

18-Apr-14

Important disclosures and disclaimers appear at the back of this document.

FISCO Ltd. Analyst  
 Noboru Terashima

## M&A a key growth strategy supplementing existing businesses

Ai Holdings is a pure holding company that has 16 operating company subsidiaries, including Dodwell BMS Ltd. and Graphtec Corporation. These subsidiaries are mainly developing 7 businesses, with its security equipment and US peripheral computer equipment businesses being the growth engines.

Q2 FY6/14 results (Jul-Dec 2013) showed sales of ¥17,813mn up 10.8% y-o-y, consolidated operating profit of ¥3,007mn up 29.3% y-o-y, consolidated recurring profit of ¥3,090mn up 26.5% y-o-y, and consolidated quarterly net profit of ¥1,923mn up 44.8% y-o-y. As a result, there was an upward revision of FY6/14 full-year forecasts, targeting sales of ¥35,600mn (+9.9% y-o-y), consolidated operating profit of ¥6,000mn (+20.6% y-o-y), consolidated recurring profit of ¥6,100mn (+20.1% y-o-y) and consolidated net profit of ¥3,750mn (+26.1% y-o-y).

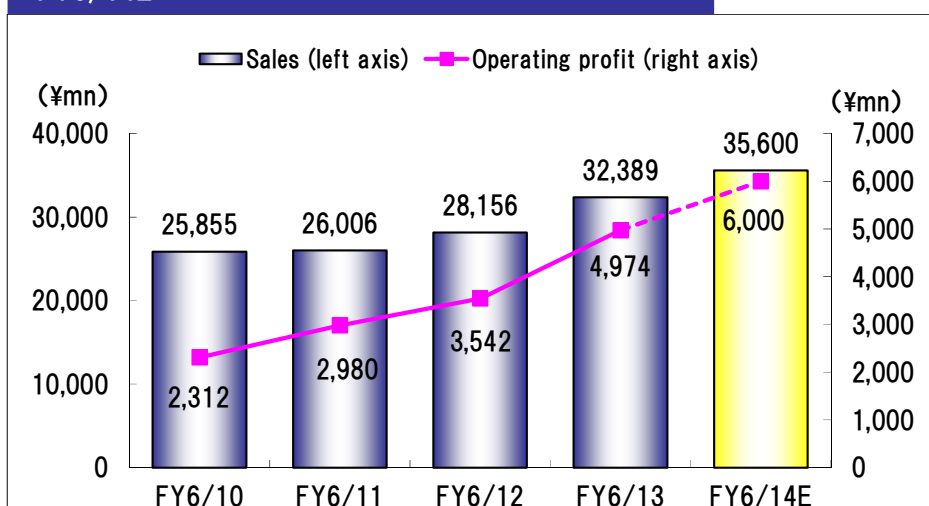
Ai Holdings has announced that it will establish a new business from the next term. Further, it has made public the fact that, in addition to existing businesses, M&A will be a key growth strategy. While always working on a number of deals, it appears that it is currently also in the process of progressing some (particular) projects. So we have to pay attention to future developments.

Further, given that it has indicated a dividend payout ratio of 30-35%, it appears there is the potential for increased dividends depending on this term's results (profits).

## Check Points

- A clear, unwavering policy & management's rapid decision-making are major strengths
- Strong current performance this term indicates the potential for results to exceed targets
- Continuous growth through a cycle of acquiring and nurturing new businesses

Consolidated Sales and Operating Profit, FY6/10-FY6/14E



## ■ Company outline

### Rejuvenation & expansion through reforms that putting priority on profits rather than sales

#### (1) Company History

Ai Holdings was established as a pure holding company in 2007, and currently encompasses 16 operating companies, of which 14 are consolidated subsidiaries, 1 is a non-consolidated subsidiary, and 1 is an equity method affiliate. Given that Dodwell BMS Ltd. and Graphtec Corporation are the main operating companies the company history for these two subsidiaries is outlined below.

Originally established in 1950 as Typewriter Service Co., Ltd., Dodwell subsequently underwent corporate reorganization, changing its name to Dodwell BMS Ltd. At the time, Dodwell was mainly engaged in the sale of office equipment such as typewriters, post office franking machines and personal computers, but its profitability languished. Subsequently, in 1994, Mr. Hideyoshi Sasaki, the current Chairman of Ai Holdings, purchased it (acquiring 51% of its shares) and became its paramount manager. The then President Sasaki promoted reform at Dodwell aimed at “putting priority on profit rather than sales”, rebuilding it to the point where in 1999 its shares were listed on the OTC market.

#### History of Dodwell BMS

1950	Established as Typewriter Service Co., Ltd.
1963	Reorganized as Dodwell Business Machines Service Co., Ltd.
1978	Renamed Dodwell BMS Ltd.
1994	Mr. Hideyoshi Sasaki took a 51% stake in the company and became its president
1999	Registered shares on the over-the-counter market
2000	Took a majority stake in Pro-Mech Corp., making it a subsidiary
2001	Took an equity stake in Takamisawa Cybernetics Co., Ltd.
2002	Listed shares on the Second Section of the Tokyo Stock Exchange
2003	Listed shares on the First Section of the Tokyo Stock Exchange
2005	Entered a business agreement with Graphtec Corp.
2007	Merged with Graphtec Corp. to form Ai Holdings Corp.

