

Shimano (7309)

UPGRADE RATING

Rating	(from NEUTRAL) OUTPERFORM
Price (21 Oct 16, ¥)	17,240
Target Price (¥)	(from 15,500) 20,000
Chg to TP (%)	16.0
Market cap (¥ bn)	1,598.49 (US\$ 15.38)
Enterprise value (¥ bn)	1,391.49
Number of shares (mn)	92.72
Free float (%)	70.0
52-week price range	19,570–13,740

*Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

*Target price is for 12 months.

Research Analysts

Shinya Yamada

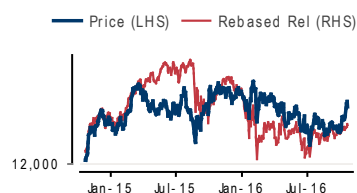
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Time to ride Shimano

- **Inventory cycle recovering:** We raise our estimates from FY12/17 onward for Shimano, upgrade the stock from Neutral to OUTPERFORM, and lift our target price from ¥15,500 to ¥20,000. Our upgrade mainly takes account of the rebound in bicycle parts exports (value basis), and our outlook for a rise in the share price, valuations, and consensus estimates, all of which closely correlate with the rate of increase in bicycle parts exports.
- **Longer-term growth potential intact:** The value of Japan's bicycle parts exports rose 5% YoY in August, with the three-month moving average narrowing to -2% versus a 16% decline in May, according to the Ministry of Finance's trade statistics. Bicycle parts underwent inventory adjustments due to excessive sports bicycle inventory, but we believe prospects for a recovery have brightened with the conclusion of inventory cutbacks. Also, we estimate that the global sports bicycle adoption rate is around 1%, which means the market is far from saturated. In addition to the substantial long-term market growth potential, we are also confident that Shimano will be able to maintain its overwhelming competitiveness. Accordingly, our outlook for Shimano's longer term profit growth potential remains intact.
- **Risks:** Risks include a weak inventory cycle rebound, sluggish bicycle sales due to an economic downturn or unfavorable weather, yen strength, and currency appreciation in Asia. In particular, we still see some uncertainty in Shimano's outlook for an earnings rebound in 4Q FY12/16.
- **Valuation:** We base our TP on a P/E of 30x applied to our FY12/17E EPS of ¥668.8. We previously used a P/E of 25x, but now switch to 30x (the average valuation during rebounds) to reflect higher prospects for an inventory cycle rebound.

Share price performance



The price relative chart measures performance against the TOPIX which closed at 1,365.29 on 21-Oct-2016
On 21-Oct-2016 the spot exchange rate was ¥103.94/US\$1

Performance	1M	3M	12M
Absolute (%)	12.5	4.2	-7.6
Relative (%)	11.6	1.3	2.5

Financial and valuation metrics

Year	12/15A	12/16E	12/17E	12/18E
Sales (¥ bn)	378.6	320.0	350.0	362.0
Operating profit (¥ bn)	85.1	67.0	82.0	88.0
Recurring profit (¥ bn)	101.1	65.0	83.0	89.0
Net income (¥ bn)	76.2	47.0	62.0	66.0
EPS (¥)	821.9	507.0	668.8	711.9
IBES Consensus EPS (¥)	n.a.	529.9	633.4	710.3
EPS growth (%)	48.7	(38.3)	31.9	6.5
P/E (x)	22.7	34.0	25.8	24.2
Dividend yield (%)	0.8	0.9	1.2	1.3
EV/EBITDA (x)	15.4	16.8	13.7	12.4
P/B (x)	4.7	4.3	3.8	3.4
ROE (%)	21.7	12.7	15.7	14.9
Net debt/equity (%)		Net cash	Net cash	Net cash

Source: Company data, Thomson Reuters, Credit Suisse estimates

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Shimano (7309)

Price (21 Oct 2016): ¥17240.0 (upside: 16.01%); Rating: (from NEUTRAL) OUTPERFORM; Target Price: (from ¥15,500) ¥20,000; Analyst: Shinya Yamada

Income statement (¥ bn)	12/15A	12/16E	12/17E	12/18E
Sales	378.6	320.0	350.0	362.0
EBITDA	100.4	83.0	99.0	106.0
Operating profit	85.1	67.0	82.0	88.0
Recurring profit	101.1	65.0	83.0	89.0
Extraordinary gain & loss	(0.7)	0.0	0.0	0.0
Profit before tax	100.4	65.0	83.0	89.0
Net income	76.2	47.0	62.0	66.0
Cash flow (¥ bn)	12/15A	12/16E	12/17E	12/18E
Operating cash flow	81.3	69.2	79.3	83.3
Depreciation & Amortization	15.3	16.0	17.0	18.0
Financing cash flow	(14.5)	(18.4)	(20.4)	(18.5)
Issuance (retirement) of stock	(0.0)	0.0	0.0	0.0
Dividends paid	(12.0)	(14.4)	(14.4)	(18.5)
Investing cash flow	(26.3)	(28.0)	(28.0)	(28.0)
Capex	(26.9)	(28.0)	(28.0)	(28.0)
Free cash flow	55.1	41.2	51.3	55.3
Net change in cash	40.5	22.8	30.9	36.8
Balance sheet (¥ bn)	12/15A	12/16E	12/17E	12/18E
Cash & cash equivalents	190.2	213.0	243.9	280.7
Current receivable	36.9	33.0	34.0	35.0
Inventories	59.6	53.0	57.0	60.0
Other current assets	9.5	9.8	9.8	9.8
Current assets	296.3	308.8	344.7	385.5
Property, plant & equipment	101.9	113.9	124.9	134.9
Investments	14.1	14.1	14.1	14.1
Intangibles	12.9	12.0	12.0	12.0
Other non-current assets	18.0	15.1	14.8	16.5
Total assets	429.1	449.8	496.4	548.9
Payables	11.4	12.0	13.0	13.0
Short term debt	8.0	6.0	0.0	0.0
Other current liabilities	31.6	40.0	45.0	50.0
Current liabilities	50.9	58.0	58.0	63.0
Long term debt	2.1	0.0	0.0	0.0
Other non-current liabilities	4.8	5.7	4.7	4.7
Total liabilities	57.8	63.7	62.7	67.7
Shareholders' equity	370.4	371.8	419.4	466.8
Minority interests	0.9	0.8	0.8	0.8

Source: Company data, Thomson Reuters, Credit Suisse estimates

Key ratios	12/15A	12/16E	12/17E	12/18E
Growth (%)				
Sales	13.6	(15.5)	9.4	3.4
Operating profit	29.2	(21.2)	22.4	7.3
EPS	48.7	(38.3)	31.9	6.5
Margins (%)				
Gross margin	40.8	42.5	43.4	43.9
EBITDA margin	26.5	25.9	28.3	29.3
OP margin	22.5	20.9	23.4	24.3
DuPont analysis				
ROE (%)	21.7	12.7	15.7	14.9
Net profit margin (%)	20.1	14.7	17.7	18.2
Sales/Assets	0.9	0.7	0.7	0.7
Assets/Equity	1.2	1.2	1.2	1.2
Credit ratios (%)				
Equity ratio	86.3	82.7	84.5	85.1
Net D/E ratio	Net cash	Net cash	Net cash	Net cash
Per share data (¥)				
Number of shares (mn)	92.7	92.7	92.7	92.7
EPS	821.9	507.0	668.8	711.9
BPS	3995.4	4010.1	4523.9	5035.9
DPS	155.0	155.0	200.0	220.0
Dividend payout ratio (%)	18.9	30.6	29.9	30.9
Valuation (x)	12/15A	12/16E	12/17E	12/18E
P/E	22.7	34.0	25.8	24.2
P/B	4.7	4.3	3.8	3.4
EV/EBITDA	15.4	16.8	13.7	12.4
Dividend yield (%)	0.8	0.9	1.2	1.3
FCF yield (%)	3.1	2.6	3.2	3.5

1: Investment rating

We upgrade Shimano from Neutral to OUTPERFORM and lift our target price from ¥15,500 to ¥20,000. We upgrade the stock mainly to reflect signs of an improvement in bicycle part exports (value basis) and a higher outlook for earnings recovery in FY12/17 and subsequent years. Our target price references a P/E of 30x, the average valuation multiple during periods of rebound, and our FY12/17E EPS.

Driven by bicycle parts inventory adjustments, Shimano's TOPIX-relative share price performance underwent a correction since the beginning of 2016 (Figure 1). However, as negative growth in the value of bicycle parts exports (three-month moving average) has gradually moderated, we now see a higher likelihood of a rebound in Shimano's share price momentum (Figure 2). We note a close correlation between bicycle parts exports data and Shimano's sales (Figure 3). Shimano allocates roughly 40% of its domestic bicycle parts production to domestic sources, and since domestic production mostly involves high-end parts we believe this has a significant earnings impact and therefore a sizable influence on the share price. However, combined sales to two major customers who manufacture bicycles in Taiwan (Giant and Merida) continue to dwindle suggesting industry conditions are still some way off from a full recovery (Figure 4). Accordingly, Shimano's uncertain earnings prospects in the near term, particularly in the Oct–Dec quarter, warrant caution. We note a remarkable rebound in bicycle parts exports to the US, Germany, and China (Figure 5). Sluggish sales to major Taiwanese bicycle makers lead us to note the ongoing negative growth in Taiwan exports.

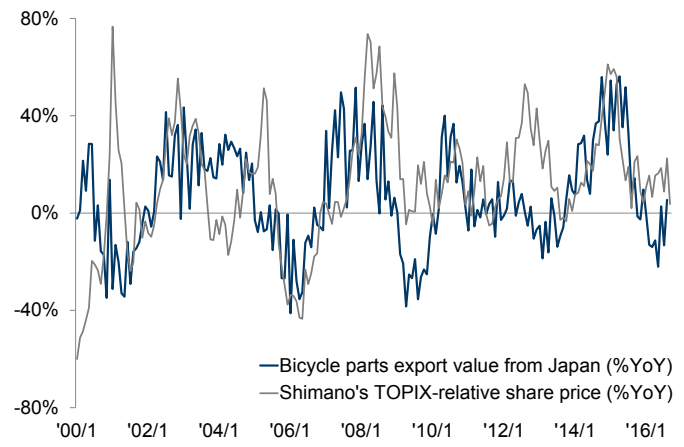
Our analyst Jeremy Chen, who covers Giant and Merida, does not expect the Chinese sales slowdown at Giant and Merida to ease in 2017. China is an important market for both as it accounted for 20–25% of their revenue. He further expects monthly sales comparisons for both companies to remain weak though 1H 2017 on a high base effect and believes valuations remain unattractive with Giant and Merida trading at respective 20.4x and 17.6x 2017E P/E with a lackluster growth outlook.

