COMPANY RESEARCH AND ANALYSIS REPORT

Ainavo Holdings

7539

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Summary

Mid-sized home equipment and exterior installation company Achieved the medium-term business plan goal (¥1,900mn in operating profit)

Ainavo Holdings <7539> (hereafter, also "the Company") is a pure holding company with three consolidated subsidiaries and one non-consolidated subsidiary. Its main businesses are installations of tile, siding, and other exterior materials, installations of kitchens and various water-related equipment, and sales of building materials and home equipment. We think it is a unique company in offering a combination of installations and building materials and home equipment wholesale businesses. While the Company primarily supplies these services to smaller general contractors and building firms, it also receives installation orders from major general contractors. Strict fund collection management and project progress management have enabled the Company to accumulate abundant net cash (cash/deposits – loans) totaling ¥7,972mn (as of the end of 2Q FY9/18) and cultivate a robust balance sheet.

1. Overview of results through 2Q FY9/18

The Company reported ¥32,972mn in net sales (+1.5% YoY), ¥998mn in operating profit (-32.0%), ¥1,093mn in recurring profit (-30.2%), and ¥691mn in quarterly net profit attributable to parent owners (-29.3%) in 2Q FY9/18. Operating profit fell sharply on weaker sales than the internal target, a 1.0ppt decline in gross margin because of the impact of transitioning to a new system and other factors, and a 6.6% rise in SG&A expenses. By segment, while standalone homes business profit dropped 11.0% YoY, large properties business profit declined 48.3%, weighing heavily on overall earnings, including difficulties at subsidiary OnchoGiken Co., Ltd.

2. FY9/18 outlook: Unchanged from the period-start stance, though not easily attained

The Company expects roughly flat results YoY in FY9/18 at ¥64,970mn in net sales (+4.0%), ¥1,910mn in operating profit (-0.2%), ¥2,100mn in recurring profit (-0.1%), and ¥1,340mn in net profit attributable to parent shareholders (+0.1%), retaining its period-start outlook. While these are not easily attainable levels because of weakness in 1H results, internal factors were mainly responsible for the sluggishness. We think full-year targets are still within reach if the Company makes necessary improvements.

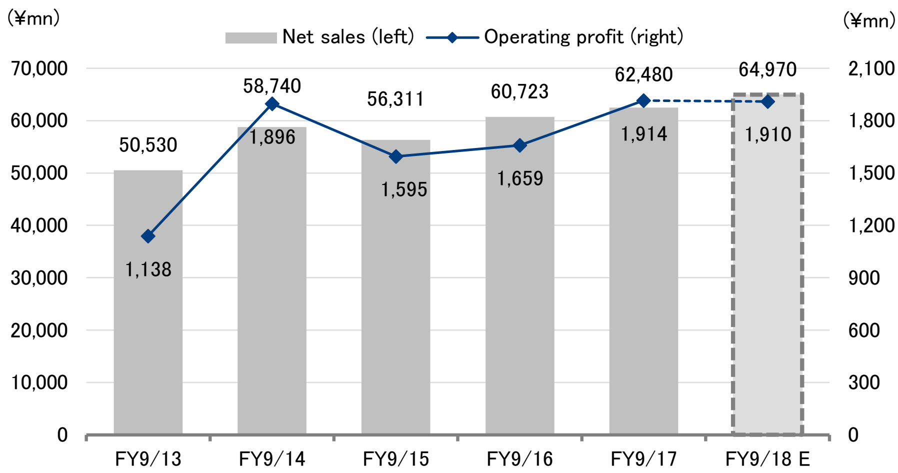
3. Medium-term business plan goals (FY9/19): Operating profit already reached the goal once, but sales are lagging

The Company previously announced a medium-term business plan that lasts through FY9/19, with numerical goals of ¥70,000mn in sales, ¥1,900mn in operating profit, and a 2.7% operating margin. While it already attained operating profit and margin goals in FY9/17, earnings slipped in 1H FY9/19. Sales have not reached the goal yet. Given these trends, the Company retained medium-term plan goals at this stage. In shareholder return, the Company targets a 30% payout ratio, but the FY9/18 dividend outlook only puts this ratio at 25.9%. There might be a dividend hike depending on actual earnings. The main aim for now, however, is reaching the profit goal.