In contrast, the predecessor to Graphtec was Watanabe Laboratories Inc., which was established in 1949 by a Mr. Watanabe, a former employee that had spun out from Yokogawa Electric Corp. (6841), being a company that developed Japan’s first X-Y plotter for the automatic production of graphs. Subsequently, the company operated globally, with its flagship product being pen plotters for computer-aided design (CAD). In the early 1990’s, however, as a consequence of Hewlett-Packard Inc., of the US, introducing ink-jet printers, the demand for pen plotters rapidly declined and corporate performance continued to deteriorate. Despite reducing offices nationwide and managing somehow to survive, the result of restructuring was deterioration in customer service, with hope for a recovery in results coming from a business alliance with Dodwell BMS.



### History of Graphtec

1961	Developed Japan's first X-Y plotter
1977	Name changed to Watanabe Measurement Equipment
1983	Name changed to Graphtec Corp.
1985	Shares listed on the Second Section of the Tokyo Stock Exchange
1987	Shares listed on the First Section of the Tokyo Stock Exchange
1995	Established a subsidiary in California, USA, now called Graphtec America Inc.
2005	Established business agreement with Dodwell BMS
2007	Merged with Dodwell BMS to form Ai Holdings Corp.

Ai Holdings was established as a pure holding company in 2007, with its shares listed on the First Section of the Tokyo Stock Exchange. Since then to the present, the company has grown operations rapidly by setting up new subsidiaries and proactively engaging in M&A.

### History of Ai Holdings

Apr-07	Established through the merger of Dodwell BMS and Graphtec. Listed on the First Section of the Tokyo Stock Exchange.
Jul-08	Purchased Neuron Co., making it a subsidiary.
Jan-09	Purchased Shiomi Sekkei Co., making it a subsidiary.
Jul-09	Established subsidiary Ai Engineering Co., Ltd.
Sep-09	Established Silhouette America Inc.
Jul-10	Shiomi Sekkei Co. changed its name to Ai Sekkei Co.

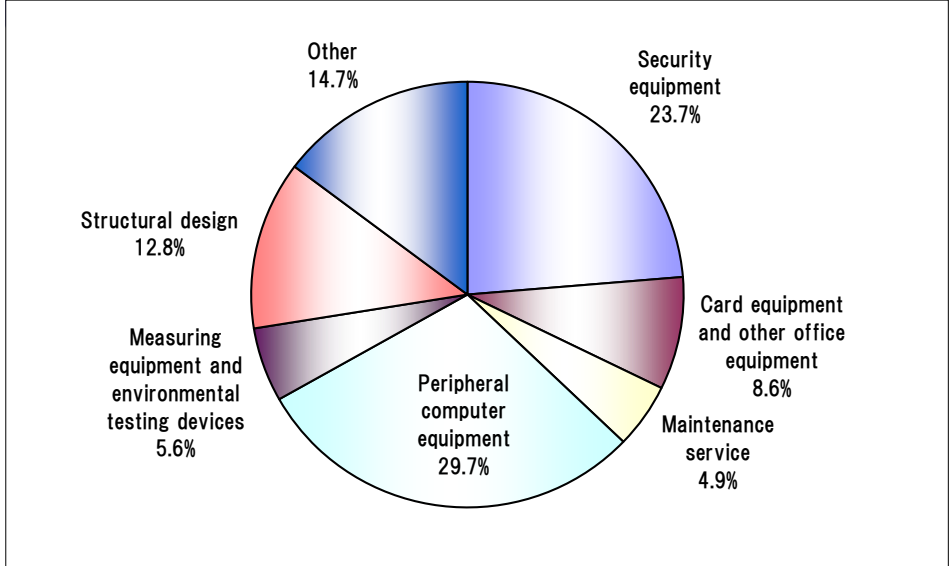
## 16 Group companies engage in 7 businesses

### (2) Description of businesses

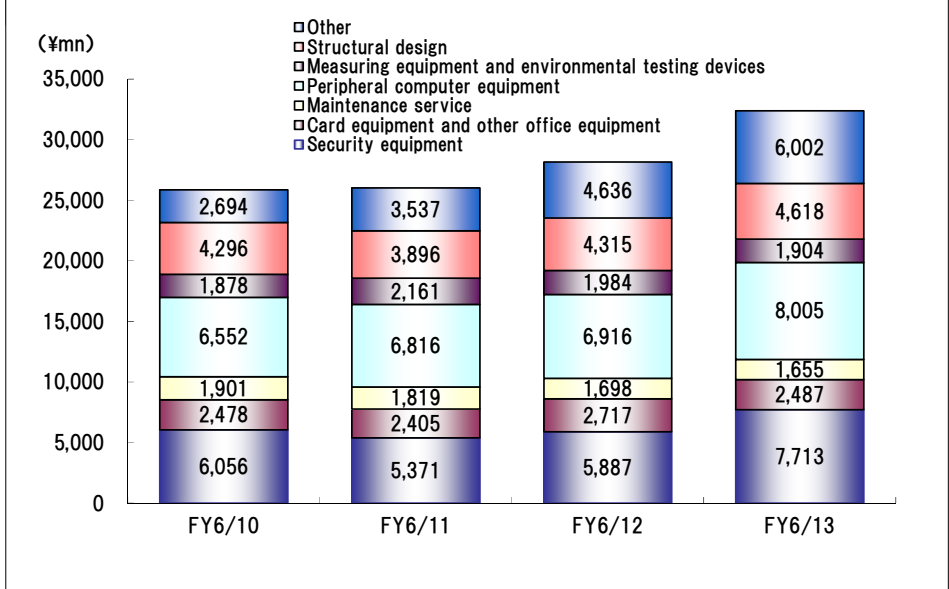
As mentioned above, Ai Holdings is a pure holding company encompassing 16 operating companies, of which, 14 are consolidated subsidiaries, 1 is a non-consolidated subsidiary, and 1 is an equity method affiliate that are mainly engaged in the 7 businesses outlined below. Looking at sales by operating segment for FY6/14 shows that: (a) security equipment was ¥4,218mn (representing a sales contribution of 23.7%), (b) card equipment and other office equipment was ¥1,524mn (8.6%), (c) maintenance services were ¥879mn (4.9%), (d) peripheral computer equipment was ¥5,282mn (29.7%), (e) measuring equipment and environmental testing devices was ¥1,001mn (5.6%), (f) design was ¥2,284mn (12.8%), and (g) other businesses were ¥2,625 (14.7%). Sales trends by segment for the last 4 years are as set out in the graph below.