Figure 1: Shimano's TOPIX-relative share price



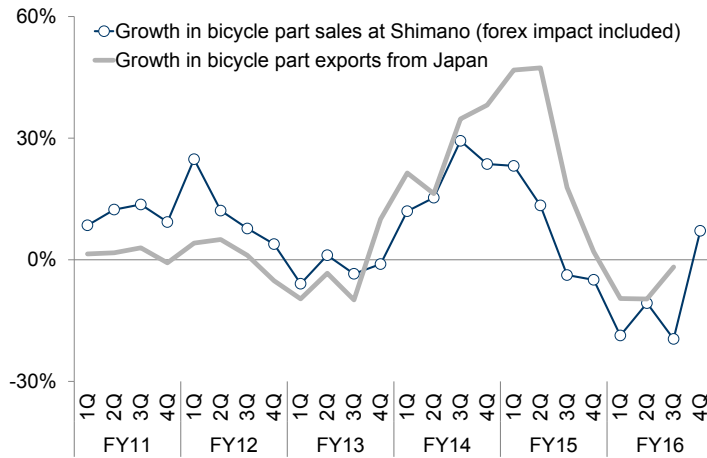
Source: Thomson Reuters Datastream

Figure 2: Shimano's share price and bicycle parts exports from Japan (%YoY)



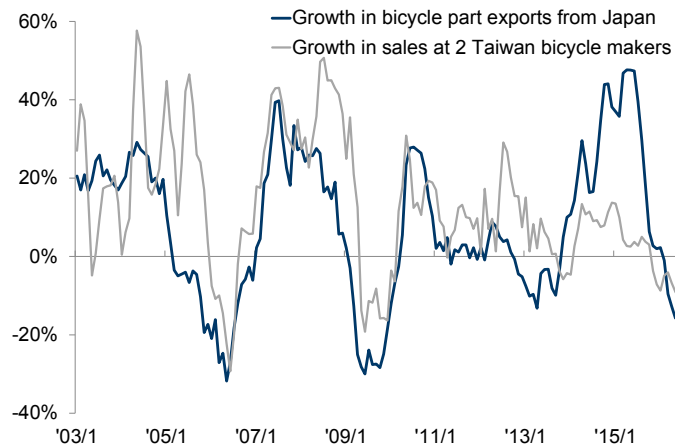
Source: MoF, Thomson Reuters Datastream

Figure 3: Bicycle part sales at Shimano and bicycle part exports from Japan (% YoY)



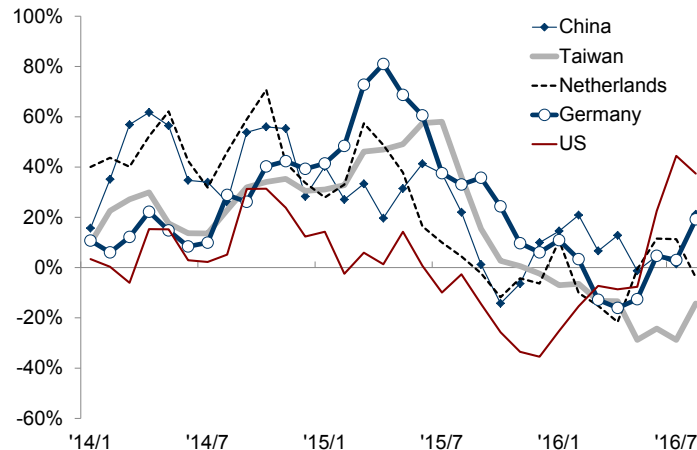
Source: MoF, Company data

Figure 4: Sales at two Taiwanese bicycle makers and bicycle part exports from Japan (% YoY, 3m ma)



Source: MoF, Company data

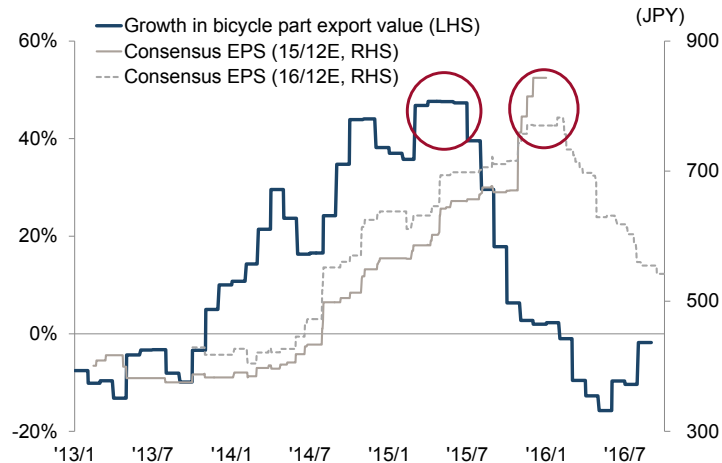
Figure 5: Bicycle part exports from Japan: YoY growth by destination



Source: MoF

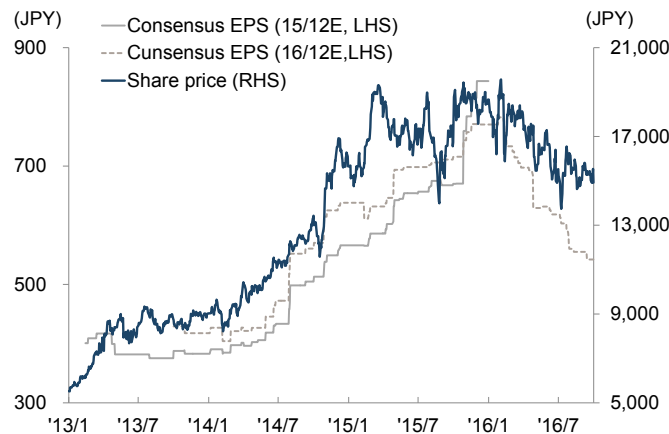
We also note that growth in bicycle parts export value is reflected in Shimano's consensus EPS estimate with a lag of roughly six months (Figure 6). The narrowing of negative growth in August exports should therefore trigger an upward revision to the consensus EPS estimate. Given the strong correlation between consensus EPS and Shimano's share price (Figure 7), an uptick in the consensus EPS figure in tandem with the rebound in bicycle parts exports should also boost shares. The consensus EPS estimate also correlates with Asian currencies (mainly MYR and SGD as Shimano has its core manufacturing bases located in Malaysia and Singapore; Figure 8). The recent weakness in Asian currencies against the US dollar not only reduces the risk of cuts to the consensus EPS estimate, but also has the potential to lead the consensus outlook higher.

Figure 6: Consensus EPS and YoY growth in bicycle part exports from Japan



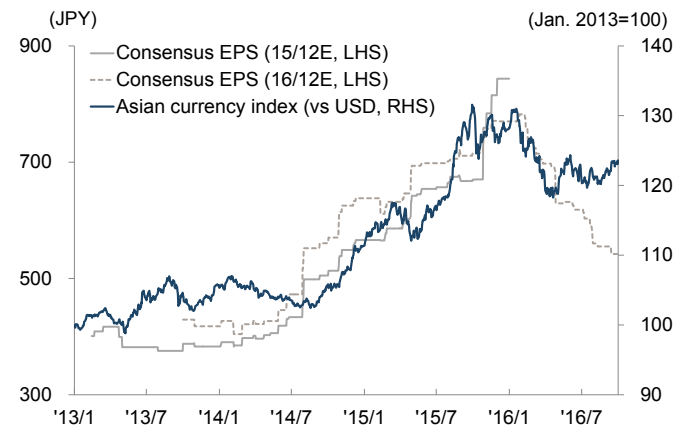
Source: BLOOMBERG, MoF

Figure 7: Consensus EPS and share price



Source: BLOOMBERG, Thomson Reuters Datastream

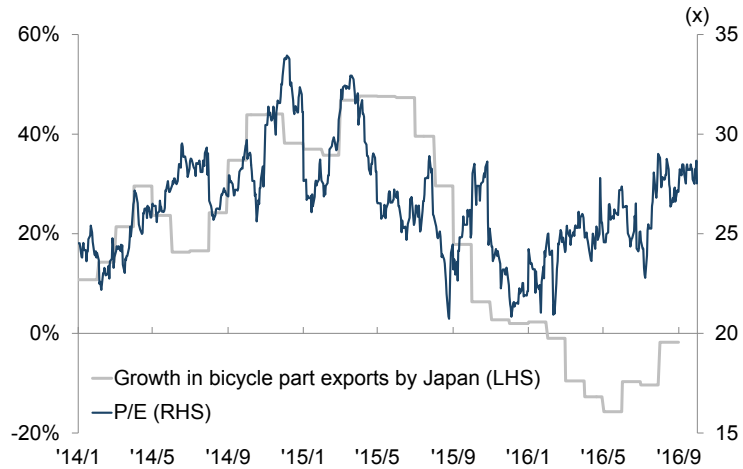
Figure 8: Consensus EPS and Asian currency



Note: Asian currency index is the average of MYR and SGD
Source: BLOOMBERG, Thomson Reuters Datastream

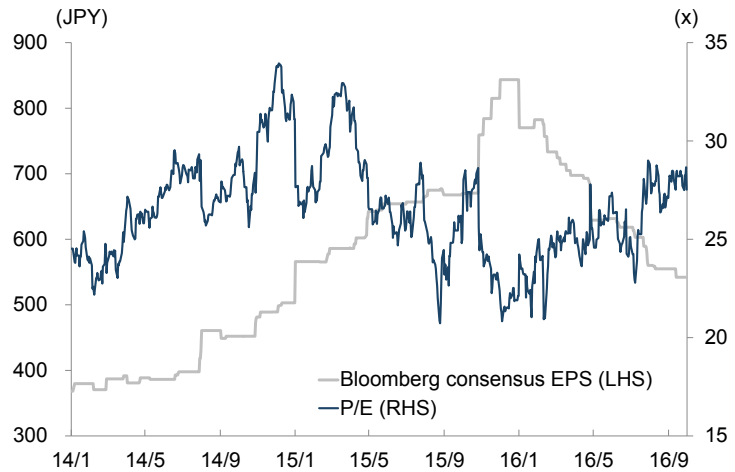
Consensus P/E tends to rise heading into a recovery in bicycle parts exports and fall after its peak (Figure 9). However, as forecast cuts continue after the peak, the resulting slower share price drop usually leads to higher a P/E (Figure 10). Thus, we note that Shimano's P/E follows that of a typical cyclical stock. With bicycle parts exports heading for recovery, we look for an uptick in its P/E valuations. As the P/E tends to reach 30x in both consensus P/E as well as underlying P/E (excluding forex gains/losses) heading into a bicycle parts exports recovery, we use a 30x multiple to calculate our target price (Figure 11).

Figure 9: Consensus P/E and YoY growth in bicycle part exports from Japan



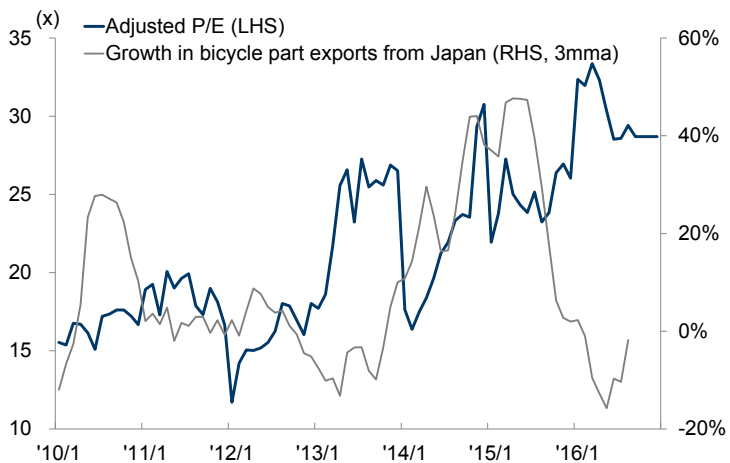
Source: BLOOMBERG, MoF

Figure 10: Consensus EPS and P/E



Source: BLOOMBERG

Figure 11: Underlying P/E and YoY growth in bicycle part exports from Japan



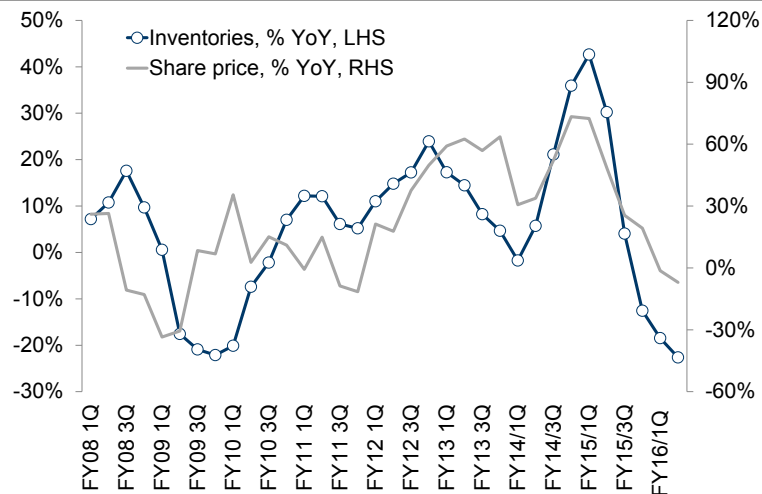
Note: Adjusted P/E excluding forex gains/losses
Source: Company data, MoF

2: Inventory cycle

Sports bicycles are mostly sold in small cycle shops (there are more than 10,000 such shops in Japan). This makes it difficult to get a good grip on the inventory situation, and there is naturally no third-party data that covers inventory at small cycle shops. In its financial results summary, Shimano provides qualitative data on the inventory situation in each country based on the information gathered by its sales personnel during delivery of bicycle parts to small shops. However, it is not realistic for us to gather inventory data in a similar manner. Below we present our inventory cycle analysis based on data disclosed by Shimano.

First, we note a correlation between the YoY change in Shimano's inventory and its share price (Figure 12). End-2Q FY12/16 (June) inventory fell a substantial 23% YoY. This drop even exceeds the 22% fall in 4Q FY12/09 in the wake of the Global Financial Crisis (GFC). However, as long as any current downturn remains milder than during the GFC, we see little likelihood of deterioration from the 23% in 2Q and accordingly believe the shares have leveled off.