Key Points

- Main businesses are exterior and home equipment installations and building materials; possesses a sturdy financial base thanks to reinforced management
- Targeting flat profits in FY9/18, though faces a challenge after 1H results
- Medium-term business plan goals (FY9/19): Operating profit already reached the goal (¥1,900mn) once, but sales are lagging

Results trends



Source: Prepared by FISCO from the Company's financial results

Business overview

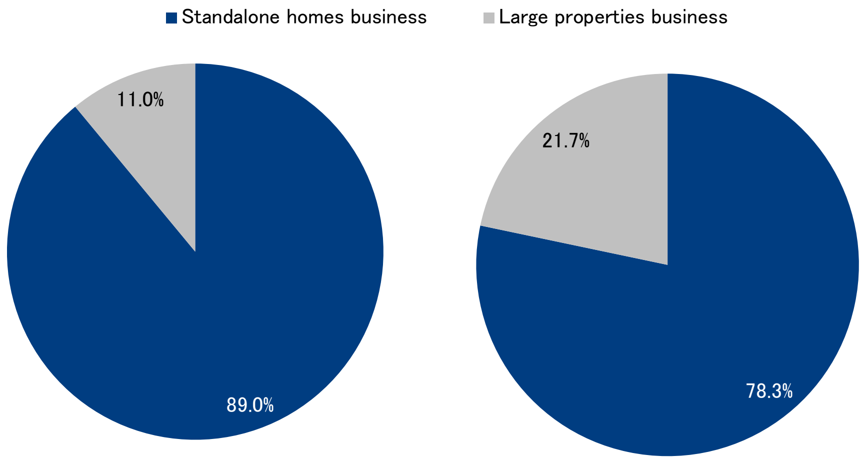
Mainly installs tile, siding, and other exterior materials and home equipment
Possesses a sturdy financial base thanks to reinforced management

1. Description of business

Ainavo Holdings, a pure holding company, has three consolidated subsidiaries and one non-consolidated subsidiary in its group as of the end of September 2017. The company's business segments are standalone homes and large properties, and segment results in FY9/17 were ¥55,621mn for standalone homes (89.0% of overall sales) and ¥6,858mn for large properties (11.0%) in sales, and ¥2,129mn and ¥590mn, respectively, in operating profit. However, the Company simply splits these segments by the relative size of customers (in terms of orders value) and actual content of business activities is the same. The former primarily covers installations for ordinary homes with orders obtained from smaller general contractors and ordinary building firms, while the latter mainly reflects orders from large general contractors and other major customers.

Net sales by business segment
(FY9/17: ¥62,480mn)

Operating profit business segment
(FY9/17: ¥2,719mn)



Note: Segment operating profit prior to companywide adjustments
Source: Prepared by FISCO from the Company's financial results

The standalone homes business breaks down further into sub-segments of exterior wall installations, home equipment installations, building materials and related products sales, and home equipment sales, and the large properties business consists of tile installations and home equipment installations. Sub-segment shares of overall sales (FY9/17) as shown below are 22.7% for exterior wall installations, 40.8% for home equipment installations, 14.9% for building materials sales, and 10.6% for home equipment sales under the large standalone homes business and 4.1% for tile installations and 6.8% for home equipment installations under the large properties business.

2. Overview of segments and sub-segments

(1) Standalone homes business

These orders primarily come from local smaller general contractors and builders and home manufacturers and related builders.* The Company does not receive many orders directly from the party conducting the project.

* Sales of tile materials and home equipment related to installation projects are booked under the respective installation segments.

a) Exterior wall installations

This business handles installations of interior and exterior tiles, floor tiles, and exteriors for ordinary homes, small condominiums, and stores. It supports not only tiles, but also sidings and other materials.

b) Home equipment installations

This business covers renovation installations (including kitchens as well as bath, toilet, and other water-related systems) and solar power generation system installations. While orders are fundamentally separate from exterior wall installations, they are received jointly in some cases. The Company is one of the industry's largest firms for bathroom installations with roughly 20,000 projects per year.

c) Building materials sales

This sub-segment handles wholesale transactions for various building materials used in ordinary homes, stores, and smaller condominiums. Tile building material sales volume is relatively large. Its primary sales destinations are building firms and local homebuilders, and Ainavo does not sell to secondary wholesale firms.

d) Home equipment sales

The Company sells home equipment to building firms and local homebuilders.