■ Company outline

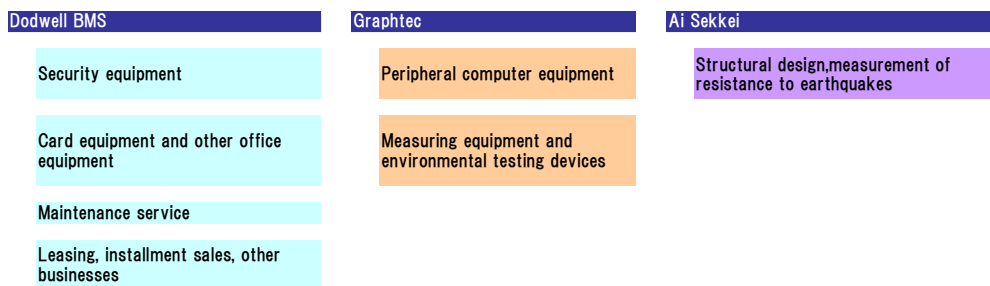
Sales Contributions by Businesses in H1 FY6/13



Sales by Businesses, FY6/10-FY6/13



While there are 14 consolidated subsidiaries, there are 3 main operating companies, being Dodwell BMS, Graphtec and Ai Sekkei, with their related businesses described in the diagram below.



### **(a) Security Equipment**

The main products are security systems such as security cameras and recorders. The products are mainly purchased from Korean manufacturers, with the company heavily involved in determining the specifications for the purchased products. The advantage of the Korean products is, among other things, that basic technology is developed from military technology and thus their performance is high relative to the cost. Accordingly, the cost performance of the company's products is superior to that of its major domestic competitors.

Further, one of distinctive features of the company is that it can provide a comprehensive service including maintenance. While it has a broad customer base, with major users being condominium buildings, financial institutions such as banks and securities companies, government agencies commercial precincts and retail store chains, in the last several years sales to existing condominium buildings have grown rapidly. When the security equipment business was initially established, it was mostly general corporate sales via agents, however, in recent years Ai Holdings has strategically expanded direct sales, particularly for existing condominium buildings (refer below for details).

### **(b) Card Equipment & Other Office Equipment**

The main products include ticket issuing machines and machines for registering return patient visits for hospitals, as well as machines for on-the-spot issuance of IC cards for financial institutions and retailers. Sales to hospitals is not a high growth area, but one from which we can expect steady demand. For financial institutions and retailers, sales of on-the-spot IC issuance machines remain minor, however, some regional banks have begun to adopt them, and additionally some megabanks have also decided to introduce them. We need to pay attention to this trend also going forward.

The other major type of equipment sold is CAD devices for steel structures. As it is a niche market it is not expected to grow rapidly, however, it is an area where steady renewal demand may be expected.

### **(c) Maintenance Services**

This business engages in maintenance services for security, card and other equipment. In the past, this business also contracted to maintain equipment produced by other companies in order to optimize the efficiency of its maintenance staff, however, in recent years, it has concentrated on maintaining Ai Holdings equipment, so the sales weighting of maintenance services for other companies has been dropping.

While only small in terms of sales, it is a key business. Much of the security and card equipment handled by the company is not purchased outright, but by way of lease contract, requiring periodic maintenance. Usually, in respect of this equipment, a maintenance contract is entered into separately from the lease contract that represents the purchase price of the equipment. However, at Ai Holdings a maintenance agreement is included in the lease contract in the form of a "Peace of Mind Package (Anshin-pack)", structured so that product sales are recorded in that business. Further, because maintenance services are an accretive stock business, it leads to mid- to long-term revenue stability. Additionally, since having a maintenance business is a strength in terms of marketing and providing customers with peace of mind, it also has an aspect of contributing to security and card equipment sales and is arguably the hidden revenue contributor.

#### **(d) Peripheral Computer Equipment**

Refers to computer peripherals such as cutting machines and scanners handled by Graphtec. Ai Holding's cutting machines were developed based on the original technology created by Graphtec for plotters, with cut width ranging from the small A4 format size to large formats that exceed 1,600 mm. It focuses on corporate users, such as outdoor advertisers and billboard manufacturers.

Further, in recent years, there has been significant growth in miniaturized products of what were previously industrial cutting machines for consumers for hobbies (mainly paper craft) in Europe and North America. The basic products are produced in China and Vietnam, with the retail price in the order of ¥10,000-20,000. In addition to this, customers that purchase the basic products become members, with there also being sales of a variety of content (designs etc.) and consumables. The main operating entity is the American subsidiary Silhouette. (Refer below for more details)

On the other hand, the scanners are industrial use equipment able to scan large displays up to A0 size, with some being supplied on an OEM basis to major precision equipment manufacturers.

#### **(e) Measuring Equipment and Environmental Testing Devices**

Measuring equipment refers to an extensive line-up of products able to handle a broad range of data gathering activities including voltage, temperature, humidity and pulse readings. Environmental testing devices refers to equipment that checks the performance of electronic components, such as printed circuit boards, under specific conditions, such as high or low temperature, and may also be customized in line with client requests.

