Time

Daito Trust Construction (1878)

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

Analyst: Shusuke Terada

Covered since December 16 2009



	Date	Rating	Target Price	Closing Price
1	18-Nov-11	*ADD MP	-	6,570

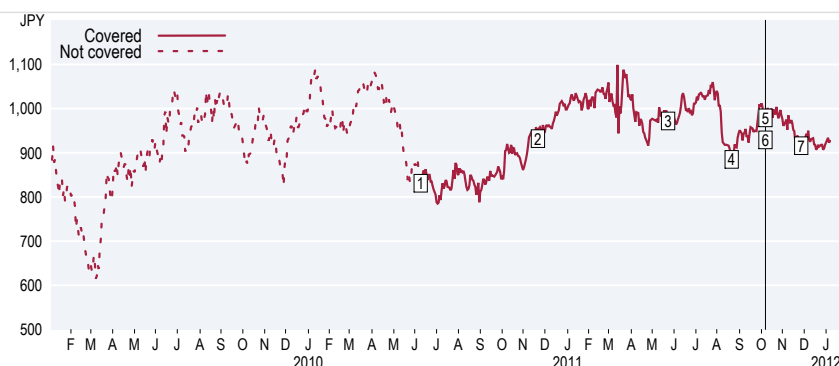
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Daiwa House Industry (1925)

Ratings and Target Price History Fundamental Research

Analyst: Shusuke Terada
Covered since June 9 2010



	Date	Rating	Target Price	Closing Price
1	9-Jun-10	1M	*1,100	831
2	22-Nov-10	1M	*1,300	952
3	24-May-11	1M	*1,200	987

* Indicates change

	Date	Rating	Target Price	Closing Price
4	21-Aug-11	1M	*1,150	885
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	1,150	980

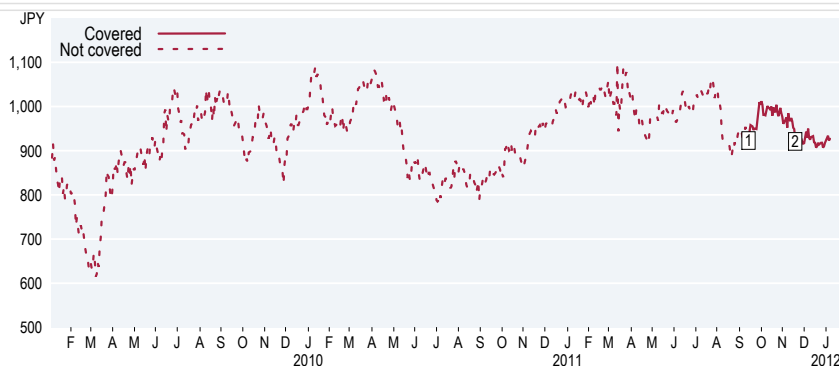
	Date	Rating	Target Price	Closing Price
7	28-Nov-11	*2	*1,020	928

Rating/target price changes above reflect Eastern Standard Time

Daiwa House Industry (1925)

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

Analyst: Shusuke Terada
Covered since June 9 2010



	Date	Rating	Target Price	Closing Price
1	14-Sep-11	*ADD MP	-	923

* Indicates change

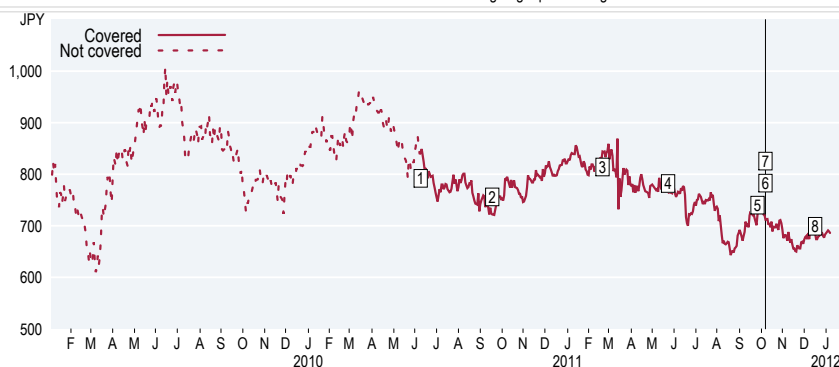
	Date	Rating	Target Price	Closing Price
2	18-Nov-11	*REM MP	-	926

Rating/target price changes above reflect Eastern Standard Time

Sekisui House (1928)

Ratings and Target Price History Fundamental Research

Analyst: Shusuke Terada
Covered since June 9 2010



	Date	Rating	Target Price	Closing Price
1	9-Jun-10	2M	*900	841
2	17-Sep-10	2M	*800	722
3	21-Feb-11	2M	*850	844

* Indicates change

	Date	Rating	Target Price	Closing Price
4	24-May-11	2M	*800	766
5	27-Sep-11	2M	*780	722
6	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	*2	780	712
8	16-Dec-11	2	*760	685

Rating/target price changes above reflect Eastern Standard Time

Sekisui House (1928)

