

June 17th, 2010

Dear clients and colleagues,

This week we would like to introduce a new stock in the portfolio - Horiba (6856 JT, ¥2571).

Business Description

Horiba is a Japan-based manufacturer of measurement equipment, specialised in the analytics and measurement in the field of environment, health, safety and energy. A wide range of products are used for vehicle emission measurement, air and water pollution monitoring, blood testing, and mass flow controller for semiconductors. It is mostly known as the world's largest maker of devices that measure automobile emissions with 80% market share. Its main customers are automakers, government regulators, clinics, and semiconductor manufacturers, etc. Founded in 1945, Horiba has grown to a truly global company that is present in 22 countries and has over 5,000 employees worldwide.

Market Data

Market Cap US\$1.2B, 2003-2007 rev CAGR +16%, 2003-2007 EPS CAGR +83%, net cash US\$128M, dividend yield 0.58%, ev/t12 sales 0.9x, ev/t12 ebitda 10.1x, fwd p/e (12/2010) 19.0x, gross profit margin 43.8%, one-year return 21%, www.horiba.com

Target Market

Horiba has four business segments targeting at different markets: automotive, analytical, medical-diagnostic and semiconductor. These segments have an aggregate market size of over ¥800B, growing at a CAGR of 4% to 11% before the financial crisis (led by semi-conductor and automotive). Horiba's sales in 2009 were ¥105B. Sales during 2003-2007 had been growing at a CAGR of 16%. Horiba has been gaining market shares in the past 7 years even during the crisis. E.g. In the semi-conductor segment, its mass flow controllers had 41% market share in 2009 vs. 26% in 2003.

Competitive Advantages

- Advanced Technologies
Horiba has a strong focus on innovation. R&D represents 5%-7% of sales.
- Strong brand and leading market shares
Horiba has an excellent reputation of high performance and standard. Below are just a few examples of their leadership positions in the niche markets:
 - 80% market share in Motor Exhaust Gas Analyzer (Automotive)
 - 35% market share in monochromator grating (Analytical)
 - 8% market share in Small-size hematology analyzer (Medical)
 - 80% market share in chemical concentration monitors (Semi)
 - 41% market share in mass flow controllers (Semi)

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Competition

Horiba competes with a few key players in each business segment:

Automotive: Ono Sokki and meidensha

Analytical: Shimadzu, Agilent Technologies, and Thermo Fisher.

Medical: Nihon Kohden, Sysmex and Beckman Coulter.

Semi-conductor: Celerity, Advanced Energy, and MKS Instruments.

Growth Strategy

1. Product innovation: Horiba is very active in new product launch. E.g. Its latest Nanoparticle Analyzer has the widest range and highest precision in the industry. Its new hematology Analyzer can process up to 60 samples an hour. Among others, Horiba aims to be the No.1 provider of a full-range automotive test systems;
2. Distribution: more penetration to developed markets, and expansion to emerging markets;
3. M&As: Near-term focus on the medical-diagnostic segment in the US where Horiba is under-penetrated.

Management

The founder's family (Horiba) holds about 5% of ownership. Mr. Atsushi Horiba (son of the founder) has been President & CEO since 1992. He was awarded France's highest order (National Order of the Legion of Honor) in January 2010, for his outstanding accomplishments in business development in France.

Risks

- Prolonged cutback in capex by related industries.
- Price competition in Medical-diagnostic products.
- Currency fluctuation: This effect should be limited due to Horiba's diversified production base and sales regions worldwide.

Investment Theme

- Long-term favorable environmental trend: Tighter Emission regulations (e.g. air and water quality). Tighter efficiency regulations (to develop new engines for enhanced fuel economy)
- Short-term strong recovery in the semiconductor industry: Management expected its silicon-related production to grow 50% in 2010, and non-silicon-related production (LED, OEL, Photovoltaic, etc.) to increase by 3 folds y/y in 2010.
- Big growth potential in emerging markets: Sales in China is expected to grow by 170% in 2010 to ¥2.7B.

Valuation

Target price = ¥5189, using DCF model at growth rate of 20% for 7 years, 6% at maturity, and risk premium of 10%.

Regards

The Global Alpha Team

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