Given that main usage purpose for all of the products is "testing equipment", it will not see rapid growth but is a stable business that records profits.

#### **(f) Design**

3 companies are involved in design operations: Ai Sekkei, the former Shiomi Sekkei that was acquired by Ai Holdings and renamed, as well as consolidated subsidiaries Tanabe Sekkei Co., and Chuo Sekkei Co. They possess over 200 related technical staff, with operations centered seismic capacity evaluation and earthquake resistant construction, which are highly specialized (areas) within the architectural design industry. Additionally, it is engaged in comprehensive construction consulting operations, leveraging its superior technological capabilities in areas including architectural design, structural design, and the design of equipment and devices, with it being a business that is producing stable profits.

#### **(g) Other Businesses**

The main operations within this segment are leasing and installment sales, where leasing and installment sales relating to sales of security, card and other equipment referred to above are undertaken. Further, as required leasing and installment sales of other companies' products are undertaken.

As noted above, Ai Holdings undertakes sale and maintenance services for a variety of equipment, and while each piece of equipment and service has its own strengths and distinctive features, as a company Ai Holdings' real strength (distinctive characteristics) may be boiled down to "Management Capability" and "Marketing Capability".

## A clear, unwavering policy and rapid decision-making are major strengths

### (3) Management Capability

The greatest strength of Ai Holdings is “management capability”, in other words the leadership and faculty for management of Chairman and CEO Sasaki. Since assuming the top leadership position at Dodwell BMS in 1994, Mr. Sasaki has always declared M&A to be a core policy in its growth strategy, with his policies (e.g. not undertaking business with low profitability and not undertaking business in mass markets that are easy for large corporations to enter) not having changed at all from those 30 years ago, or in other words being unwavering. The fact that this sort of unwavering management policy pervades is indeed Ai Holdings’ strength, and arguably why its M&A success rate is so high.

Further, the fact that all types of management decisions are taken quickly and then implemented quickly is also a strength of Ai Holdings. Perhaps an example is that when acquiring Silhouette Inc., which forms the company’ s US operations and is discussed later, in circumstances following the Lehman shock where the market was poor, its future promise was discerned and M&A undertaken in an extremely short time frame. On the other hand, not all M&A and corporate alliances proceed smoothly. There are many cases where, contrary to expectations, actual circumstances are poor, however, in these cases the company will without hesitation act to sell-off the underperforming subsidiary or dissolve the business alliance. As a result, it avoids greater risk and facilitates the next investment. The ability to make decisions and implement them in this way is due to Mr. Sasaki’ s unwavering management policies and strong leadership.

## Marketing capability nurtured through in-house training is a major strength

### (4) Marketing Capability

Another strength of the company is its marketing capability, and in particular its security equipment marketing capabilities. In recent years the sales style of the company has been shifting, including its female staff, towards “proposal-based sales”. Additionally, sales targets also have been focused on existing condominiums building, from their previous corporate (financial institution, school, public facility, commercial facility etc.) focus, to best utilize the strengths of the company’ s products.

Further, we understand that ample support structures are a cornerstone in supporting the company’ s marketing capabilities. The company is has developed businesses aimed at professionals, such as corporate office equipment sales and the manufacture and sale of cutting machines. The support capability cultivated through marketing to professionals allowed that company to display its true strength by amongst other things garnering significant acclaim from users in America. At present also in security, card and other equipment sales also, a major strength is possessing a maintenance business in-house, and carrying out maintenance services directly with customers.

Moreover, the company has put (considerable) effort into the recruitment and training of sales staff. In particular, in the recruitment of sales staff, centered on new graduates, top management (Mr. Sasaki) become involved personally and have recruited many unique human resources. The result of the company’ s original training of these human resources is the current powerful salesforce. The increase in security equipment sales in recent years is not simply a result of the equipment’ s performance and pricing, but in many aspects is a result of this marketing capability. The current “mind and soul sales” should be able to be put to use not only for security equipment, but also in new businesses acquired via M&A in the future. The strength of this sort of marketing capability is another strength of the company.



## ■ Business trends

### Q2 operating profit exceeds initial forecasts

#### (1) Q2 FY6/14 Results

##### (a) Earnings

Q2 FY6/14 results showed consolidated sales of ¥17,813mn (+10.8% y-o-y), consolidated operating profit of ¥3,007mn (+29.3% y-o-y), consolidated recurring profit of ¥3,090mn (+26.5% y-o-y) and consolidated quarterly net profit of ¥1,923mn (+44.8% y-o-y).

Initial forecasts were for operating profit of ¥2,450mn, however, actual results were positive, significantly exceeding this target. The main factors behind this were significant increases in security equipment (mainly for condominium buildings) and cutting machines for the consumer market in which US subsidiary Silhouette is engaged, which are the current growth drivers for Ai Holdings.

#### Summary Income Statement

(Unit: ¥mn, %)

	Q2 FY6/13		Q2 FY6/14		Change	
	Amount	Ratio	Amount	Ratio	Amount	Rate
Sales	16,079	100.0	17,813	100.0	1,734	10.8
Gross profit	6,121	38.1	7,552	42.4	1,431	23.4
SGA cost	3,795	23.6	4,544	25.5	749	19.7
Operating profit	2,326	14.5	3,007	16.9	681	29.3
Recurring profit	2,442	15.2	3,090	17.3	648	26.5
Net profit	1,327	8.3	1,923	10.8	596	44.8

#### ● Security Equipment

Sales were ¥4,218mn (+12.7% y-o-y), while operating profit also increased significantly to ¥1,251mn (+16.7% y-o-y). The major factor behind this was sound performance in sales for condominium buildings, which the company has focused on in recent years. The total number of condominium building installations in H1 was 2,089, with both new buildings and renewals of existing buildings performing well. According to the company, the rate of progress towards the full-year target has already reached 55%, and considering that the normal trend is for the H2 sales ratio to be higher, these actual numbers are arguably far exceeding initial targets.

