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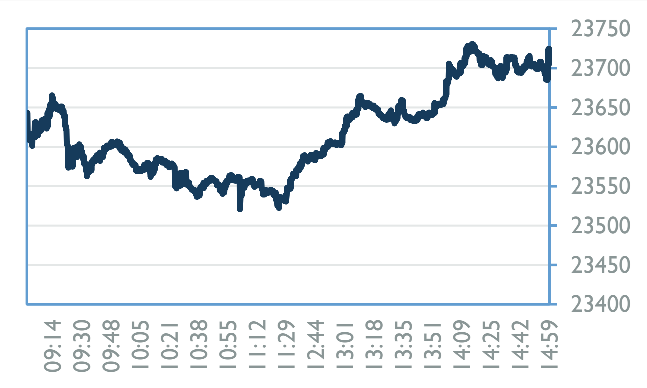
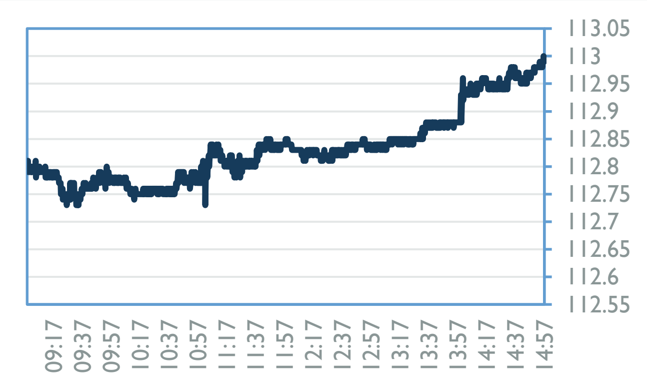
# PSA Today

5 January 2018

## Stock Price Chart




## Currency (¥/$) Chart




## Key Data

| Index / Cross | Price | Chg | % Chg |
|---|---|---|---|
| Nikkei 225 | 23,714.53 | +208.20 | +0.9% |
| Topix | 1,880.34 | +16.52 | +0.9% |
| Jasdaq | 180.27 | +1.83 | +1.0% |
| Mothers | 1,250.20 | +7.36 | +0.6% |
| ¥/$ | 113.00 | +0.34 | |
| JGB (10yr) | 0.060% | +0.006% | |

Source: Bloomberg

## Main Points

- Nikkei continues to rally led by high-beta names and exporters
- **Canon (7751)** to up IC stepper production in 2H 2018
- **Toshiba (6502)** sells Westinghouse for US$4.6bil
- Sprint (S US) gets new CFO
- **Sumitomo Metal Mining (5713)** gets a boost from gold
- **Nippon Shokubai (4114)** threatened again by LG Chemical (051910 KS)
- Exuberance from **Daikin**'s **(6367)** share performance
- Automation notes
- **CyberAgent (4751)** continues to blossom

## Market Comment

Tokyo continued where it left off yesterday, with another 1% gain today. As occurred yesterday, the market was led by high-beta names, and there was again a good performance from exporters; but there was a slight air of rotational buying, with some laggards coming to the fore. (Autos, for instance, outperformed electricals and machinery, and you can't say that often, of late.) Broker reports paid a significant part in today's trading, with nine recommendations identified by *Bloomberg*, three of which – **Rheon Automatic (6272)** (¥2,348 +16.8%), **Tocalo (3433)** (¥5,950 +16.2%) and **Goldwin (8111)** (¥10,210 +13.3%) – saw considerable buying. It was a mixed day for the Ripple stocks following news that Coindesk will not be adding more coins to its service. **SBI Holdings (8473)** (¥2,697 -4.0%) slipped, while **Solxyz (4284)** (¥1,760 +4.2%) gained.