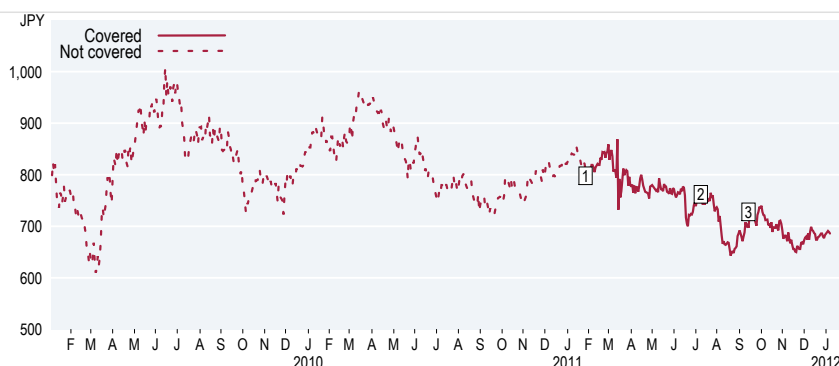
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Shusuke Terada

Covered since June 9 2010



	Date	Rating	Target Price	Closing Price
1	27-Jan-11	*ADD LP	-	809

* Indicates change

	Date	Rating	Target Price	Closing Price
2	8-Jul-11	*REM LP	-	756

	Date	Rating	Target Price	Closing Price
3	14-Sep-11	*ADD LP	-	697

Rating/target price changes above reflect Eastern Standard Time

TOTO (5332)

Ratings and Target Price History

Fundamental Research

Analyst: Shusuke Terada

Covered since April 6 2011



	Date	Rating	Target Price	Closing Price
1	6-Apr-11	*1M	800	632
2	18-May-11	1M	*700	599

* Indicates change

	Date	Rating	Target Price	Closing Price
3	8-Jul-11	1M	*750	631
4	30-Sep-11	1M	*810	692

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	Stock rating system changed	-	-
6	7-Oct-11	*1	810	667

Rating/target price changes above reflect Eastern Standard Time

TOTO (5332)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Shusuke Terada

Covered since April 6 2011



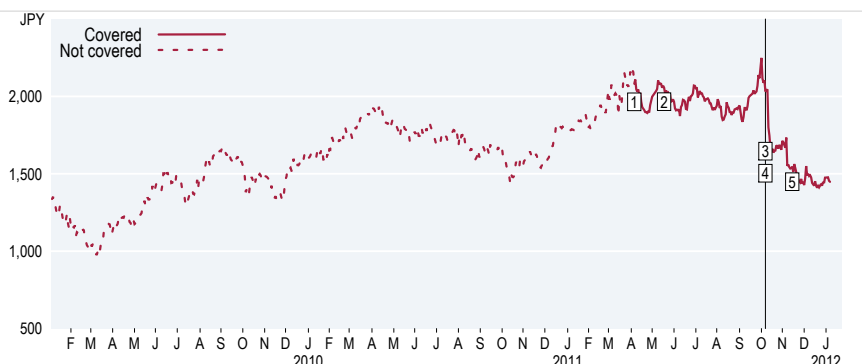
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

JS Group (5938)

Ratings and Target Price History Fundamental Research

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

* Indicates change

	Date	Rating	Target Price	Closing Price
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*1	2,700	2,031

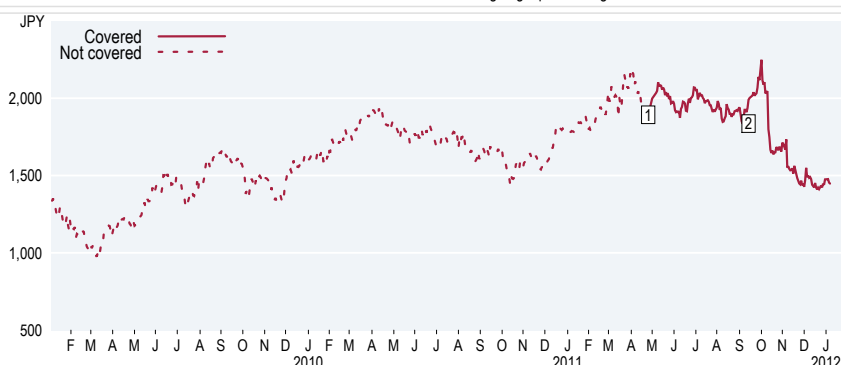
	Date	Rating	Target Price	Closing Price
5	15-Nov-11	1	*2,200	1,546

Rating/target price changes above reflect Eastern Standard Time

JS 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

* Indicates change

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

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Daito Trust Construction, Daiwa House Industry, TOTO, JS Group in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Daito Trust Construction, Sekisui House, TOTO, JS Group.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: Daito Trust Construction, Daiwa House Industry, TOTO, JS Group.

Analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Citigroup Global Markets Inc. and its affiliates ("the Firm"). Like all Firm employees, analysts receive compensation that is impacted by overall firm profitability which includes investment banking revenues.

The Firm is a market maker in the publicly traded equity securities of Daiwa House Industry, Sekisui House.

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Citi Investment Research & Analysis Ratings Distribution

Data current as of 31 Dec 2011

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	41%	40%	49%	43%	41%

Guide to Citi Investment Research & Analysis (CIRA) Fundamental Research Investment Ratings:

CIRA's stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

Risk rating takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

Investment Ratings: CIRA's investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. ETR is the sum of the forecast price appreciation (or depreciation) plus the dividend yield for a stock within the next 12 months. The Investment rating definitions are: Buy (1) ETR of 15% or more or 25% or more for High risk stocks; and Sell (3) for negative ETR. Any covered stock not assigned a Buy

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