On the other hand, corporate sales declined 11.7% y-o-y to ¥1,175mn, however, given that big ticket deals, including those for the airport customs and immigration facilities and for major securities companies, are concentrated in H2, there appears to be no need to view full-year targets with concern.

#### ● Card Equipment & Other Office Equipment

Segment sales were ¥1,524mn (+26.2% y-o-y), with operating profit of ¥427mn (+63.0% y-o-y). A breakdown reveals that card machine sales performed well being ¥231mn (+54.5% y-o-y), with a major regional bank and a major retail group contributing significantly. Further, other equipment sales also increased greatly to ¥196mn (+74.2% y-o-y).



## ■ Business trends

## ● Peripheral Computer Equipment

Segment sales were ¥5,282mn (+40.5% y-o-y) and operating profit ¥586mn (+59.9% y-o-y), with the core of growth coming from sales related to cutting machines for the consumer market engaged in by Silhouette, continuing the trend from the previous term. As noted above, in this type of business model, in addition to basic equipment sales, customers that buy the equipment become members, so that there are also sales of a variety of content (design etc.) to these members. While the sale the basic equipment represents a significant proportion of (overall) sales, from a profit perspective the contribution from content is significant. Moreover, as is the case with computer game manufacturers, it enables a business model whereby basic equipment sales ⇒ increased members ⇒ increased content sales ⇒ increased profits.

Silhouette's Q2 FY6/14 sales of USD26.94mn (+80.9% y-o-y) and operating profit of USD4.38mn (+95.8% y-o-y) (both) showed dramatic increases, contributing significantly to the increase in segment profits. There were sharp increases in sales of the basic equipment, consumables and content, centered on direct marketing firms such as Amazon and large specialty retailers. In particular, sales have increased significantly in line with increases in web-based members.

## ● Design

Design sales were ¥2,284mn (+6.0% y-o-y), with operating profit of ¥335mn (+5.2% y-o-y). While not particularly exceptional growth, performance was sound, supported by solid seismic capacity evaluation and related orders. In line with legislative enactments, the target for anti-earthquake measures is shifting from public facilities to large-scale private buildings, and we feel performance will be sound for the time being.

## Breakdown of Sales by Business

(Unit: ¥mn, %)

	Q2 FY6/13		Q2 FY6/14		Change	
	Amount	Ratio	Amount	Ratio	Amount	Rate
Security equipment	3,742	23.3	4,218	23.7	476	12.7
Card equipment / other office equipment	1,208	7.5	1,524	8.6	316	26.2
Maintenance service	868	5.4	879	4.9	11	1.3
Peripheral computer equipment	3,760	23.4	5,282	29.7	1,522	40.5
Measuring equipment / environmental testing devices	891	5.5	1,001	5.6	110	12.3
Design	2,155	13.4	2,284	12.8	129	6.0
Other businesses	3,455	21.5	2,625	14.7	-830	-24

## Breakdown of Operating Profit by Business

(Unit: ¥mn, %)

	Q2 FY6/13		Q2 FY6/14		Change	
	Amount	Ratio	Amount	Ratio	Amount	Rate
Security equipment	1,072	46.1	1,251	41.6	179	16.7
Card equipment / other office equipment	262	11.3	427	14.2	165	63.0
Maintenance service	90	3.9	89	3.0	-1	-1.1
Peripheral computer equipment	366	15.7	586	19.5	220	60.1
Measuring equipment / environmental testing devices	89	3.8	134	4.5	45	50.6
Design	318	13.7	335	11.1	17	5.3
Other businesses	129	5.5	185	6.2	56	43.4

## Plan to use treasury stock for M&A in the future

### (b) Financial Condition

Total assets at the end of Q2 FY6/14 were ¥35,241mn (+ ¥2,208mn compared to the previous term end). The main reasons for this were increases in current assets, namely a ¥457mn increase in cash and deposits, a ¥983mn increase in bills and accounts receivable, an increase of ¥643mn in inventories and finished product, an increase of ¥95mn in other current assets, a decline of ¥83mn in goodwill within intangible fixed assets, and an increase of ¥140mn in investment securities within investments and others assets.

Liabilities were ¥10,099mn (an increase of ¥539mn over the previous term), with the main reasons including an increase of ¥685mn in bills and accounts payable, and a decline of ¥223mn in accrued taxes payable within current liabilities as well as an increase of ¥274mn in fixed liabilities.

Net assets were ¥25,141mn (a rise of ¥1,669mn over the previous term), with the main reasons including the recording of ¥1,923mn in quarterly profit, and an increase of ¥95mn in the valuation difference on available-for-sale securities. As a result, the shareholders' equity ratio was 71.3%. Further, there are ¥4,689mn in treasury stock, with the company commenting that basically it wants to use them for future M&A.