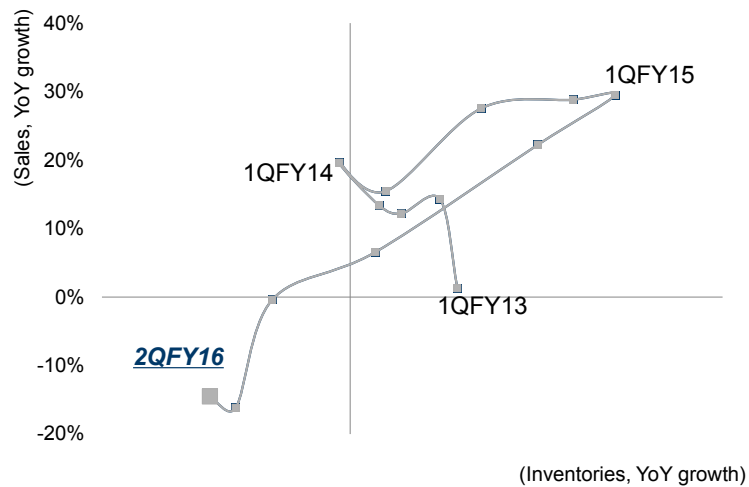
Figure 12: Correlation between YoY change in inventory and share price



Source: Company data, Thomson Reuters Datastream

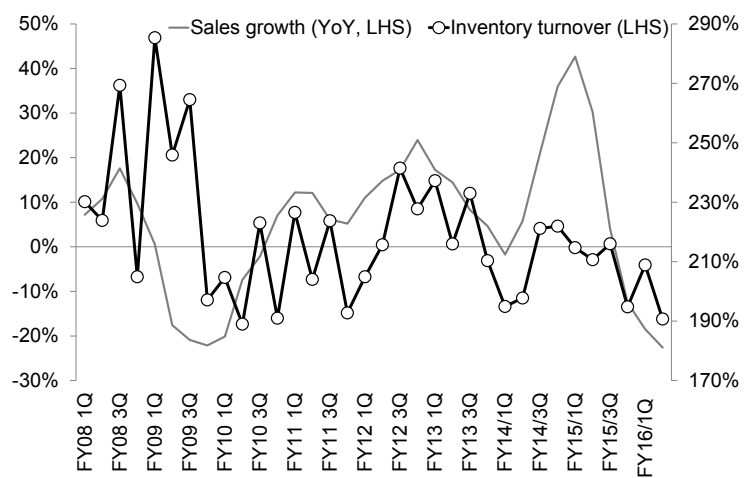
An inventory cycle chart (clockwise) using Shimano's sales and inventory data places 2Q FY12/16 in the third quadrant (lower sales, reduced inventory) representing the bottom of the cycle (Figure 13). Also, due partly to yen appreciation, the rate of decline in sales has hit levels seen in the wake of the GFC, but as opposed to the sharp rise in inventory rates (an unintended inventory buildup) after the financial crisis, Shimano has successfully kept down its inventory-to-sales ratio in line with the sales drop (an intended inventory reduction; Figure 14). We believe this indicates improvement in Shimano's inventory management capability due partly to the automation at the company's headquarters plant.

Figure 13: Shimano's inventory cycle



Source: Company data

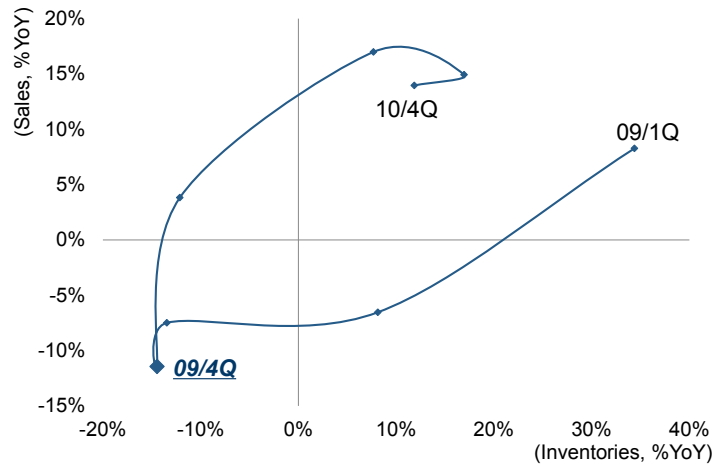
Figure 14: Shimano's sales growth and inventory turnover



Source: Company data

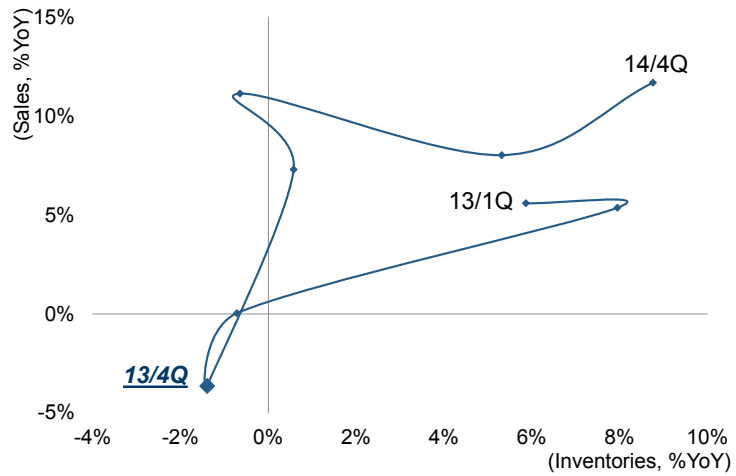
Both 4Q FY12/09 and 1Q FY12/14 represent the nadir in Shimano's sales growth rate since FY12/08. Below we analyze the relation between these rates and the inventory cycle chart of the two leading Taiwanese bicycle makers, Shimano's core customers. We note that the inventory cycle chart for the two Taiwanese bicycle makers around 4Q FY12/09 and 1Q FY12/14, show 4Q FY12/09 and 4Q FY12/13 as the beginning of the third quadrant (Figure 15–16). We therefore think the beginning of the third quadrant in the inventory cycle chart is highly likely to lead to a cyclical recovery thereafter. Based on past experience, we believe the beginning of the third quadrant for the two major Taiwanese makers in 2Q FY12/16 (lower sales; reduced inventory) indicates a potential strong rebound in Shimano's sales (Figure 17).

Figure 15: Inventory cycle of two Taiwanese bicycle makers around 4Q FY09



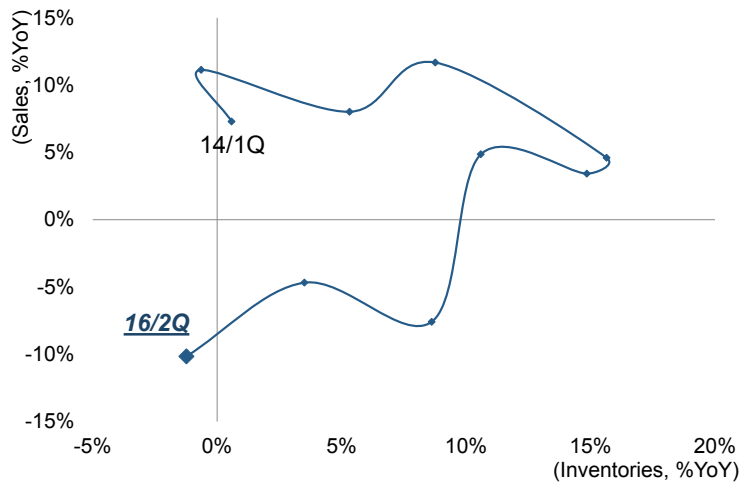
Source: Company data

Figure 16: Inventory cycle of two Taiwanese bicycle makers around 1Q FY14



Source: Company data

Figure 17: Inventory cycle of two Taiwanese bicycle makers

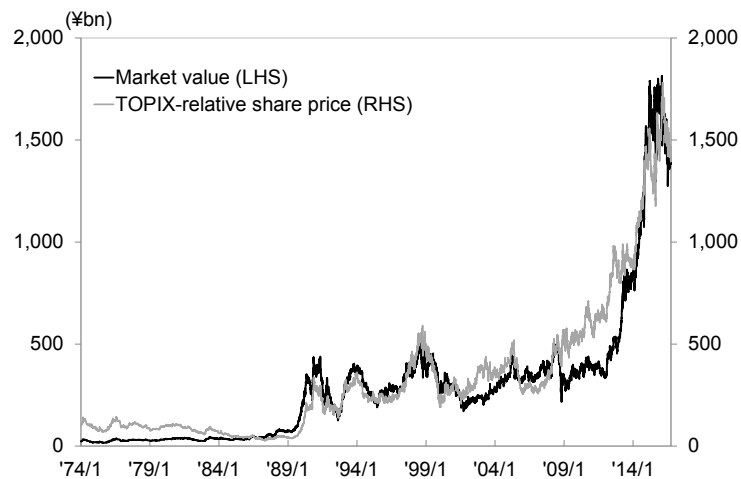


Source: Company data

3: Long-term share price and earnings

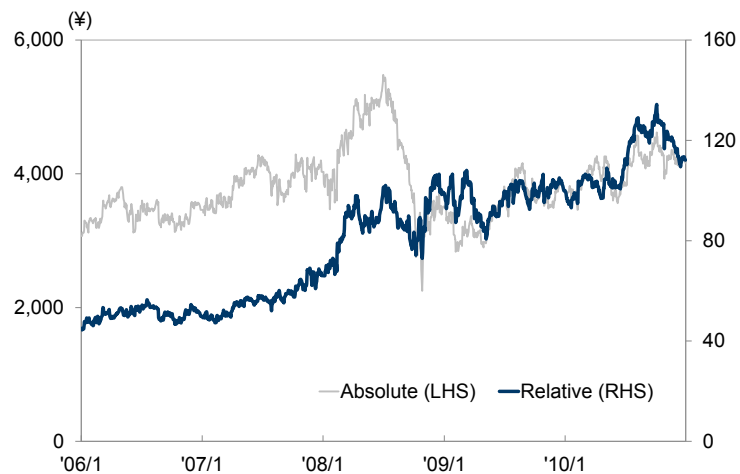
Shimano's long-term share price entered an uptrend starting in the 2000s, which then gained momentum in the 2010s (Figure 18). We regard Shimano's shares as highly resilient to macroeconomic shocks as their TOPIX-relative performance showed a sustained uptrend post-GFC (Figure 19). We think Shimano deserves credit for its long-term OP growth, not only in profit but also in operating margins (Figure 20). The absence of even one single annual operating loss in the 40 years since FY75 is also worthy of note (Figure 21). Share price momentum seen since the 2010s is mainly due to higher profit growth rates. Compared with profit figures from ten years earlier, the annualized profit growth rate has steadily exceeded 10% (Figure 22). We believe the long-term share price remains highly favorable due to the consistent double-digit profit growth and look for this trend to remain intact. We also highlight that Shimano's stock outperformed TOPIX in all but two calendar years over the since 2000 (2001 and 2005; outperformed in 88% of years). We accordingly regard Shimano as a promising stock for long-term investors who size up stocks based on their index-relative performance and regard buying the stock while it is still at the bottom of the inventory cycle as a valid investment strategy.