(2) Large properties business

Business content is the same as the standalone homes business, but the Company books installations at large properties (buildings, condominiums, and others) for major general contractors in this segment. It receives a relatively large amount of orders from Obayashi <1802>, Konoike, and Haseko Corporation <1808>.

a) Tile installations

Interior and exterior tiles, floor tiles, stone material installations

b) Home equipment installations

Kitchens and other home equipment and air-conditioning equipment installations mainly for buildings and condominium buildings.

3. Main procurement and sales counterparts

The Company has roughly 7,000 customers, including major general contractors. Collection of accounts receivables is a key point in business operations, as explained below, because these customers are not always active and value per project varies significantly from a few million yen to over ¥100mn.

LIXIL Group <5938> is the primary procurement source for construction materials and home equipment, and the Company also purchases extensively from TOTO <5332>, Rinnai <5947>, Cleanup <7955>, and Daiken <7905>.

While the Company has about 2,000 subcontractors (large and small) handling projects, roughly half of the subcontractors work exclusively with the Company and the two sides sustain longstanding trust relationships thanks to support from the insurance framework described below.

4. Competition, features, and strengths

Many companies are involved in exterior wall installations or selling building materials and home equipment, and the Company faces numerous rivals in its various areas of business. While it is not easy to find a clear rival as an overall business, the most likely competitors are Koizumi and Watanabe Pipe. However, rivals are declining for exterior wall installations due to the downward trend in the number of contractors in recent years. The Company promotes differentiation with rivals in the current environment leveraging the following features.

One of the Company's unique features is the comprehensive skills training center where it provides training in highly specialized skills for its numerous subcontractors. The Company is capable of supporting a variety of project types because it implements training. The skills center also inspects whether project work is taking place properly at various sites once every half year and reduces discrepancies in completed work due to individual differences through this process.

Another feature is the role of its own insurance program. The Company charges subcontractors 0.2% of transaction value and pools the funds in a cooperative association for use to cover income for one week if a subcontractor (worker) is unable to work due to an accident. This program strengthens the trust relationship between the Company and subcontractors and also boosts the retention rate for skilled workers and precision of finished work.

While it is normal for companies to implement sales management, cost management, and project process management, the Company also carefully conducts billing management, deposit management, and uncollected fund management. Specifically, it manages procurement and sales for each project on an individual-line basis, even with small amounts, and applies the management (checks) to not only the income statement, but also the balance sheet. The ability to assess this type of balance-sheet management while monitoring project progress is important and not simple. There have been numerous cases in recent years of other firms in the business of selling building materials entering the installations business, though many rivals later exit the installations portion due to the difficulty (inefficiency) of unpaid funds management. This aspect serves as a “hidden barrier to entry,” and the Company’s ability to manage it is an important strength. These efforts have enabled the Company to accumulate abundant net cash (cash/deposits – loans) totaling ¥7,972mn (as of the end of 2Q FY9/18) and cultivate a robust balance sheet.

Results trends

Operating profit dropped by double digits in FY9/18 due to weaker gross margin and higher spending

1. Results through 2Q FY9/18

(1) Status of profit and loss

The Company reported ¥32,972mn in net sales (+1.5% YoY), ¥998mn in operating profit (-32.0%), ¥1,093mn in recurring profit (-30.2%), and ¥691mn in quarterly net profit attributable to parent owners (-29.3%) in 2Q FY9/18. Operating profit fell sharply on weaker sales than the internal target, a 1.0ppt decline in gross margin because of the impact of transitioning to a new system and other factors, and a 6.6% rise in SG&A expenses. By segment, while standalone homes business profit dropped 11.0% YoY, large properties business profit declined 48.3%, weighing heavily on overall earnings, including difficulties at subsidiary OnchoGiken Co., Ltd.

Breakdown of operating profit changes shows a ¥52mn boost from higher sales that is more than offset by setbacks of ¥153mn in additional costs related to system renewal, ¥310mn on lower gross margin (1.0ppt), and ¥58mn from increase in other SG&A expenses. Operating profit hence fell ¥470mn YoY.