### Balance Sheet

(Unit: ¥mn)

	FY6/13	FY6/14 Q2	Change
Cash & deposits	12,565	13,023	458
Sales and promissory notes receivable	4,706	5,690	984
Lease assets	701	770	69
Marketable securities	100	100	0
Inventories	3,229	3,873	644
Other current assets	2,029	2,493	464
<b>Current assets</b>	<b>23,768</b>	<b>25,949</b>	<b>2,181</b>
Tangible fixed assets	6,156	6,193	37
Intangible fixed assets	768	681	-87
Investments, etc.	2,339	2,416	77
<b>Fixed assets</b>	<b>9,263</b>	<b>9,291</b>	<b>28</b>
<b>Total assets</b>	<b>33,032</b>	<b>35,241</b>	<b>2,209</b>
Trade accounts and promissory notes payable	3,658	4,343	685
Taxes due	976	753	-223
Other current liabilities	1,879	2,002	123
<b>Current liabilities</b>	<b>6,832</b>	<b>7,098</b>	<b>266</b>
Fixed liabilities	2,727	3,001	274
<b>Total liabilities</b>	<b>9,560</b>	<b>10,099</b>	<b>539</b>
Shareholders' equity	23,625	25,074	1,449
Treasury stock	-4,688	-4,689	-1
Other comprehensive cumulative profit	-153	67	220
<b>Total equity</b>	<b>23,472</b>	<b>25,141</b>	<b>1,669</b>
<b>Total liabilities and equity</b>	<b>33,032</b>	<b>35,241</b>	<b>2,209</b>

## ■ Business trends

**(c) Cashflow**

As per the table below, Q2 FY6/14 quarterly cashflow showed an increase in cashflow from operating activities of ¥1,171mn, a decrease of ¥307mn in cashflow from investment activities, and a decrease of ¥534mn in cashflow from financial activities. As a result, cash and equivalents rose ¥383mn, with period-end cash and equivalents reaching ¥12,293mn.

**Summary Cash Flow Statement**

(Unit: ¥mn)

	FY6/13 Q2	FY6/14 Q2
Cash flow from operations	889	1,171
Cash flow from investments	475	-307
Cash flow from financing	-427	-534
Change in cash & cash equivalents	1,020	383
Year-end balance of cash & cash equivalents	9,804	12,923

## Sound underlying progress this term provides the potential also for outperformance

**(2) FY6/14 Forecasts**

In the FY6/14 term currently underway, the forecast calls for consolidated sales of ¥35,600mn (+9.9% y-o-y), consolidated operating profit of ¥6,000mn (+20.6% y-o-y), consolidated recurring profit of ¥6,100mn (+20.1% y-o-y), and consolidated net profit of ¥3,750mn (+26.1% y-o-y). This forecast has been revised up from the forecast at the beginning of the term (consolidated sales of ¥35,200mn, consolidated operating profit of ¥5,500mn), however, given that the company always announces forecasts where the degree of attaining the target numbers is high, and further taking into consideration also the sound state of underlying (Q2 actual results) performance, the likelihood of achieving these revised forecasts is high, and we may expect a further upward revision.

Detailed forecasts for sales and operating profit by segment are not disclosed, however, the status of the major businesses is as set out below.

**Forecast for FY6/14**

(Unit: ¥mn)

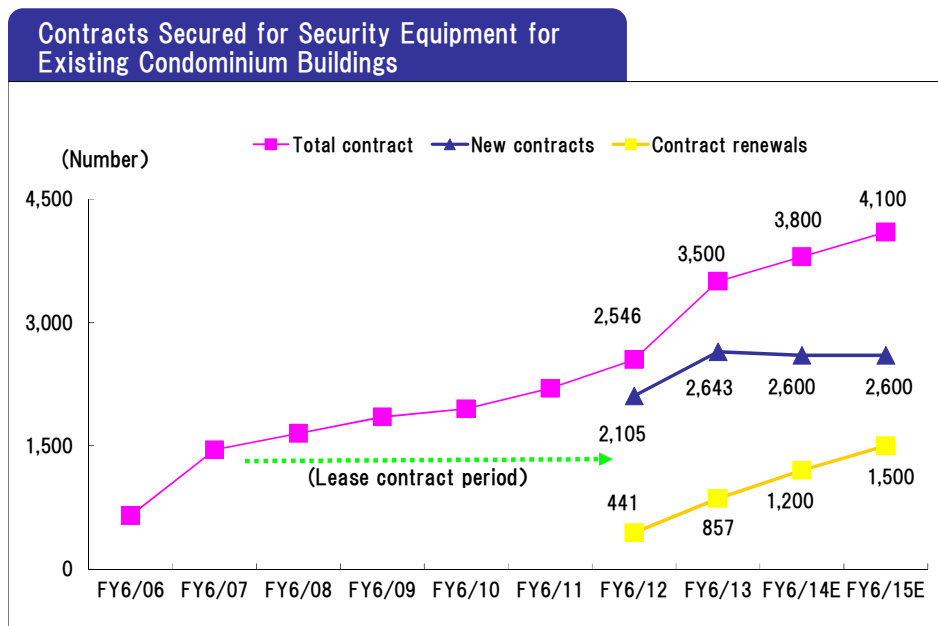
	FY6/13		Forecast FY6/14		Change	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Sales	32,389	100.0	35,600	100.0	3,211	9.9
Operating profit	4,974	15.4	6,000	16.9	1,026	20.6
Recurring profit	5,080	15.7	6,100	17.1	1,020	20.1
Net profit	2,974	9.2	3,750	10.5	776	26.1

**● Security Equipment**

Security equipment for condominium buildings remains sound. Full-year installation numbers are forecast to reach 3,800 (a rise of 300 y-o-y), with the breakdown showing the number of new buildings acquired being 2,600 (a y-o-y decline of 43 buildings) and renewals of existing buildings of 1,200 (up 343 buildings y-o-y). However, as noted above, there were already 621 existing building renewal installations in H1, and 1,468 new building installations, reaching a total number of 2,089 installations. Considering that normally the proportion of sales is higher in H2, there is a high degree of certainty in achieving the initial term forecast. Accordingly, the likelihood of sales and operating profit from this segment exceeding forecasts is high.