Figure 18: Shimano's long-term share price



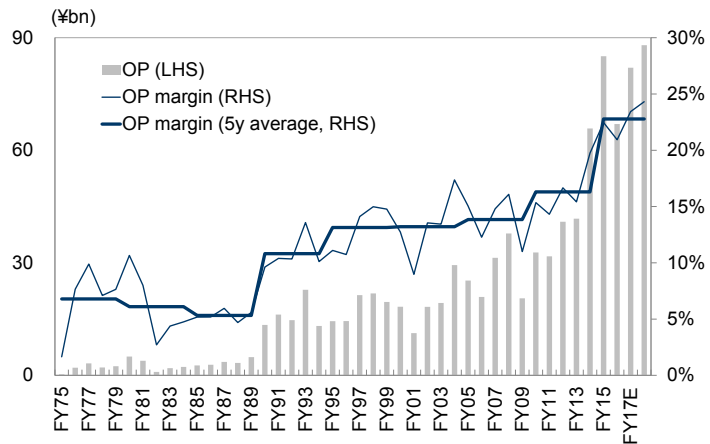
Source: Thomson Reuters Datastream

Figure 19: TOPIX-relative performance around Global Financial Crisis



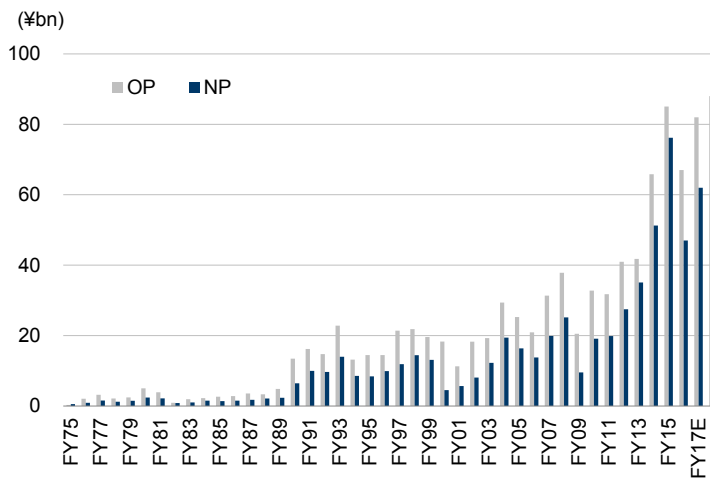
Source: Thomson Reuters Datastream

Figure 20: Shimano's OP and OP margin



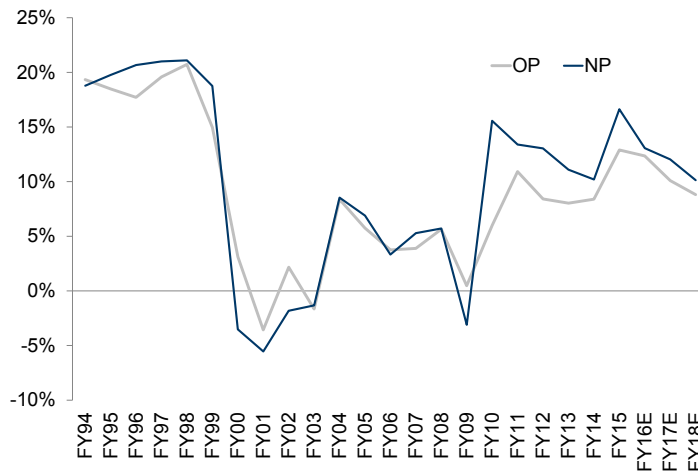
Note: November FY-end prior to FY99; non-consolidated results prior to FY83
Source: Company data, Credit Suisse estimates

Figure 21: Shimano's OP and NP



Source: Company data, Credit Suisse estimates

Figure 22: Shimano's CAGR

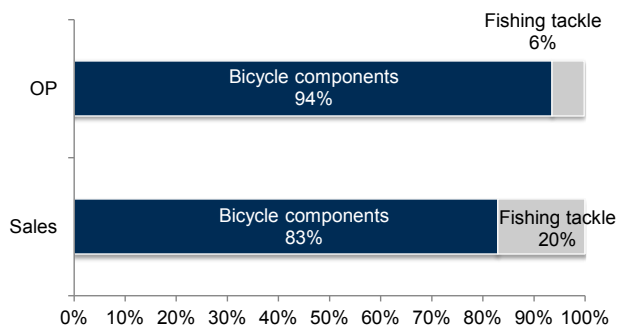


Note: FY15 growth rate represents ten year annualized growth rate since FY05
Source: Company data, Credit Suisse estimates

4: Business structure, shareholder returns

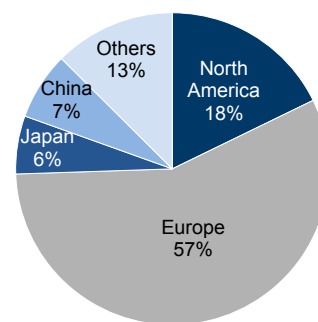
Bicycle components represent an overwhelming portion of Shimano's earnings, with FY12/15 sales breaking down, before eliminations, as 83% from bicycle components and 20% from fishing tackle and OP breaking down as 94% and 6% (Figure 23). Bicycle components sales composition by (end-user) region shows Europe accounting for a majority of Shimano's sales at 57%, with North America (18%), China (7%), Japan (6%), and others (13%) (Figure 24). OP at the bicycle components business is on an uptrend in tandem with the growth in operating margins (Figure 25). The uptrend in bicycle components operating margins is attributable to volume growth (an estimated 45% contribution margin means greater profit contribution from a production boost), improved product mix, price hikes, and gains from weaker Asian currencies. We present a detailed analysis below. Fishing tackle OP is also on a sustained uptrend, both in profit growth and operating margins (Figure 26). This is attributable to higher sales volume as well as greater synergy stemming from having certain fishing tackle production processes overlap with those for bicycle components.

Figure 23: Sales and OP by segment (FY12/15)



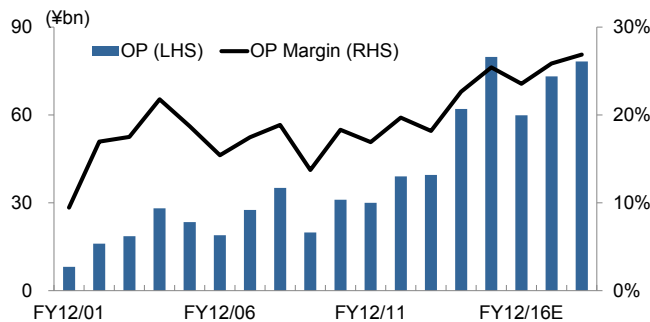
Source: Company data

Figure 24: Bicycle parts sales by region (FY12/15)



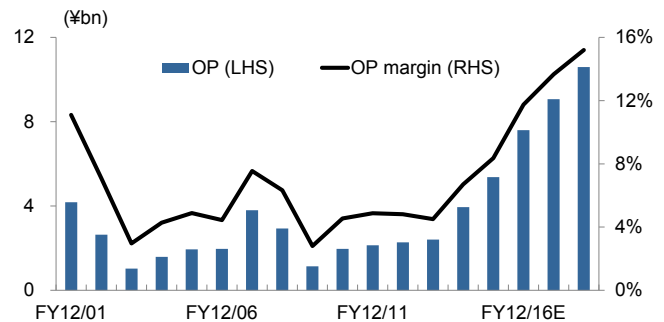
Source: Company data

Figure 25: OP at bicycle components segment



Source: Company data, Credit Suisse estimates

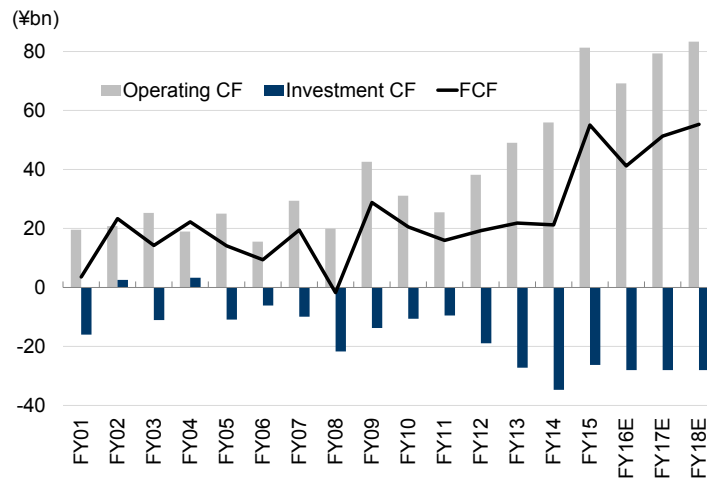
Figure 26: OP at fishing tackle segment



Source: Company data, Credit Suisse estimates

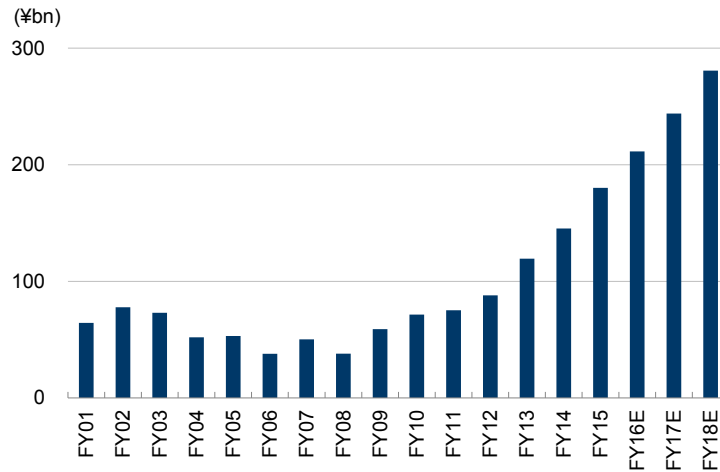
The profit uptrend also means growth in Shimano's operating cash flow. Since capex as a proportion of sales is not substantial, Shimano faces a modest growth in its investment cash flow while enjoying high free cash flow (Figure 27). As a result, cash and equivalents on the balance sheet have risen sharply since 2010 (Figure 28). We look for Shimano to enhance its shareholder returns policy, particularly in light of the CEO's statement at a recent analyst briefing favoring ¥200bn as the optimum level for cash and equivalents. Although Shimano has continued to raise dividends, the 30.2% payout ratio (company estimate) for FY12/16 and a dividend yield under 1% are not particularly high (Figure 29). We nevertheless note an increase in the payout ratio from 18.9% in FY12/15 and 19.0% in FY12/14 and look for Shimano to maintain a future payout ratio of more than 30%, in line with its estimated FY12/16 payout ratio.

Figure 27: Cash flow



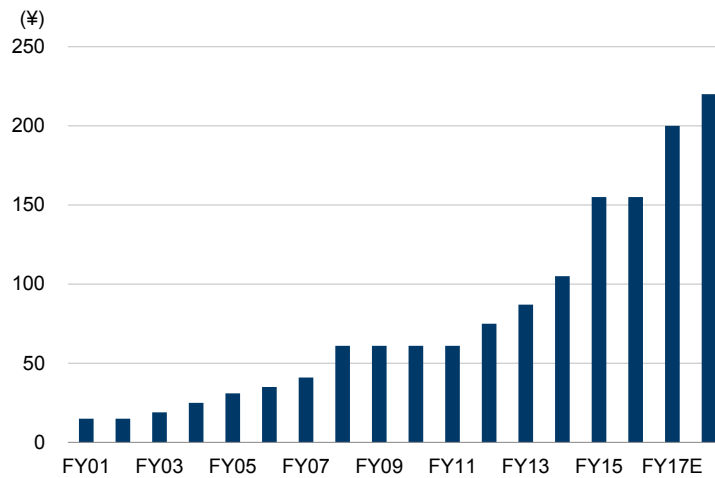
Source: Company data, Credit Suisse estimates

Figure 28: Net cash



Source: Company data, Credit Suisse estimates

Figure 29: DPS



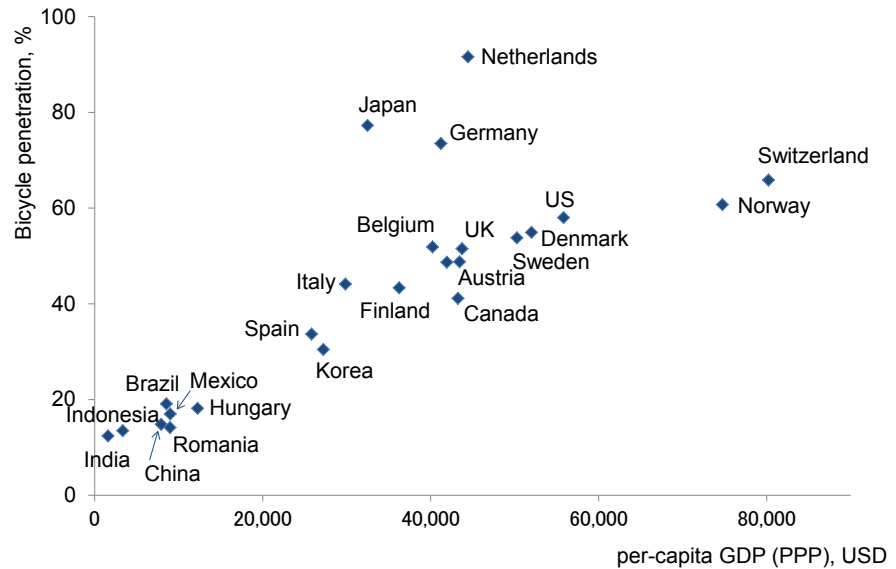
Source: Company data, Credit Suisse estimates

