STOCK CHOSEN: **DAIKIN INDUSTRIES**
RECOMMENDATION: **BUY**

REASONS TO BUY:

1. DIVERSIFIED OPERATIONS: Daikin has operations in a variety of industries such as HVAC, Chemicals, defense systems. Has both B2B & B2C products. Diversification = Reduces unsystematic risk
2. CONSISTENT POSITIVE GROWTH: Daikin has achieved record sales results in 2021 despite COVID-19
3. GLOBAL PRESENCE: Wide customer base, losses in one region can be compensated by profits in other regions, ability to have year-round sales for HVAC products
4. HEALTHY FINANCIALS: Low debt, positive cash flow, Daikin has the capability to acquire other companies to break into new markets.

Business Description:

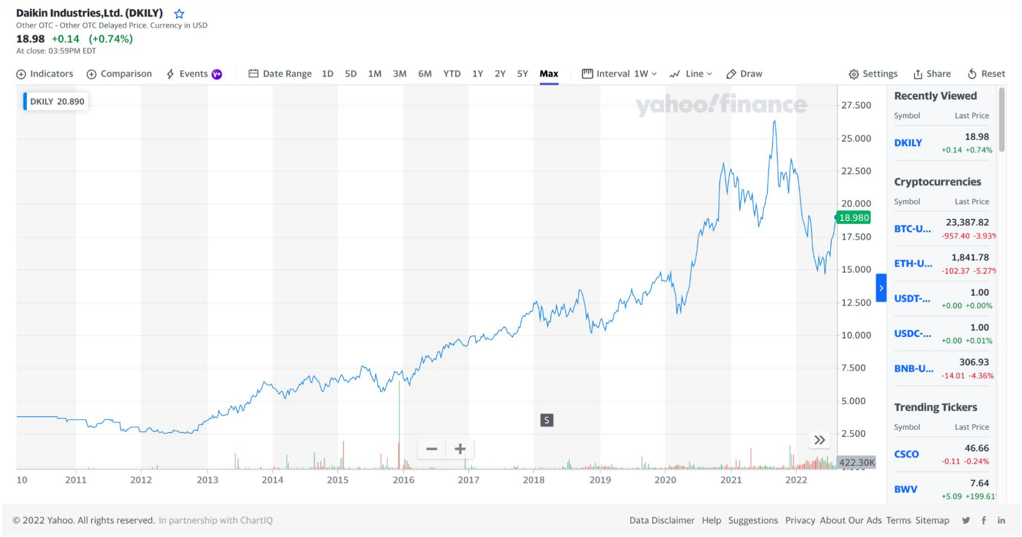
Daikin Industries produces HVACs, Hydraulics and Chemicals for Businesses & People, with a reputation for innovation, reliability and localised distribution and after sales support.

<u>Stock Price Movement since listing</u>

Consistent upwards trend with decreases that are generally consistent with the S&P 500

<u>Key drivers for major stock price movement:</u>

1. COVID-19 causing supply shocks and stock market downturns.
2. Releases of Daikin's Annual Reports and Financial statements where growth was realised but below expected growth rates.



Competitive Landscape:
Sectors that Daikin Industries operate in have a relatively low barriers to entry. Regional competitors are able to manufacture cheaper products, global competitors have better brand recognition in consumer-facing markets.
Products that Daikin manufactures have many substitutes and significant effort is required for product differentiation through marketing, innovation or outstanding after sales experience.

Other significant competitors

Electronics / HVAC

1. Carrier: Largest HVAC company, mostly focused in USA, HVACs are priced cheaper than that of Daikin's to target the mid to low end market.
2. Hitachi: Global conglomerate, manufactures HVACs and defense systems, HVACs are priced cheaper than that of Daikin's, Hitachi might be able to better target developing markets with "value for money" products.
3. Samsung: Global conglomerate, manufactures consumer electronics that are priced higher than that of Daikin's, Samsung's higher end products have the capability to be connected in a Samsung smart home system, thereby locking consumers into a Samsung only home appliance ecosystem.
4. Mitsubishi: Global conglomerate, manufactures consumer electronics, air conditioners are priced in the similar range as some of Daikin's products,
5. Panasonic:
6. Lennox: HVAC company,

Chemicals

1. Honeywell: Global conglomerate, manufactures chemicals and consumer electronic products similar to Daikin. Daikin Chemicals Europe has an existing partnership with Honeywell to distribute Honeywell's refrigerant in Europe,

Capital structure for Daikin Industries

Daikin Industries has a relatively healthy capital structure.