Overview of results through 2Q FY9/18

(¥mn, %)

	2Q FY9/17		2Q FY9/18		
	Value	Share of total value	Results	Share of total value	YoY change
Net sales	32,491	100.0	32,972	100.0	1.5
Gross profit	4,687	14.4	4,429	13.4	-5.5
SG&A expenses	3,218	9.9	3,430	10.4	6.6
Operating profit	1,468	4.5	998	3.0	-32.0
Recurring profit	1,567	4.8	1,093	3.3	-30.2
Quarterly net profit attributable to parent shareholders	978	3.0	691	2.1	-29.3

Source: Prepared by FISCO from the Company's financial results

(2) Status by business segment

Below we review trends by segments and sub-segments.

a) Standalone homes business

Standalone homes business posted ¥29,702mn in net sales (+1.7% YoY) and ¥1,350mn in profit (-11.0%). Sub-segment sales were exterior wall installations at ¥7,930mn (+3.9% YoY; +¥295mn), home equipment installations at ¥11,064mn (-16.1%; -¥2,119mn), building materials sales at ¥5,572mn (+13.9%; +¥682mn), and home equipment sales at ¥5,134mn (+46.4%; +¥1,629mn). These values incorporate impact of redefining home equipment installations and home equipment sales categories from FY9/18. Sub-segment sales movements excluding the revisions were exterior wall installations at +¥356mn, home equipment installations at -¥272mn, building materials sales at +¥73mn, and home equipment sales at +¥329mn.

In both cases, segment sales faced considerable pressure from decline in home equipment installations business. Gross margin moved lower on insufficient control of production costs due to looser procurement activity accompanying the transition to a new system. In spending, logistics and disposal costs grew more than anticipated. Segment profit hence booked a double-digit decline.

b) Large properties business

Large properties business recorded ¥3,269mn in net sales (-0.2% YoY) and ¥176mn in profit (-48.3%). Sub-segment sales were tile installations at ¥1,273mn (+7.5%) and home equipment installations at ¥1,996mn (-4.5%). Segment profit fell substantially on non-recurrence of reserve reversals booked in FY9/17 (about ¥100mn) and sluggish results at OnchoGiken, a subsidiary that handles air-conditioning installations and renewal projects in relatively large buildings.

Results by segment

(¥mn, %)

	2Q FY9/17		2Q FY9/18			
	Value	Share of total value	Value	Share of total value	Change in value	Change rate
Net sales	32,491	100.0	32,972	100.0	481	1.5
Standalone homes business	29,215	89.9	29,702	90.1	486	1.7
Exterior wall installations	7,635	23.5	7,930	24.1	295	3.9
Home equipment installations	13,183	40.6	11,064	33.6	-2,119	-16.1
Building materials sales	4,890	15.1	5,572	16.9	682	13.9
Home equipment sales	3,505	10.8	5,134	15.6	1,629	46.4
Large properties business	3,275	10.1	3,269	9.9	-5	-0.2
Tile installations	1,183	3.6	1,273	3.9	90	7.5
Home equipment installations	2,091	6.4	1,996	6.1	-95	-4.5
Operating profit	1,468	4.5	998	3.0	-470	-32.0
Standalone homes business	1,517	-	1,350	-	-167	-11.0
Large properties business	341	-	176	-	-165	-48.3
(Adjustments)	-390	-	-528	-	-	-

Source: Prepared by FISCO from the Company's financial results and results briefing materials

(3) Update on progress with priority issues

Below we review progress in areas that the Company has earmarked as "priority issues."

Progress with priority issues

(¥mn)

	Siding	Siding pre-cut (buildings)	Lumber building materials	Sashes
2Q FY9/17	1,392	264	645	988
2Q FY9/18	1,473	319	737	1,051
YoY	105.8%	120.8%	114.3%	106.4%
FY9/18 targets	3,650	1,000	1,840	3,000
Progress rate	40.4%	31.9%	40.1%	35.0%

Source: Prepared by FISCO from the Company's results briefing materials

Looking at the situation with priority issues for individual products, while sales climbed YoY in all products, fulfillment rates are not very high. However, the fulfillment rates reflect progress toward internal goals set by the Company itself and shortfalls are not an immediate cause for concern.