5: Sports bicycle parts market analysis

Adoption rate

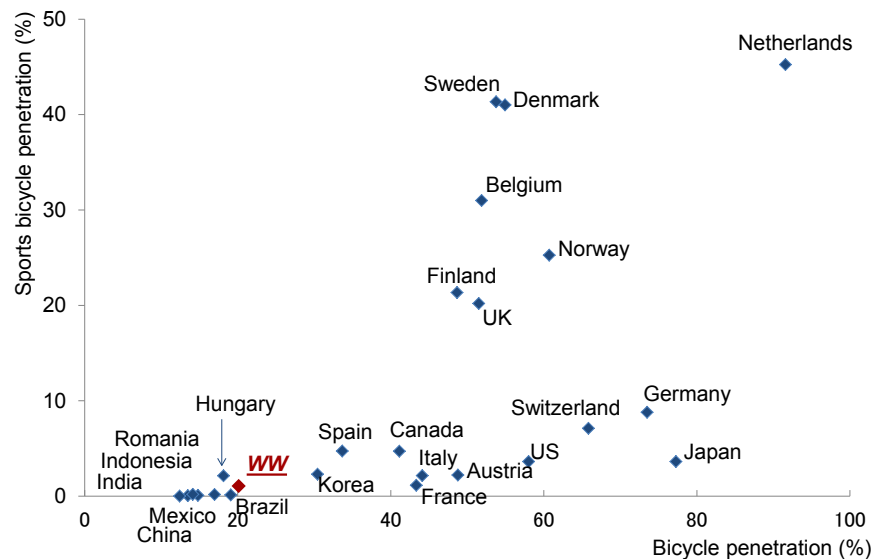
Worldwide bicycle penetration is broadly correlated with per-capita GDP (PPP). We estimate penetration as a percentage of population at around 20% (Figure 30). However, sports bicycle penetration is low at around 1% (Figure 31). The sports bicycle parts market that is the company's core business is thus far from mature, with substantial growth potential.

Figure 30: Bicycle penetration is broadly correlated with per-capita GDP (PPP)



Source: World Bank, Credit Suisse estimates

Figure 31: Bicycle penetration and sports bicycle penetration

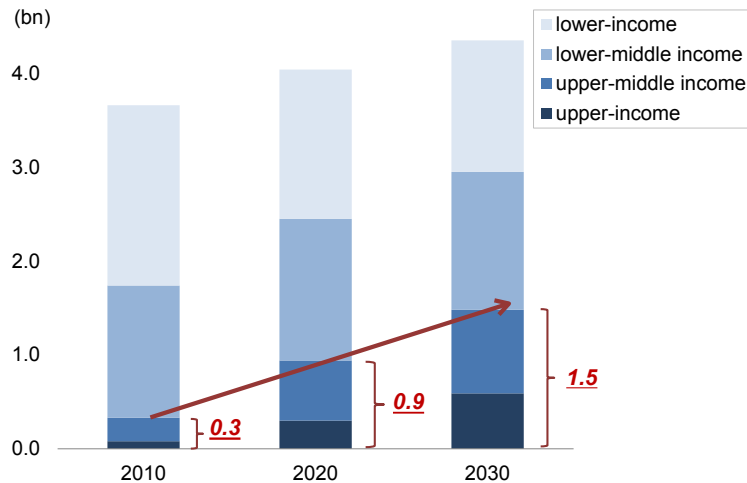


Source: UN, JETRO, Credit Suisse estimates

Longer-term growth drivers

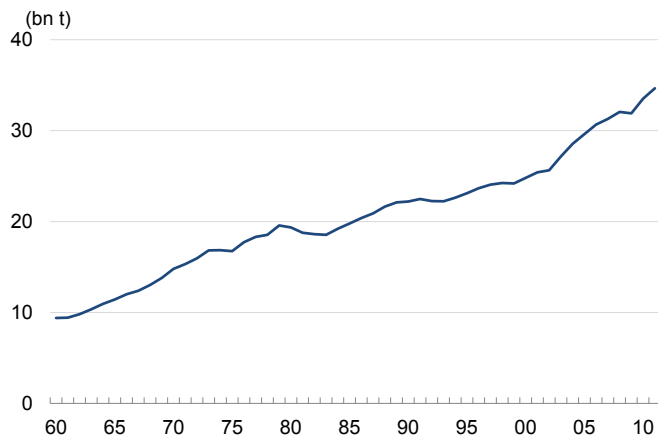
Longer-term growth drivers include growth in the number of middle income earners, measures to reduce atmospheric pollution and ease congestion, and efforts to reduce medical expenditures via health promotion. In Europe (the largest market for sports bicycles), demand has shifted from casual bikes to sports cycles due to customer preference for more comfortable bikes. We think this preference will increase due to rising incomes, and just as middle income earner expansion in emerging economies has led to growth in demand for bicycles, we look for medium-term growth in the sports bicycle market (Figure 32). We also think demand for bicycles, especially sports bicycles which can go long distances, will increase as they are a low-pollution means of transport and it is impossible to ignore global warming and damage to health caused by fine particulate matter (PM2.5) and growing CO₂ emissions (Figures 33–34). Switching from cars to bicycles will also reduce congestion and solve parking shortages, and if the exercise involved leads to better health, it will also help reduce medical expenditures. Accordingly, a growing number of national and local governments are striving to promote cycling and we believe this will also lead to growth in demand for sports bicycles. In short, we see longer-term market growth as likely.

Figure 32: Middle income earner expansion in emerging economies



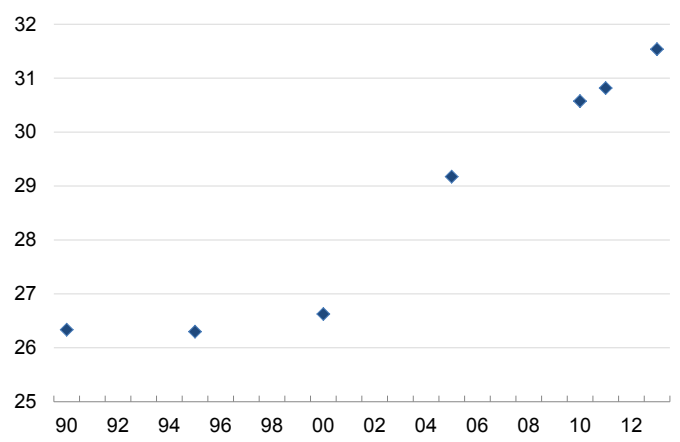
Source: METI

Figure 33: CO₂ emissions



Source: World Bank

Figure 34: PM_{2.5} air pollution, mean annual (µg/m³)

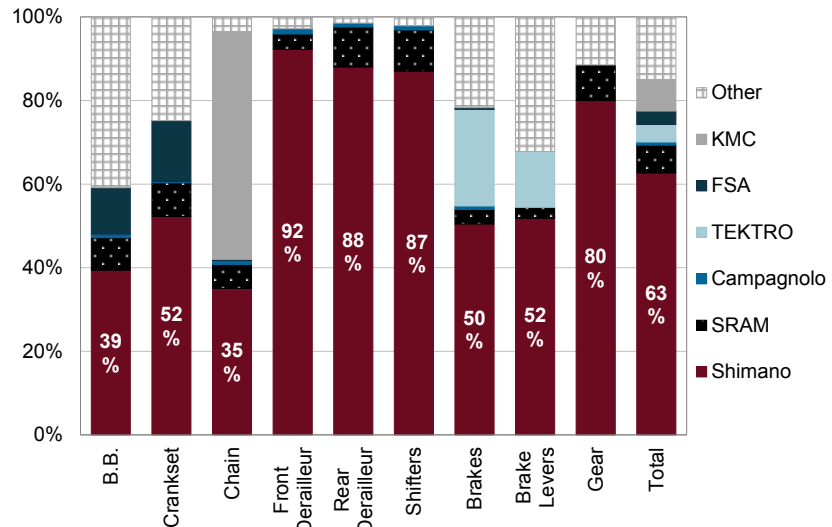


Source: World Bank

Market shares

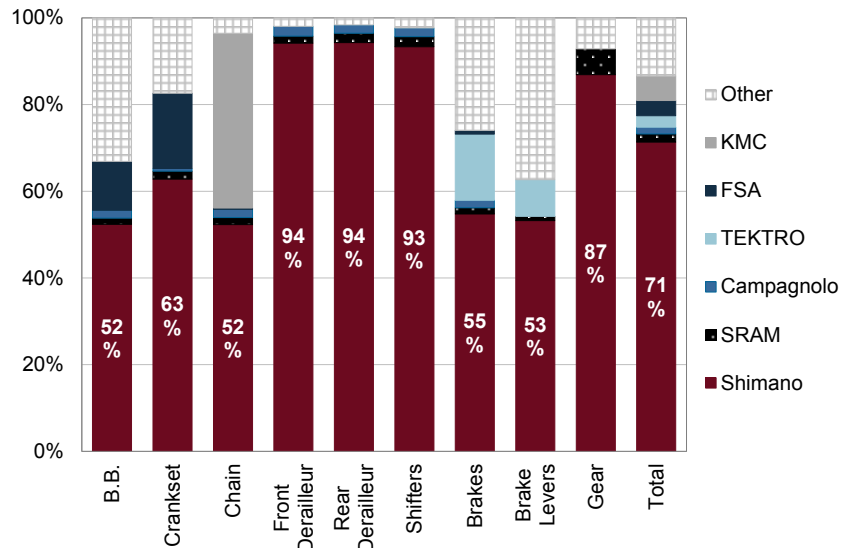
We estimate the company's global market share (sports bicycle parts) at 70–80% on a value basis. In new bicycles sold in Japan (2016 models), the company has the lion's share of the parts market (around 90%) especially in derailleurs and shifters, which are key sports bike parts (Figure 35). It also has a higher share in parts for road bikes than mountain bikes (Figures 36–37). Comparing 2014 and 2015 new models, we see that the company gained share in 2016 models, especially in derailleurs (Figures 38–39).

Figure 35: Sports bike part market share (2016 models of 10 makers)



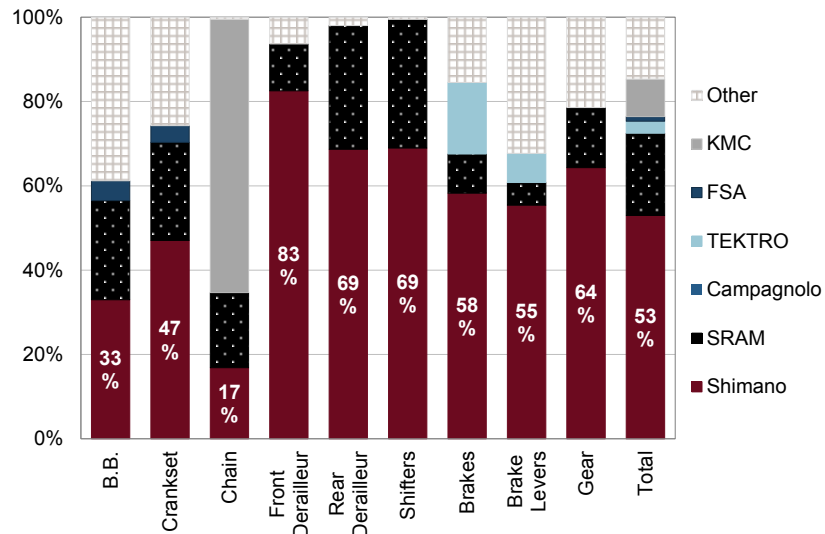
Note: 10 makers are: Giant, Merida, TREK, Bianchi, Gios, Cannodale, Specialized, Scott, Lous Garneau, and Anchor
Source: Company data, Credit Suisse

Figure 36: Road bike part market share (2016 models of 10 makers)