## Canon to Up IC Stepper Production

The *Nikkei* reported that **Canon (7751)** (¥4,262 -0.4%) is planning to increase IC stepper capacity and output in 2018 – the former by 50~100% in 2H 2018 – and the latter by 100%. These numbers are seemingly conflicting because Canon's 2017 stepper output was considerably below capacity in 1H 2017. PSA reckons that Canon has the capacity to make around 30 steppers per quarter. If Canon ups this to – say – 50 steppers in the 2H, this would enable it to make 160 steppers in 2018, which is roughly double the 78 we expect Canon to build in 2017.

It should be pointed out here that this story is nothing to do with the OLED deposition story. Production of Canon Tokki's deposition equipment, used to make the screens for the *iPhone X*, is also being ramped up, but Canon is struggling to source high-tech parts. So: we expect production of deposition equipment to grow by around 60% in 2018, after doubling in 2017. Instead, the IC stepper capacity report is linked to a story from last month that Canon has unveiled 200mm versions of its 300mm i-line and KrF steppers.

Thanks to IoT, there is growing demand for low-cost semiconductors on the one hand, and low-print-run semiconductors on the other. This means growing demand for lithography equipment with very low cost-of-ownership. Because Canon's steppers are both fast and have small footprints, you can produce more semiconductors in any given-sized fab per month.

While Canon has outlined no details, we expect that, while some of the capacity increase will go to making these new 200mm steppers, most will go to making 300mm steppers. Since it seems highly unlikely that production of 200mm wafers will increase, there is no point in producing incremental 200mm stepper capacity. Rather, Canon's new equipment will *replace* outdated or damaged 200mm litho equipment which, while probably heavily in demand at present, clearly addresses a finite market. Longer term, the demand is going to be in more low-cost 300mm equipment.

Still, this IC stepper capacity news is significant. Even if we assume that ASPs fall in 2018 because of increased production of this replacement 200mm equipment, we are probably eyeing a 60~70% increase in sales from 2017, which would take revenues to ¥110bil from ¥65bil. Marginal OP on that additional ¥45bil is going to be at least ¥10bil, and may be as much as ¥20bil.

## Toshiba Sells Westinghouse to Brookfield "for US$4.6bil"

**Toshiba (6502)** (¥330 +2.2%) has sold the US and EU parts of Westinghouse to private equity firm Brookfield for a theoretical sum of US$4.6bil. While Toshiba's share rose today, this could have been because of a buoyant market; this news is not as positive as it reads at first. No cash changes hands, as the US$4.6bil refers to the value of the liabilities that Brookfield is taking on. The deal excludes the North Carolina / Georgia power plants. These will be shuttered at a cost of US$1.3bil, which Toshiba will have to pay. The move, a positive one for Toshiba in terms of going asset light, is a negative one in terms of enterprise value / operating profit. The latter will rise by the US$1.3bil compensation cost, while OP is likely to fall, because Toshiba will now lose the profitable US / EU nuclear maintenance business, worth some ¥40bil/yr in OP.

Separately, Toshiba is continuing to sell off the family silver, by selling equity holdings in **Shibaura Mechatronics (6590)** (¥469 -06%)) and **Toda Kogyo (4098)** (¥3,065 +1.0%). To what extent this is being driven by the newly onboarded shareholders as opposed to existing management's policy is open to debate. What is clear is that, by the day, Toshiba is being slimmed down to a semiconductor company. One can well believe that what its new owners want to be owning is a focused business like that, rather than the sprawl that the existing entity remains, even after all the hatchet work that has been carried out so far.

## Sprint Gets New CFO

**SoftBank**'s **(9984)** (¥9,241 -0.7%) US subsidiary Sprint (S US) has announced the appointment of Michael Combes as CFO / President, reporting to CEO Marcelo Claure. Combes replaces Tarek Robbiati, who leaves Sprint at the end of January.