Progress with priority issues

(¥mn)

	Brand business		ZEH/zero energy/ certified homes (units)	New customer development	
	Maristo (tiles)	Artis (unit bathrooms)		Value (¥mn)	Number of units
2Q FY9/17	870	195	-	334	316
2Q FY9/18	811	75	16	166	314
YoY	93.2%	38.4%	-	49.6%	99.4%
FY9/18 targets	1,660	374	200	1,650	700
Progress rate	48.8%	20.0%	8.0%	10.0%	44.9%

Source: Prepared by FISCO from the Company's results briefing materials

In priority areas, fulfillment rates are also not that high, though shortfalls should not immediately weigh on income results because these are based on internal goals, similar to the products breakdown. Development of new customers, however, is an important indicator because it leads to future sales gains. In 1H results, volume was reasonable, but sales value dropped substantially and this means smaller orders per deal. We think it is necessary to closely monitor these trends.

Sturdy financial base with surplus net cash of ¥7,900mn

2. Financial condition

We review financial conditions as of end-2Q FY9/18. Current assets totaled ¥25,071mn (up ¥292mn from the end of FY9/17). Key item trends were cash and deposits down ¥1,037mn, notes receivable and unpaid funds on finished projects up ¥1,505mn, and unfinished project spending up ¥26mn. Fixed assets totaled ¥8,504mn (up ¥287mn), including tangible fixed assets at ¥5,674mn (down ¥24mn), intangible fixed assets at ¥788mn (up ¥111mn), and investments and other assets at ¥2,042mn (up ¥201mn). Total assets hence climbed ¥579mn to ¥33,576mn.

Current liabilities totaled ¥13,441mn (up ¥134mn) with the main changes as increases of ¥500mn for notes payables and unpaid project costs and ¥100mn for unpaid factoring. Fixed liabilities declined ¥20mn to ¥1,375mn. As a result, total liabilities were ¥14,816mn (up ¥113mn). Net assets amounted to ¥18,760mn (up ¥466mn), mainly on a ¥472mn gain in surplus profit from booking quarterly net profit attributable to parent shareholders.

The Company possesses a sturdy financial base with extensive surplus net cash (cash and deposits – loans) at ¥7,972mn as of end-2Q FY9/18 with ¥8,602mn in cash and deposits versus ¥630mn in total loans (long-term + short-term loans).

Consolidated balance sheet

(¥mn)

	End-FY9/17	End-2Q FY9/18	Change in value
Cash and deposits	9,639	8,602	-1,037
Notes receivables and finished project unpaid funds	12,275	13,780	1,505
Unfinished project spending	1,521	1,548	26
Current assets (total)	24,779	25,071	292
Tangible fixed assets	5,698	5,674	-24
Intangible fixed assets	677	788	111
Goodwill	362	340	-22
Investments and other assets	1,841	2,042	201
Fixed assets (total)	8,217	8,504	287
Assets (total)	32,996	33,576	579
Notes payables and unpaid amounts	6,456	6,956	500
Unpaid factoring	3,730	3,830	100
Current liabilities (total)	13,307	13,441	134
Long-term loans	222	215	-7
Fixed liabilities (total)	1,395	1,375	-20
Liabilities (total)	14,703	14,816	113
Net assets	18,293	18,760	466

Source: Prepared by FISCO from the Company's financial results

3. Cash flow situation

We review the cash flow situation as of the end of 2Q FY9/18. Cash flow from operating activities totaled a net deficit of ¥579mn. Main income sources were ¥1,093mn in quarterly net profit prior to taxes and other adjustments and ¥574mn from a rise in procurement liabilities, while main outflows were ¥1,422mn from a rise in sales credits. Cash flow from investing activities totaled a net deficit of ¥426mn. Main outflows were ¥137mn from purchase of intangible fixed assets and ¥249mn from acquisition of investment securities (net). Cash flow from financing activities totaled a net deficit of ¥31mn, mainly due to inflows of ¥193mn from a net increase in short-term and long-term loans and outflows of ¥219mn from dividend payments. These trends resulted in a decrease of ¥1,037mn in cash and cash equivalents during the period to an end-quarter balance of ¥8,602mn.