The table below shows data compiled from Daikin's annual reports and financial statements from the past three years.

Net Debt/EDITBA ratio is generally low and decreasing, shows that Daikin is able to pay back its debts in a relatively short amount of time if net debt and EDITBA are constant.

Debt to total equity ratio is relatively low and is on a downwards trend, showing that Daikin's purchases are mostly funded by shareholders' assets and not debt, which is good.

Consistently generates revenue, has positive cash flow

Financial Stats (Jun of each year)	2020	2021	2022
Net Debt/EDITBA	1.405	2.018	1.776
Debt to Total Equity	0.507	0.380	0.314

Investment Thesis

1. Daikin has relatively healthy financials and has the capabilities for expansion as well as being able to weather through potential downturns.
2. Daikin has been shown that it is actively committed to long term sustainability and business growth by through its strategic management plan Fusion. Daikin has achieved its Fusion 20 plan and is set to achieve targets in its Fusion 25 plan.
3. Diversification: Daikin has global presence with strong local distribution capabilities and after-sales support as well as a relatively diversified variety of products, thus lowering the risk of global downturns or disruptions in one industry or region affecting the profitability of the entire company.

Questions to ask Daikin’s upper management:
1. What would you consider as Daikin’s core strengths that sets Daikin apart from industry?
2. How operationally feasible are the targets in Daikin’s Fusion25 plan given the increasingly volatile post-COVID world?
3. Would Daikin explore other business models (subscription, independent regional dealerships, etc) that are not purely one-time sales driven for its HVAC products?

Key Risks

- Lockdown risk: China is home to its production bases, with China's 'Zero Covid' policy and unpredictable lockdowns in cities, Daikin's production and distribution capabilities would be stalled
- Compliance and Regulatory risk: Introduction of legislation from countries such as stricter regulations on carbon emissions, energy efficiency or types of refrigerants allowed, resulting in obsolescence of Daikin's products.
- Strategy risk: Existing regional competitors entering the global market, competitors entering the HVAC or air filter markets through acquisition of smaller firms
- Market Outlook: With rising inflation and the Fed's decision to raise interest rates, consumers have an increasingly negative outlook on the economy and would delay purchases of large ticket items like HVAC systems.

Key Revenue Drivers

1. Sales of HVAC, Air Filters, Oil Hydraulics, Chemicals and Defense Products
    a. Operating Revenue = Number of HVAC units/Oil Hydraulics/ Chemicals / Defense Products x Price of product x Quantity of Products sold

How investment thesis affects key revenue drivers

1. Climate change, such as increasingly hotter summers and colder winters, together with increasing focus on energy efficiency and sustainability would drive consumers to purchase HVAC units from Daikin, which is relatively well established in these areas.
2. Rising tensions between Japan, China and United States may see an increase in Japan's defense spending, both China and United States' efforts to increase their semiconductor design and manufacturing capabilities, which will drive sales of Daikin's products in semiconductor etching and defense.
3. Daikin's presence globally, especially building production and distribution bases in developing markets will pay off when the emerging middle class in developing markets in Africa and APAC have more disposable income, would opt for Daikin's HVAC and air filtration products due to brand familiarity and Daikin's superior localised coverage for after-sales service.

Key costs

- Research & Development
- Employee cost: Employees' salaries, pension fund contributions
- Corporate Tax
- Cost of raw materials
- Operating costs: Marketing, Distribution, Cost of electricity used in manufacturing plants & corporate offices
- Repair & Depreciation of equipment used for manufacturing products
- Rental cost for Production bases, Offices and Storage
- Mergers & Acquisition of other companies

How investment thesis affects projected key costs

- Expect R&D costs to increase in future as other competitors introduce products with similar capabilities and specifications as Daikin -> Daikin has to continually innovate
- Expect other competitors to target emerging markets with mid to lower tier products as compared to Daikin's relatively premium products -> Marketing cost and operating cost to increase as Daikin fights for market share and brand recognition in these markets.

Anything else to mention about the company: Daikin