This move sees a financial engineer replaced by an outright cost-cutter. Combes built his reputation as a hard-nosed cost control executive at Vodafone (VOD LN) where he cut US$3bil out of costs. He also turned Alcatel-Lucent around to the point that it could be sold to Nokia (NOKIA FH). However, he recently ran into difficulties at Altice (ATC NA), where it was felt that he wasn't bringing down debt quickly enough, although the issues at Altice are arguably down to the owner, Patrick Drahi. Meanwhile, Robbiati was responsible for Sprint's phone and infrastructure leasing deals which, well received at the time, are now increasingly questioned (Sprint recently reversed its tower-light approach, by announcing the deployment of "a few thousand" more towers). Analysts have also questioned Robbiati's assertion that Sprint will return to revenue growth in 2018, arguing that this would require post-paid gross adds to growth nearly 20% in 2018, which few people expect.

Given Combes's short tenure at Altice, it seems highly unlikely that Combes will be encouraging the merger of Altice and Sprint which is one of the few remaining options for SoftBank if Masayoshi Son remains interested in offloading its US telco business. The assumption from this move, therefore, is the reverse: that Sprint will remain, for better or worse, a part of SoftBank. Altice and Sprint did ink an MVNO deal back in November, but Sprint inks MVNO deals all the time; that is probably as far as that relationship will now go.

It is probably good, but equally necessary, for Sprint in the longer term that a cost-cutter like Combes has come on board. Sprint's one real USP is its extensive 2.5GHz spectrum holding, but it needs to massively up its capex in order to monetize that. To avoid that capex becoming a huge burden for Sprint's short-term performance, it needs to be accompanied by significant headcount reduction. Of course, everyone already says that this has been done at Sprint – Sprint employs half as many people as T-Mobile (TMUS US) – but while employment is half, SG&A costs are around two-thirds. There's savings to be had somewhere.

The somewhat abrupt departure of Robbiati does hint that we may be about to hear some bad news when Sprint reports 3Q FY17 numbers on January 23. There have been stories concerning sluggish net adds in the December quarter, which have been blamed on *iPhone X* shortages; and the decision to reverse policy on pricing also suggests that Sprint has taken deep discounting as far as it can.

In the big scheme of SoftBank things, Sprint doesn't matter hugely, but it is totemic of the strategic mess that SoftBank has got into. It is also remarkable that SoftBank is nowhere to be seen on the blockchain story, despite having a VC fund with ample cash to spend on it. Instead, SoftBank is messing around in 'sharing economy' apps, which is so very 2016. For Japan-only investors, there's a place in the portfolio for SoftBank, because of its discount to NAV, but we see more promise in SBI Holdings. For global investors, the situation remains: if you like Alibaba (BABA US), own Alibaba, and if you don't like Alibaba, don't own SoftBank.

## Sumitomo Metal Mining gets a Boost from Gold

Shares of **Sumitomo Metal Mining (SMM, 5713)** (¥5,490 +2.5%) continue their steady ascent, supported by expectations that rising copper prices could boost earnings still higher in H2. Production difficulties at Tesla (TSLA US) do not appear to be worrying enough to disrupt the trend. Another likely contributor to share price strength is the rising gold price. Gold futures in New York have risen for ten straight days now, and that run could well continue if tensions in the Middle East remain high. SMM still lags in its medium-term strategy to increase exposure to gold to 30 tons a year; deals concluded in 2017 should raise output to nearly 18 tons. Gold generally works as a natural hedge against SMM's other non-ferrous metal activities.