Consolidated cash flow statement

(¥mn)

	2Q FY9/17	2Q FY9/18
Cash flow from operating activities	913	-579
Quarterly net profit prior to taxes and other adjustments	1,561	1,093
Change in sales credits (- is an increase)	-1,345	-1,422
Change in inventories (- is an increase)	110	23
Change in procurement liabilities (- is a decline)	1,076	574
Cash flow from investing activities	-65	-426
Income from fixed-term deposit returns	300	-
Purchase of intangible fixed assets	-134	-137
Outflow from deposits to fixed-term deposits Acquisition of investment securities (net)	-187	-249
Cash flow from financing activities	135	-31
Net change in short-term loans (- is a decline)	293	193
Dividend payments	-150	-219
Change in cash and cash equivalents (- is a decline)	983	-1,037
Quarter-end cash and cash equivalents balance	9,349	8,602

Business outlook

FY9/18 outlook unchanged from the period-start stance, though not easily attained

● FY9/18 outlook

The Company expects ¥64,970mn in net sales (+4.0%), ¥1,910mn in operating profit (-0.2%), ¥2,100mn in recurring profit (-0.1%), and ¥1,340mn in net profit attributable to parent shareholders (+0.1%) in FY9/18. It retained period-start levels.

Nevertheless, it is likely to be difficult to reach targets in light of modest sluggishness in 1H results, as explained above. Because internal factors contributed much of the 1H weakness, the Company might improve profit margin by resolving these matters and the plan hence is not totally out of reach. We expect standalone homes business to fuel overall results from a segment perspective.

Overview of the FY9/18 forecast

(¥mn, %)

	FY9/17		FY9/18 (E)		
	Value	Share of total value	Value	Share of total value	YoY change
Net sales	62,480	100.0	64,970	100.0	4.0
Standalone homes business	55,621	89.0	58,210	89.6	4.7
Large properties business	6,858	11.0	6,760	10.4	-1.4
Operating profit	1,914	3.1	1,910	2.9	-0.2
Recurring profit	2,101	3.4	2,100	3.2	-0.1
Net profit attributable to parent shareholders	1,338	2.1	1,340	2.1	0.1

Source: Prepared by FISCO from the Company's results briefing materials

The Company's segment sales targets are ¥58,210mn in standalone homes business (+4.7% YoY) and ¥6,760mn in large properties business (-1.4%). It expects ¥1,550mn in operating profit (vs. ¥1,442mn in the previous year) at core subsidiary Avelco Co., Ltd. and ¥160mn at INTELGROW Corporation (+¥133mn), but just ¥160mn at OnchoGiken (-¥215mn) due to relatively upbeat results in FY9/17 and delays in some deals.

Medium- to long-term growth strategy

Already attained the medium-term plan goal (¥1,900mn in FY9/19 operating profit), making another challenge

● Currently implementing five priority measures to reach the medium-term plan goal

The Company announced a medium-term business plan that lasts through FY9/19, following realization of previous medium-term plan goals in FY9/16, with numerical goals of ¥70,000mn in sales, ¥1,900mn in operating profit, and a 2.7% operating margin. It intends to take action on the five points listed below as priorities in order to attain the goals. This stance is unchanged from the initial announcement.

(1) Build new business pillars to deal with changes in the market environment
Promote ZEH (solar panels, exterior, and sashes) responses at group companies

(2) Quickly realize group synergies
Regional expansion strategy to address shrinkage of the domestic market

(3) Conduct strategic decision-making in group management
Reorganization, efficient investments, and dealing with common group issues

(4) Enhance support capabilities for group companies
Improved responsiveness to national policies and better business efficiency (develop a new core system and leverage Avelco Vietnam)

(5) Strategically utilize human resources
Recruit and train human resources and promote horizontal interactions

In fact, the Company already reached the medium-term business plan's operating profit goal (¥1,900mn in operating profit) in FY9/17. Nevertheless, it is pursuing the goal again in FY9/18 and FY3/19 after modest sluggishness in recent earnings as explained earlier. It is likely to begin preparation of the next medium-term business plan once visibility of achieving the goal has been obtained.

Shareholder return policy

Sustaining a stable dividend with a payout ratio target of 30%

The Company fundamentally aims for a 30% dividend payout ratio as its shareholder return policy. The FY9/18 ratio works out to 25.9% using the current earnings forecast and ¥30 target. We think uncertainty whether net profit attains the FY9/18 goal is likely to postpone the possibility of a dividend hike until at least next fiscal year. However, the Company states that it wants to maintain a stable dividend payout ratio of 30% and this implies a hike depending on profit results.

Disclaimer