## Business trends



### ● Card Equipment & Other Office Equipment

This has been a business from which it has been hard to expect significant growth to date, however, recently regional banks and other firms have started to install automatic cashcard dispensing machines, and in H1 already Ai Holdings has had large-scale projects to supply them to major regional banks and retailers. Additionally, even at the megabanks, which have lagged in the introduction of automatic dispensing machines, moves have emerged for their introduction, with a decision to install them in one megabank made in January 2014 (525 units, approximately ¥300mn). The actual recording of the sales will be in the next period (after July 2014), however, the fact that the megabanks have begun to move is a tailwind for the company.

### ● Peripheral Computer Equipment

The growth core will continue to be Silhouette's cutting machines for the consumer market. Given that content and membership numbers are growing steadily and, in line with increases in basic equipment sales, the results for income from consumables and content is also growing steadily, there is a strong probability of significant growth in Silhouette's sales and operating profit.

However, on the other hand, it is expected that operating profit at Graphtec (Japan) will decline significantly for the full-year also (H1 actual results of ¥26mn, -83.2% y-o-y). The main reasons for this are increased research and development costs and investment in dies for Graphtec's new business that will be seen to take shape from next term. The result of this is that the profits from Silhouette will be partially offset, however, strong profit growth is expected from the business overall.

## ■ Business trends

## ● Design

Operating profit from the design business is forecast to be ¥765mn (+7.0% y-o-y). Demand is expected to shift from anti-earthquake measures for public facilities to anti-earthquake construction for large-scale private buildings in line with legislative enactments. However, because there is a limited number of technical staff rapid growth is not anticipated.

The forecast for the major businesses are as set out above, however, in each segment they are relatively modest, and we feel that they are forecasts (assumptions) with some leeway in them. As forecasts announced by the company always carry a high degree of certainty, there is a string possibility that the current forecasts will be exceeded and it is essential to pay attention to future trends.

## ■ Growth Prospects over the Medium- to Long-Term

### Further room for growth with security equipment focusing on condominium buildings

Ai Holdings, as noted above, is engaged mainly in 7 businesses, however, currently security equipment and peripheral computer equipment for consumers in the US (cutting machines), that Silhouette engages in, are supporting profit growth. The reason why these businesses are growing is examined below.

#### (1) Security Equipment

##### ● The Environment for the Overall Security Equipment Market

According to a survey by the Fuji Keizai Group, it is forecast that the security-related market (equipment, systems, and services) will go from an estimated ¥581.9bn in 2013 to ¥623.9bn (7.2% per annum) in 2016. Further, the market for security cameras (such as those) provided by Ai Holdings is forecast to go from an estimated ¥71.5bn in 2013 to ¥85.3bn (19.3% growth per annum) in 2016. Going forward the security camera market is forecast to continue higher growth than the overall security market for the reasons set out below.

##### ▲ Public Facilities

The majority of crimes against the person such as robberies and ride-by attacks are resolved by analyzing security camera footage, and it is expected that going forward also, most train stations, airports, function facilities and other public facilities and locations will be equipped with security cameras. Further, it is expected there will be a trend for semi-public facilities such as commercial precincts, downtown areas, parking lots, and condominium buildings to install security cameras for the same reasons.

##### ▲ Corporate Facilities

In addition to those retailers (supermarkets, convenience stores etc.) that have hitherto installed security cameras, recently, due to the impact from occurrences such as incidents at financial institutions and poisonings at food processing plants, the trend is growing for security cameras to be installed in companies (offices, factories etc.).

Previously, there were many groups and companies that hesitated in installing security cameras from a protection of privacy point of view, however, in recent years the imperative for crime prevention has become stronger, which is undoubtedly a tailwind for the company's security equipment business.

### ● Focus on Condominium Buildings

For the very reason that this security equipment market is expected to expand in this fashion, competition is fierce. One reason that the company has been able to increase sales in a market where in particular, Panasonic Corporation (6752) and Mitsubishi Electric Corporation (6503) and others are dominant, is that rather than a “shotgun sales approach”, it has engaged in marketing focusing on condominium buildings. (Of the 3,291 actual installations in the 6 months from Jul-Dec 2013, 65% were for condominium buildings.)

The reason for focusing on condominium buildings is because it was a more efficient to have a focus and utilize a salesforce that is limited relative to the major players. As noted below, given that there is considerable room to expand even within the condominium building market, Ai Holdings has succeeded by having as a core strategy the tackling of this market for the time being, rather than engaging in “shotgun marketing” in multiple markets.

### ● Potential Market

Is there still room for the condominium building security camera market, which is a key strategy for the company to expand. In a survey by Ai Holdings there were 5.9 million condominium buildings in Japan as of the end of 2012, of which 3.18 million (54%) were managed by the 14 major building management companies. Additionally, the number of body corporates managed by these 14 major management companies (with an average of 55.1 apartments), however, of these the company’s security cameras were only installed by 7,303 body corporates (14.3%). In other words, even among the body corporates managed by the 14 major management companies, there is still ample room to increase its share by taking replacement demand from competitors.

Further, it seems that there are even some body corporates managed by the 14 major management companies that have yet to install security camera systems. Also, there are many body corporates nationwide that are not managed by the 14 major management companies. Accordingly, in addition to increasing the share within the major players, by making inroads into undeveloped markets, for the next several years even the condominium building market alone will offer ample potential to increase security equipment sales, with the room for growth arguably substantial.

## Still significant room for Silhouette to expand

### (2) Silhouette (US Peripheral Computer Equipment Business)

#### ● Outline of Silhouette & Its Business Model

Currently, the main products sold by Silhouette are small-scale hobby cutting machines used in craft (priced at around ¥10,000-20,000), consumables for those products (blades, mats, pens etc.), and digital content for crafts, with Silhouette currently developing one of the largest scale digital contents business within the craft industry. The main customers are the craft market (refer below), education, and retailers.