## Shokubai Threatened again by LG Chemical

**Nippon Shokubai (4114)** (¥7,910 +1.7%) failed to benefit very much in 2017 from China's environmental crackdown, even though this proved to be a big blessing for so many other Japanese petrochemical manufacturers. Any tailwind the company has been receiving from that source has been diluted the past couple years by the eroding profitability of super absorbent polymer (SAP), where LG Chemical (051910 KS) with its aggressive price discounting, is viewed as the principal culprit. OP generated by Shokubai's Fine & Specialty Chemicals Segment fell from ¥21.4bil in FY15 to ¥12.1bil in FY16, and Shokubai predicts a recovery to only ¥14.5bil in FY17. Management intends to address price erosion through an "SAP Survival Project", designed to significantly improve efficiency, but the impact from the planned measures still requires more time. Aside from SAP, Shokubai did issue a moderately positive announcement on Dec 26 explaining a feasibility study in Thailand for its detergent surfactant *Softanol*. *Softanol* is a successful, significant niche product. As it requires ethylene oxide as the key raw material, the project centers around a tie-up with Thailand's PTT Global Chemical Public Company Ltd. (PTTGC TB). Unfortunately, in our view this modestly positive news was immediately more than offset by an announcement from LG Chemical, on the same day, outlining its plans to spend around US$275mil to expand capacity in Korea for SAP as well as its raw material acrylic acid. The project will hike LG's SAP capacity by 20% to 500,000tpa in 2019. Shokubai therefore enters 2018 under a bit of a cloud, since the overriding question in investors' minds has been precisely what it will take to revive profitability in the SAP business.

## Exuberance from Daikin's share performance

**Daikin (6367)** (¥14,085 +0.6%) posted a consecutive listing high and its first close above the ¥14,000 level, though trading was heavily tilted towards the close. Nearly 30% of volume came in the last minute of trading, with 20% on close. Overall volume was 1.5x above average daily trading. We expect Q3 to come in above plan on the strength of the Chemicals Division, for which management low-balled guidance, and for overall OP, produced its first quarterly double-digit gain for FY17. Even so, Daikin's share price strength seems somewhat premature to us.

## Automation Notes

Action in automation continued to be led by **Fanuc (6954)** (¥29,680 +3.1%) posting a consecutive listing high; it has now risen 9.7% over the past two days. Again, we expect a stellar Q3 and guidance upgrade at the Jan 26 release. **Daifuku (6383)** (¥6,500 +2.2%) finally shook off its equity financing shackles to post a new listing high, while **Mitsubishi Electric (6503)** (¥1,988 +2.2%), Japan's largest purveyor of FA, finally hit a listing high despite disappointment over this year's air-conditioning profitability. **SMC (6273)** (¥49,570 +4.1%) and **Yaskawa (6506)** (¥5,270 +2.1%) both closed less than 1% away from record highs.

Elsewhere in machinery, a number of small cap names as well as the construction machinery makers posted new listing highs.

## CyberAgent continues to blossom

**CyberAgent (4751)** (¥4,555 +2.5%) posted encouraging gains today. Download rankings of *AbemaTV* have been on an upward trend recently. Over the last five days, the app is one of the ten most downloaded apps in Japan. This was probably thanks to the broadcast of special contents over the New Year holiday. Six original dramas and romance reality shows are to be rolled out this month, which should further attract users' attention, especially females. The company also seems to continue to do well on the Game front. As of today Jan 5, five of its seven major games were in the top 20 of the overall grossing charts. Given the ongoing intensifying competition of the smartphone game market, achieving this kind of performance cannot be due to pure luck. We continue to believe in CyberAgent's smartphone expertise and its ability to succeed in new business(es) leveraging smart devices, including the Internet TV station service, *AbemaTV*.

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### Research Team:

Pelham Smithers: Electronics, Telecoms, Pharma
+44 (0)20 3740 5501
pelham@pelhamsmithers.com

Julie Boote: Autos
+44 (0)1326 340159
julie@pelhamsmithers.com

Joel Scheiman: Materials
+813 5701 3041
joel@pelhamsmithers.com

Thao Nguyen: Internet
+44 (0)20 3740 5507
thao@pelhamsmithers.com

William Nestuk: Auto Parts, Machinery
+81 80 6707 0080
will@pelhamsmithers.com

### Sales Team:

James Ford
+44 (0)15 4885 7358
james@pelhamsmithers.com

Cindy Baker
+44 (0)20 3740 5505
cindy@pelhamsmithers.com

Debby Guthrie
+44 (0)20 3740 5504
debby@pelhamsmithers.com

Robert Jameson
+81 90 6508 1853
robert@pelhamsmithers.com


  