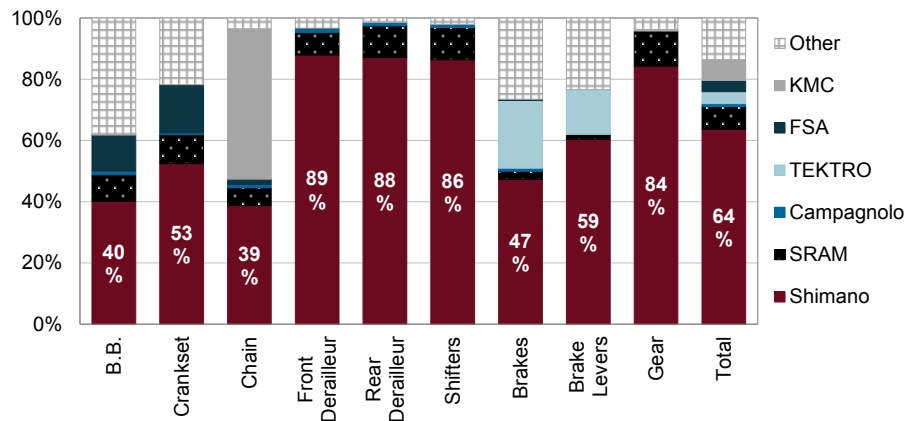
Note: 10 makers are: Giant, Merida, TREK, Bianchi, Gios, Cannodale, Specialized, Scott, Lous Garneau, and Anchor
Source: Company data, Credit Suisse

Figure 37: Mountain bike part market share (2016 models of 10 makers)



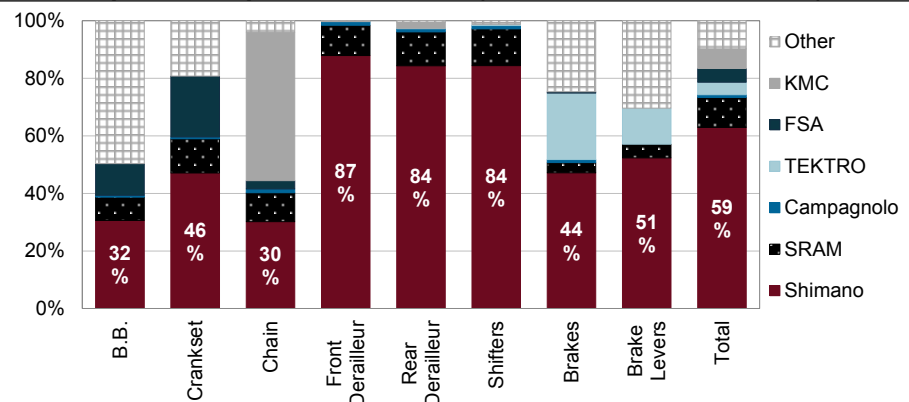
Note: 10 makers are; Giant, Merida, TREK, Bianchi, Gios, Cannodale, Specialized, Scott, Lous Gameau, and Anchor
Source: Company data, Credit Suisse

Figure 38: Sports bike part market share (2015 models of 10 makers)



Note: 10 makers are; Giant, Merida, TREK, Bianchi, Gios, Cannodale, Specialized, Scott, Lous Gameau, and Anchor
Source: Company data, Credit Suisse

Figure 39: Sports bike part market share (2014 models of 10 makers)



Note: 10 makers are; Giant, Merida, TREK, Bianchi, Gios, Cannodale, Specialized, Scott, Lous Gameau, and Anchor
Source: Company data, Credit Suisse

Rising sales prices

Comparing 2014 and 2016 domestic retail prices, we find prices of the 105, Tiagra, and Sora parts, which were revised over the two years, rose sharply (by 9%, 18%, and 48%, respectively; Figure 40). As the company raised the prices of all models made in Japan by 5% in May 2015, prices of the high-end Dura-Ace and Ultegra parts, which were not remodeled, have also risen by 5%. These increases have helped boost margins.

The company has been able to raise prices due to the substantial price spread versus rival products. In a comparison of top-end parts ranges of three sports bike parts companies (Shimano's Dura-Ace, Campagnolo's Super Record, SRAM's Red22), Super Record parts are priced 92% and Red22 parts 75% higher than Shimano's own Dura-Ace components (based on retail prices in Japan). However, there are hardly any differences in weight, a key quality indicator. We think price increases are possible due to this outstanding cost-performance and that these price differences reflect differences in production costs. Shimano's production costs are among the lowest in the sector due to disparities in production scale and technology for fusing different materials.

Figure 40: Domestic retail prices of bicycle parts

Domestic retail prices (2016)									
		B.B.	Crankset	Chain	Front Derailleur	Rear Derailleur	Shifters	Brakes	Total
Price (JPY)									
Shimano	Dura-Ace9000	3,594	55,096	4,723	10,883	20,840	51,318	32,129	174,989
	ULTEGRA 6800	2,845	24,995	3,863	4,399	7,665	32,740	12,956	86,618
	105	2,440	14,913	2,638	3,226	4,692	22,318	8,573	56,360
	TIAGRA	1,608	11,851	2,432	3,137	4,101	22,425	3,175	47,121
	SORA	1,608	9,469		2,622	3,104	20,090	2,627	37,912
Campagnolo	Super Record	6,800	126,000	8,500	24,000	67,000	62,500	48,000	336,000
	<i>vs Dura-Ace</i>	<i>189%</i>	<i>229%</i>	<i>180%</i>	<i>221%</i>	<i>321%</i>	<i>122%</i>	<i>149%</i>	<i>192%</i>
SRAM	Red 22		66,000	9,000	20,000	50,000	84,000	77,000	306,000
	<i>vs Dura-Ace</i>		<i>120%</i>	<i>191%</i>	<i>184%</i>	<i>240%</i>	<i>164%</i>	<i>240%</i>	<i>175%</i>
Weight (g)									
Shimano	Dura-Ace9000	65	683	247	78	158	365	297	1,828
Campagnolo	Super Record		603	239	71	166	342	297	1,718
	<i>vs Dura-Ace</i>		<i>88%</i>	<i>97%</i>	<i>91%</i>	<i>105%</i>	<i>94%</i>	<i>100%</i>	<i>94%</i>
SRAM	Red 22		609	242	69	145	280	449	1,794
	<i>vs Dura-Ace</i>		<i>89%</i>	<i>98%</i>	<i>88%</i>	<i>92%</i>	<i>77%</i>	<i>151%</i>	<i>98%</i>

Domestic retail prices (2014)									
		B.B.	Crankset	Chain	Front Derailleur	Rear Derailleur	Shifters	Brakes	Total
Price (JPY)									
Shimano	Dura-Ace9000	3,421	52,472	4,107	10,364	19,849	48,879	30,605	166,276
	ULTEGRA 6800	2,717	23,831	3,310	4,197	7,308	31,206	12,357	82,209
	105	1,501	14,185	2,398	2,849	4,381	20,122	7,645	51,580
	TIAGRA	1,137	8,103	2,697	2,783	3,819	20,442	2,147	39,991
	SORA	1,137	6,450		1,707	2,035	13,673	1,813	25,678
Campagnolo	Super Record	5,600	106,000	7,200	19,100	52,800	50,800	40,000	275,900
	<i>vs Dura-Ace</i>	<i>164%</i>	<i>202%</i>	<i>175%</i>	<i>184%</i>	<i>266%</i>	<i>104%</i>	<i>131%</i>	<i>166%</i>
SRAM	Red 22		57,000	8,000	18,000	46,000	77,000	58,000	264,000
	<i>vs Dura-Ace</i>		<i>109%</i>	<i>195%</i>	<i>174%</i>	<i>232%</i>	<i>158%</i>	<i>190%</i>	<i>159%</i>
Weight (g)									
Shimano	Dura-Ace9000	54	683	243	78	158	365	297	1,824
Campagnolo	Super Record		584	239	72	155	330	297	1,677
	<i>vs Dura-Ace</i>		<i>86%</i>	<i>98%</i>	<i>92%</i>	<i>98%</i>	<i>90%</i>	<i>100%</i>	<i>92%</i>
SRAM	Red 22		609	242	69	145	280	387	1,732
	<i>vs Dura-Ace</i>		<i>89%</i>	<i>100%</i>	<i>88%</i>	<i>92%</i>	<i>77%</i>	<i>130%</i>	<i>95%</i>

Changes in prices (2014 =>2016)									
		B.B.	Crankset	Chain	Front Derailleur	Rear Derailleur	Shifters	Brakes	Total
Price (JPY)									
Shimano	Dura-Ace9000	5%	5%	15%	5%	5%	5%	5%	5%
	ULTEGRA 6800	5%	5%	17%	5%	5%	5%	5%	5%
	105	63%	5%	10%	13%	7%	11%	12%	9%
	TIAGRA	41%	46%	-10%	13%	7%	10%	48%	18%
	SORA	41%	47%		54%	53%	47%	45%	48%
Campagnolo	Super Record	21%	19%	18%	26%	27%	23%	20%	22%
SRAM	Red 22		16%	13%	11%	9%	9%	33%	16%
Weight (g)									
Shimano	Dura-Ace9000	20%	0%	2%	0%	0%	0%	0%	0%
Campagnolo	Super Record		3%	0%	-1%	7%	4%	0%	2%
SRAM	Red 22		0%	0%	0%	0%	0%	16%	4%

Source: Company data, Credit Suisse

Cost competitiveness

As noted above, disparities in production scale are decisive in the bicycle parts industry, where the contribution margin is estimated at 45%. Moreover, Shimano's cost competitiveness has increased due to expansion of in-house production, efficiency gains, and automation at the company's headquarters plant in Sakai (Osaka Prefecture), which was rebuilt in 2014. We think the company's competitiveness will increase further due to the start of operations at a new production line at its Shimonoseki plant in Yamaguchi Prefecture scheduled for early 2017. The company already has by far the largest production scale, making it difficult in our view for rivals and new entrants to compete on cost.

The easiest way to reduce the weight of bicycle parts is to use lightweight materials such as carbon fiber. Taking a different tack, Shimano has worked to develop lighter weight, lower priced products by combining carbon fiber with other materials such as aluminum. Fusing different materials may seem an easy task, but maintaining the strength of the fused section requires higher technical capabilities than working with a single material. We believe Shimano holds an edge over its rivals in this area of technology. Considering that the company operates on a larger scale than its rivals and can set aside a sizable R&D budget, we see little risk of competitors emulating Shimano.

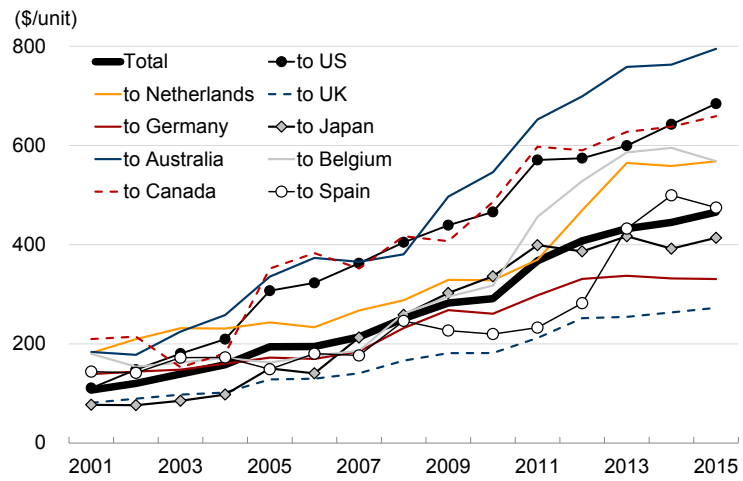
Value-added in sports bicycles

The need for greater comfort and safety in sports bicycles has spurred high value-added in parts, frame, and wheels, which has led to a higher average unit price globally (Figures 41–42). A key example of high value-added is weight reduction for enabling a faster and more comfortable ride as bicycle frames have evolved from steel (high tensile as well as chromium molybdenum) to aluminum and carbon fiber.

A leading example of a breakthrough in high-value-added parts is Shimano's development of the world's first electronic gear shift—a mechanism that enables users to shift gears instantly and smoothly through use of electric switches. Shimano's Di2 system costs roughly three times as much as a mechanical gear shift (based on the Dura-Ace retail price in Japan), but its uptake has picked up due to factors such as greater user comfort and easy serviceability. The use of disc brakes on MTBs is already on the rise due to greater braking efficiency; their adoption is also picking up for normal road bicycles.