By producing the basic equipment in China and Vietnam the retail price can be kept low. Additionally, a business model has been developed whereby customers that buy the basic equipment become members, and, in addition to a variety of consumables, a specialist website provides over 48,000 specialist cutting designs (as of March 2014), with a fee being charged corresponding to the unit price and number of downloads whenever the user buys a specialist design.

■ Growth Prospects over the Medium- to Long-Term

According to the company, compared with basic equipment sales, sales of consumables and content (downloads) carry a higher gross margin, with content services becoming the greatest source of income. Moreover, with no compatibility in formatting of the download data with the manufacturer, it creates a positive cycle whereby users that purchase the company’s basic equipment (cutting machines) continue to purchase content from the company.

● Market Size & Future Outlook

According to the US Craft & Hobby Association (CHA) the craft and hobby market in 2011 was USD30.3bn (¥3.3trillion), however, Silhouette’s target paper craft and artisanal craft market is estimated to be approximately USD6.5bn (¥650bn) in total. It is hard in Japan to imagine that paper craft market could be such an enormous hobby market, however, in the US it is an extremely popular hobby, being firmly established in the housewife bracket with craft named among travel, sports and craft as one of the three biggest hobbies.

Even now most people use scissors and cutters when cutting out paper to engage in paper craft, however, in line with the proliferation in computers, the number of people that use design content and cutting machines to undertake a higher level of paper craft is increasing year-by-year, with Silhouette being a provider of this content. Further, to date sales channels also have mainly been large direct marketing companies (mainly Amazon), however, with a specialty craft retail store chain that has more than 1,000 stores throughout the US and others commencing sales in earnest from December last year, future sales growth is expected.

It is unclear how many people within the massive USD6.5bn market as noted above will shift from the manual to the Silhouette method and how much it will grow, however, competitors have already posted actual sale of more than ¥20bn and, from reading the daily appraisals by people that have actually purchased Silhouette’s products via Amazon, there is arguably still significant room for this business to expand. The company plans for Silhouette’s FY6/16 sales to be USD109mn (approximately ¥10.9bn), with gross profit of USD52mn (approximately ¥5.2bn), which ought to be a readily achievable target.

Examples of Craft and Hobby Activity



Source: Company



## The company to start a new business from next term, with RP of ¥10bn within their sights

### (3) New Business and M&A

As with the Silhouette example above, the company is constantly exploring new businesses, including M&A, however, in this instance it has announced it will be commencing a new business from next term. A detailed briefing (announcement) regarding the particulars of the new business will be made around May 2014, however, sales forecasts for the new business have not been included at all in the current term (FY6/14). On the other hand, R&D costs for the new business of ¥160mn have already been recorded in H1, with ¥300mn for dies budgeted to be recorded in H2. While the nature of the new business is uncertain, it will bring a fresh outlook for the next term.

Another crucial factor in the company's mid- to long-term outlook is its M&A strategy. As mentioned several times already, M&A has been positioned as a key growth strategy for the company, with a policy going forward also of proactively undertaking deals which have merit. Currently there have not been any specific deals announced, and it is impossible to predict future profits from M&A, however, given that in any event it is unlikely for them to provide a negative impact on the company's income, we may look forward to what sort of deals present themselves.

The company has to date not announced numerical targets in a mid-term management plan, however, this time there has been a comment from the CEO Mr. Sasaki that "recurring profit of ¥10bn is within our sights". It was not clarified as to which fiscal term this would occur, however, if conditions such as: (1) existing businesses do not decline significantly, (2) the current growth engines, security equipment and Silhouette's operations expand steadily, and (3) a new business is added from next term, are met then there is the potential to clear this target as early as FY6/17.

## ■ Shareholder Return Policy

### A 35% dividend payout ratio provides the potential for higher dividends with outperformance in profits

Basically Ai Holdings has declared it will have a dividend payout ratio of 30-35%. Thus the annual dividend increased from ¥16 in FY6/12 to ¥20 in FY6/13, with it planned to increase again to ¥24 in FY6/14. Given the dividend payout policy, if profits exceed forecasts, there appears to be the potential for a further increase in the dividend.



### Disclaimer

FISCO Ltd. (the terms “ FISCO” , “we ” , mean FISCO Ltd.) has legal agreements with the Tokyo Stock Exchange, the Osaka Exchange, and Nikkei Inc. as to the usage of stock price and index information. The trademark and value of the “JASDAQ INDEX” are the intellectual properties of the Tokyo Stock Exchange, and therefore all rights to them belong to the Tokyo Stock Exchange.

This report is based on information that we believe to be reliable, but we do not confirm or guarantee its accuracy, timeliness, or completeness, or the value of the securities issued by companies cited in this report. Regardless of purpose, investors should decide how to use this report and take full responsibility for such use. We shall not be liable for any result of its use. We provide this report solely for the purpose of information, not to induce investment or any other action.

This report was prepared at the request of its subject company using information provided by the company in interviews, but the entire content of the report, including suppositions and conclusions, is the result of our analysis. The content of this report is based on information that was current at the time the report was produced, but this information and the content of this report are subject to change without prior notice.

All intellectual property rights to this report, including copyrights to its text and data, are held exclusively by FISCO. Any alteration or processing of the report or duplications of the report, without the express written consent of FISCO, is strictly prohibited. Any transmission, reproduction, distribution or transfer of the report or its duplications is also strictly prohibited.

The final selection of investments and determination of appropriate prices for investment transactions are decisions for the recipients of this report.