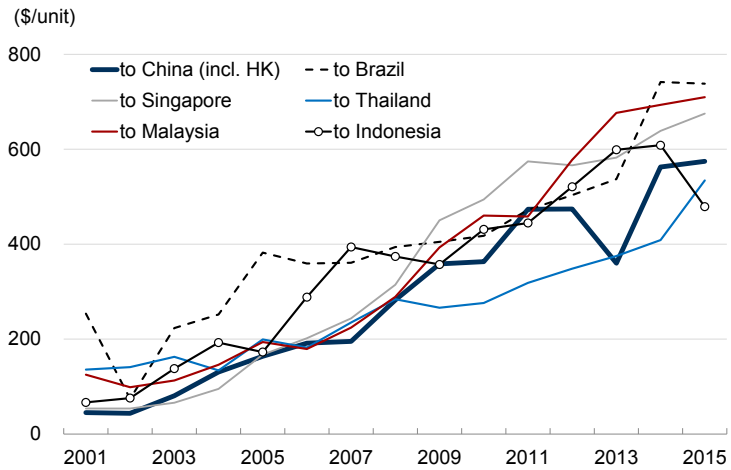
Moreover, bicycle makers have started mounting electric power assist function on sports bicycles. This year, Shimano introduced electric power assist parts (STEPS E8000 Series) for MTBs, which makes the climb uphill an easy task on these sports bicycles designed primarily for enjoying a downhill ride. Accordingly, we foresee higher demand arising for electric power assist on MTBs and a sustained growth in its sales. The combined sales of disc brakes for road bicycles and electric power assist components totaled roughly ¥10bn in FY12/15, but we forecast this to rise to ¥40bn in FY12/18 (Figure 43).

Figure 41: Taiwan's bicycle export unit price



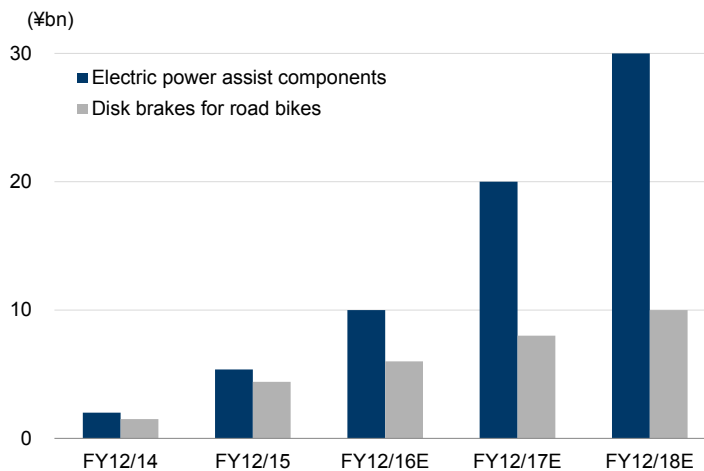
Source: JETRO world trade atlas

Figure 42: Taiwan's bicycle export unit price



Source: JETRO world trade atlas

Figure 43: Sales of electric power assist parts and disk brakes for road bikes



Source: Company data, Credit Suisse estimates

6: Earnings forecasts

FY12/16 forecasts

We lower our FY12/16 OP forecast from ¥72bn to ¥67bn, mainly to reflect the cut from ¥80bn to ¥68bn in Shimano's guidance at 1H results. This downward revision to guidance is mainly attributable to forex factors including appreciation in Asian currencies and the yen (¥9.2bn) and higher SG&A costs (¥4.8bn). Although bicycle parts sales slumped due to inventory cutbacks, we expect Shimano to offset lower sales through a more favorable product mix. Our forecast cut is mainly due to higher assumptions for SG&A costs (¥5bn), which we mainly attribute to higher promotional spend.

In its regular disclosure of its quarterly earnings outlook to investors, Shimano calls for a 30% YoY and 24% QoQ decline in 3Q OP to ¥13.8bn, but anticipates a 0.4% YoY and a 45% QoQ increase in 4Q OP to ¥20.1bn following a substantial rebound. Our forecast likewise calls for an earnings low in 3Q followed by a recovery in 4Q stemming from the inventory cycle rebound, but we think the pace at which the recovery will unfold is uncertain. If the recovery is slower than the company anticipates, it could entail downside risks to profit projections. We thus see a need to monitor near-term earnings.

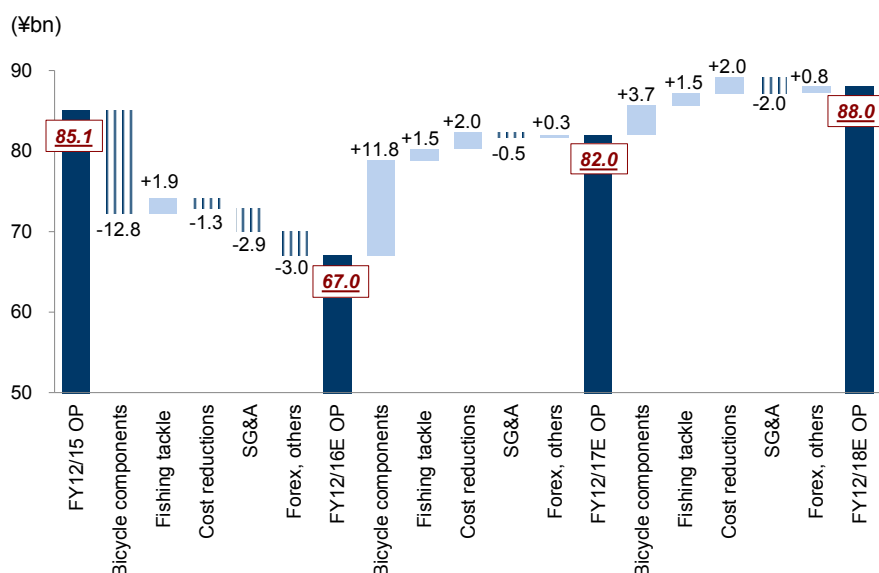
FY12/17 forecasts

We lift our FY12/17 OP forecast from ¥77bn to ¥82bn, which mainly reflects upward revisions to bicycle parts sales estimates (profit boost of ¥5bn) driven by prospects for an upturn in the inventory cycle. We raise our estimates for bicycle parts sales from ¥271bn (+7% YoY) to ¥283bn (+11%). Our estimates for sales growth by region is as follows: +2.9% in Japan, +6.7% in North America, +10.5% in Europe, and +17.8% in other regions (Japan figures based on JPY, all others on USD). We base our sales growth estimates on annual figures for the last 14 years (since the start of data disclosure by Shimano). Sales post-inventory-correction increased 17% in FY12/10 following the GFC and 26% in FY12/14 following the 2013 inventory adjustments, but this time we keep our sales growth estimate at a modest 11%.

FY12/18 forecasts

We raise our FY12/18 OP forecast from ¥83bn to ¥88bn, mainly to reflect the upward revision to our FY12/17 estimate (¥5bn). We lift our bicycle parts sales estimates from ¥279.1bn to ¥291.1bn, but keep our forecast for a 3% YoY increase intact. This sales growth estimate is substantially lower than the average growth rates registered over the last 14 years as we keep our forecasts conservative in light of possible weather fluctuations and macroeconomic uncertainties in 2018.

Figure 44: OP swing factors



Source: Company data, Credit Suisse estimates

Figure 45: Earnings forecast summary

		Sales		Operating profit		Recurring profit		Net profit		EPS	
		¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥	YoY (%)
Consolidated											
Dec-14	A	333,168	22.9	65,816	57.5	71,019	49.4	51,237	46.0	552.7	46.0
Dec-15	A	378,645	13.7	85,053	29.2	101,110	42.4	76,190	48.7	821.9	48.7
Dec-16	CS E (new)	320,000	-15.5	67,000	-21.2	65,000	-35.7	47,000	-38.3	507.0	-38.3
	CSE (prev)	325,000	-14.2	72,000	-15.3	70,000	-30.8	52,500	-31.1	566.3	-31.1
	CoE	325,000	-14.2	68,000	-20.0	65,400	-35.3	47,500	-37.7	512.4	-37.7
	IBES E	327,075	-13.6	70,145	-17.5	67,150	-33.6	49,493	-35.0	529.9	-35.5
Dec-17	CS E (new)	350,000	9.4	82,000	22.4	83,000	27.7	62,000	31.9	668.8	31.9
	CSE (prev)	338,000	4.0	77,000	6.9	78,000	11.4	57,500	9.5	620.3	9.5
	IBES E	352,111	7.7	78,524	11.9	79,267	18.0	59,621	20.5	633.4	19.5
Dec-18	CS E (new)	362,000	3.4	88,000	7.3	89,000	7.2	66,000	6.5	711.9	6.5
	CSE (prev)	352,000	4.1	83,000	7.8	84,000	7.7	62,000	7.8	668.8	7.8
	IBES E	374,100	6.2	87,289	11.2	88,643	11.8	67,612	13.4	710.3	12.1

Source: Company data, I/B/E/S, Credit Suisse estimates

Figure 46: Segment information

Consolidated income statement (¥m)	11/12	12/12	13/12	14/12	15/12	16/12E	17/12E	18/12E
Sales	221,770	245,843	271,037	333,168	378,645	320,000	350,000	362,000
Operating profit	31,742	40,961	41,775	65,816	85,053	67,000	82,000	88,000
Non-operating profit	1,626	1,645	6,721	6,472	16,899	2,000	2,000	2,000
Non-operating expenses	1,666	3,066	947	1,269	841	4,000	1,000	1,000
Recurring profit	31,701	39,539	47,549	71,019	101,110	65,000	83,000	89,000
Net profit	19,862	27,487	35,088	51,237	76,190	47,000	62,000	66,000
Segment information (¥m)	11/12	12/12	13/12	14/12	15/12	16/12E	17/12E	18/12E
Sales								
Bicycle components	177,307	198,190	217,263	273,955	314,010	254,387	283,028	291,140
Fishing tackle	43,884	47,234	53,398	58,825	64,245	64,698	66,365	69,684
Others	578	419	376	387	390	915	607	1,176
Total	221,770	245,843	271,037	333,168	378,645	320,000	350,000	362,000
Operating profit								
Bicycle components	29,966	39,012	39,505	62,033	79,816	59,905	73,178	78,237
Fishing tackle	2,139	2,274	2,404	3,943	5,372	7,601	9,065	10,592
Others	-363	-326	-135	-160	-135	-506	-243	-829
Total	31,742	40,961	41,775	65,816	85,053	67,000	82,000	88,000

Source: Company data, Credit Suisse estimates

Figure 47: Bicycle component segment: Sales by region (final destination)

	FY12/11	FY12/12	FY12/13	FY12/14	FY12/15	FY12/16E	FY12/17E	FY12/18E
Japan (¥mn)	16,781	17,131	17,842	19,885	18,895	17,920	18,440	18,993
YoY %	25%	2%	4%	11%	-5%	-5%	3%	3%
North America (\$mn)	431	481	413	449	461	467	499	514
YoY %	8%	12%	-14%	9%	3%	1%	7%	3%
Europe (\$mn)	1,276	1,337	1,174	1,402	1,470	1,244	1,374	1,415
YoY %	8%	5%	-12%	19%	5%	-15%	11%	3%
Others (\$mn)	293	450	454	551	506	492	579	597
YoY %	57%	54%	1%	21%	-8%	-3%	18%	3%

Source: Company data, Credit Suisse estimates

Forex impact

Forex is the main factor for downward revisions to Shimano's FY12/16 guidance. As forex trends bear close monitoring, we present our views here. Shimano manufactures over 40% of its bicycle parts in Japan and less than 60% overseas; sales of Japan-made parts to domestic and exports to overseas customers are denominated in yen (Figure 48). As a result, Shimano is able to avoid forex impact on the roughly 40% of its sales that are yen-denominated, but it is still open to forex impact on the roughly 60% of its sales that are in foreign currency. Shimano does not disclose its foreign currency-denominated OP data, but if the figure is in line with its ratio of foreign-currency sales, it would imply a foreign currency OP of roughly \$480m (at ¥103/\$) in FY12/17. This further implies a profit fluctuation of ¥480mn for each ¥1/\$ swing (a stronger yen resulting in lower profits). Our forex premise for 2H FY12/16 and beyond is ¥103/\$ (guidance ¥100/\$).

Figure 48: Domestic/overseas production, and sales in yen/foreign currencies

	FY13		FY14		FY15	
	¥mn	%	¥mn	%	¥mn	%
Domestic production	116,492	43%	146,061	44%	173,231	46%
Overseas production	154,545	57%	187,107	56%	205,415	54%
Sales in yen	104,783	39%	128,347	39%	154,384	41%
Sales in foreign currencies	166,254	61%	204,821	61%	224,262	59%

Source: Company data

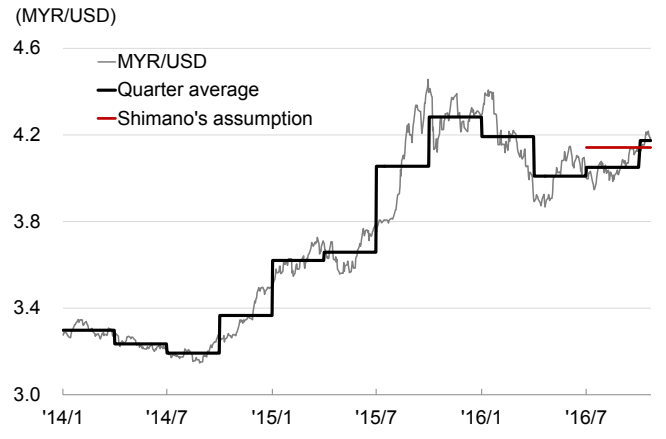
Meanwhile, in Asia (Shimano's core production base), Chinese production is mainly geared toward local demand and thus free from forex impact, but in Malaysia and Singapore, which form the company's production base for exports to Europe and the US, weaker local currencies versus the dollar (sales denominated in USD) have a positive forex impact, while stronger local currencies have a negative forex impact. Shimano does not disclose its production scale in these countries, but by using headcount and the book value of machinery, equipment, and vehicles, we estimate Shimano's Malaysian production be larger than Singapore's (Figure 49). Shimano's disclosures also leave out the company's earnings sensitivity to the two currencies. Our forex premise for 2H FY12/16 and beyond is MYR/USD of 4.06 and SGD/USD of 1.35 (vs. guidance of 4.14 and 1.34). It is worth noting that both of MYR/USD rates and SGD/USD rates are tracking below Shimano's premise (Figures 50–51).

Figure 49: Shimano's production bases (FY15)

	Regular employee	Temporary employee	Employee Total	Machinery, equipment and vehicles Book value (¥mn)
Head office	948	250	1,198	3,868
Shimonoseki	191	90	281	3,008
Singapore	581	8	589	1,749
Malaysia (Johor)	1,596	1,597	3,193	2,506
China (Kunshan)	1,069	8	1,077	4,640
China (Tianjin)	745	-	745	2,682
Philippines (Batangas)	88	-	88	1,614

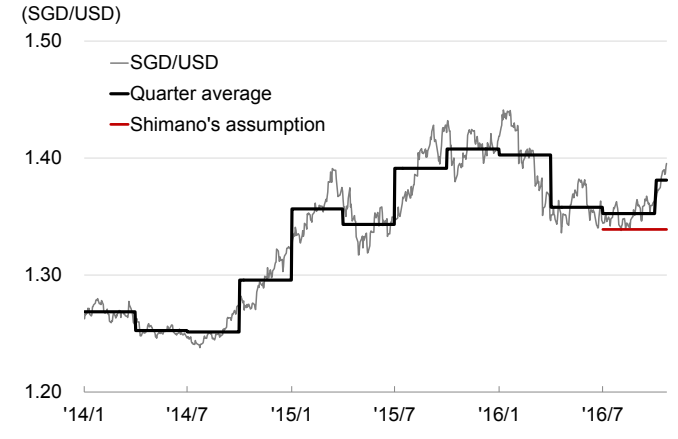
Source: Company data

Figure 50: Malaysian ringgit



Source: Thomson Reuters Datastream

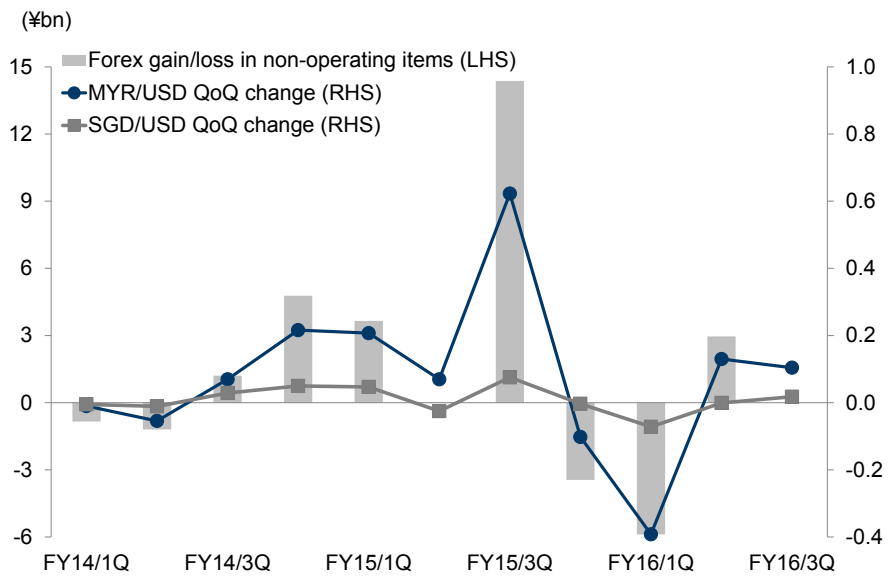
Figure 51: Singapore dollar



Source: Thomson Reuters Datastream

In addition to the above factors for OP fluctuation, we also note gains/losses from forex differentials in Shimano's non-operating items (Figure 52). The weakening of the MYR and SGD versus the USD leads to currency translation gains, whereas their strengthening leads to currency translation losses. As Asian currencies were weaker at end-September 2016 than at end-June, we see prospects for currency translation gains of around ¥1–2bn in 3Q. However, neither our estimates nor guidance reflect this.

Figure 52: Gains/losses from forex differentials and QoQ change in Asian currencies



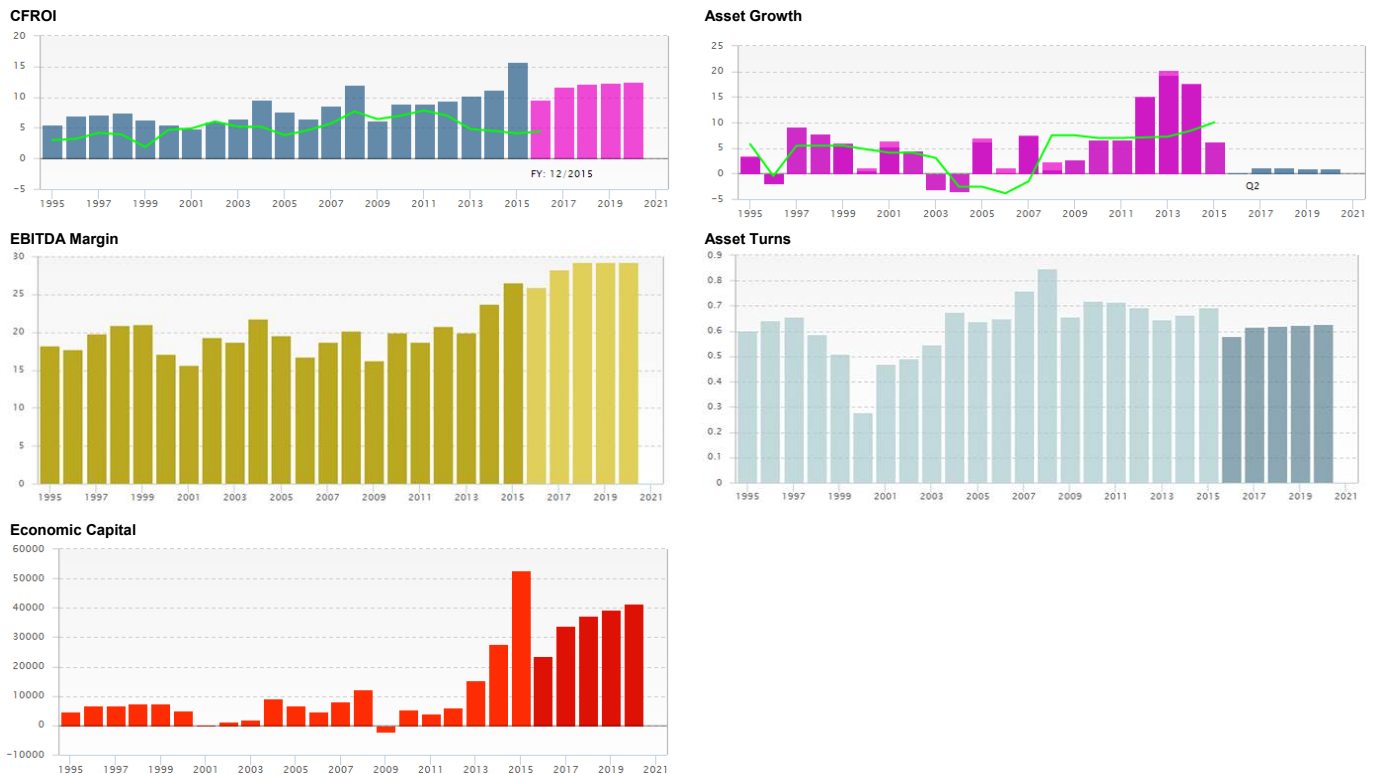
Source: Company data, Thomson Reuters Datastream

HOLT analysis

HOLT analysis shows that CFROI (excluding currency translation gains in FY12/15) is on a sustained, long-term uptrend and well above cost of capital. This has largely been driven by improving EBITDA margins (and our expectation that this will continue) although the reduction in sales volume expected this year has otherwise served to depress asset efficiency.

This analysis additionally points to sharp growth in economic profit (defined as cash flow less a capital charge) since the start of the current decade. Save for FY12/15 which was boosted by foreign currency, HOLT economic profit should ratably increase from here and settle in at about ¥40bn over the next five years. While the shares otherwise appear expensive in the HOLT framework, this analysis seemingly bears out Shimano’s favorable earnings and wealth creation profile for which we believe the market should be willing to pay a premium.

Figure 53: HOLT analysis



Source: Company data, Credit Suisse estimates, HOLT®

Companies Mentioned (Price as of 21-Oct-2016)

- Campagnolo** (Unlisted)
- Cannondale Bicycle Corporation** (Unlisted)
- F.I.V. Edoardo Bianchi** (Unlisted)
- Giant Manufacturing Co Ltd** (9921.TW, NT\$220.0)
- Gios** (Unlisted)
- Lous Garneau** (Unlisted)
- Merida Industry Co Ltd** (9914.TW, NT\$140.0)
- SCOTT** (Unlisted)
- SRAM** (Unlisted)
- Shimano** (7309.T, ¥17,240, OUTPERFORM, TP ¥20,000)
- Specialized Bicycle Components** (Unlisted)
- Trek Bicycle Corporation** (Unlisted)

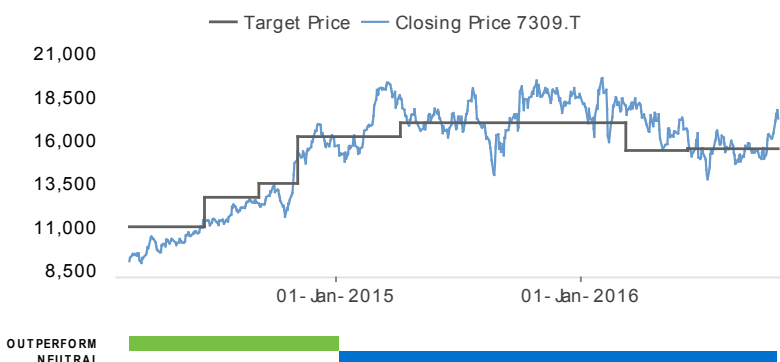
Disclosure Appendix

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3-Year Price and Rating History for Shimano (7309.T)

7309.T	Closing Price	Target Price	
Date	(¥)	(¥)	Rating
27-Feb-14	9,010	11,000	O *
19-Jun-14	11,540	12,700	
08-Sep-14	12,340	13,500	
05-Nov-14	15,340	16,200	
07-Jan-15	15,160	16,200	N
07-Apr-15	18,400	17,000	
08-Mar-16	17,990	15,400	
08-Jun-16	16,510	15,500	



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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Shimano (7309.T)

Method: Our ¥20,000 target price for Shimano uses a P/E of 30x, the average valuation during inventory cycle rebounds, applied to our FY12/17E EPS. We expect the rebound in bicycle part exports, and a rise in the share price, valuations, and consensus estimates, all of which closely correlate with the rate of increase in bicycle part exports. We base our OUTPERFORM rating on expected 12-month total return and a comparison with our coverage universe.

Risk: Risks to our ¥20,000 target price and OUTPERFORM rating for Shimano include a weak inventory cycle rebound, sluggish bicycle sales due to an economic downturn or unfavorable weather, yen strength, and currency appreciation in Asia. In particular, we still see some uncertainty in Shimano's outlook for an earnings rebound in 4Q FY12/16.

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