COMPANY RESEARCH AND ANALYSIS REPORT

Ainavo Holdings

7539

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Summary

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

Ainavo Holdings <7539> (hereafter, also "the Company") is a pure holding company with four 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 ¥8,286mn (as of the end of 2Q FY9/19) and cultivate a robust balance sheet.

1. Overview of results through 2Q FY9/19: Operating profit increased 54.9% YoY due to the improvement in gross margin

The Company reported ¥35,597mn in net sales (+8.0% YoY), ¥1,547mn in operating profit (+54.9%), ¥1,684mn in recurring profit (+54.0%), and ¥1,017mn in net profit attributable to parent owners (+47.1%) in 1H FY9/19. Operating profit rose significantly due to the combination of solid sales, a 1.2 ppt improvement in gross margin, and SG&A expenses being kept within the forecasted range. Still, the weak results in the prior year was one reason for the large increase in operating profit. Both segments saw an increase in profits, as profit in the standalone homes business increased 28.3% YoY, while the profit in the large properties business increased 44.7% YoY.

2. FY9/19 outlook: Forecasting a 21.3% YoY increase in operating profit

For FY9/19, the Company is forecasting net sales of ¥69,800mn (+10.4% YoY), operating profit of ¥1,850mn (+21.3%), recurring profit of ¥2,060mn (+20.5%) and net profit attributable to parent owners of ¥1,290mn (+15.9%). These forecasts are unchanged from those made at the start of the fiscal year. Based on the fact that the Company posted operating profit of ¥1,547mn in 1H, these forecast values will almost certainly be reached. The question is to what extent the forecasts will be revised upwards.

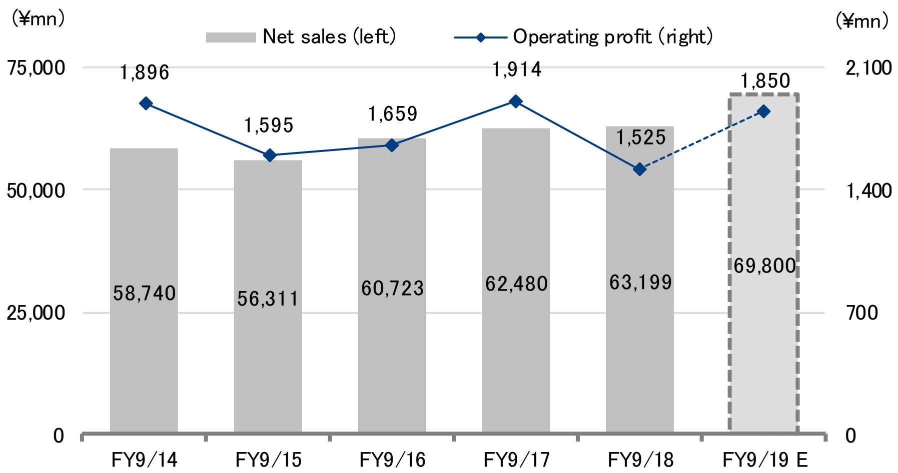
3. Medium-term business plan goals (FY9/19): Operating profit already reached the goal once, now taking on another challenge

The Company previously announced a medium-term business plan that runs through FY9/19, with numerical targets of ¥70,000mn in sales, ¥1,900mn in operating profit, and a 2.7% operating margin. While the Company reached the operating profit and operating margin targets in FY9/17, profits declined in FY9/18, so the Company is pursuing these targets once again. Based on the current situation, it is practically given that the targets will be reached in FY9/19. We expect the Company to announce a new medium-term business plan during FY9/20. The Company will likely target net sales of 100,000mn, which is a high level. In shareholder returns, the Company targets a 30% payout ratio, and for FY9/19 the Company will maintain an annual dividend of ¥32 (forecast payout ratio of 28.7%), but the Company may hike its dividend depending on the operating results.

Key Points

- Main businesses are exterior and home equipment installations and sales of building materials; possesses a sturdy financial base thanks to reinforced management
- The industry environment does not warrant optimism, but the Company aims for a 21.3% YoY increase in operating profit in FY9/19
- Achieving the medium-term business plan target (FY9/19 operating profit of ¥1,900mn) is almost of certainty

Results trends



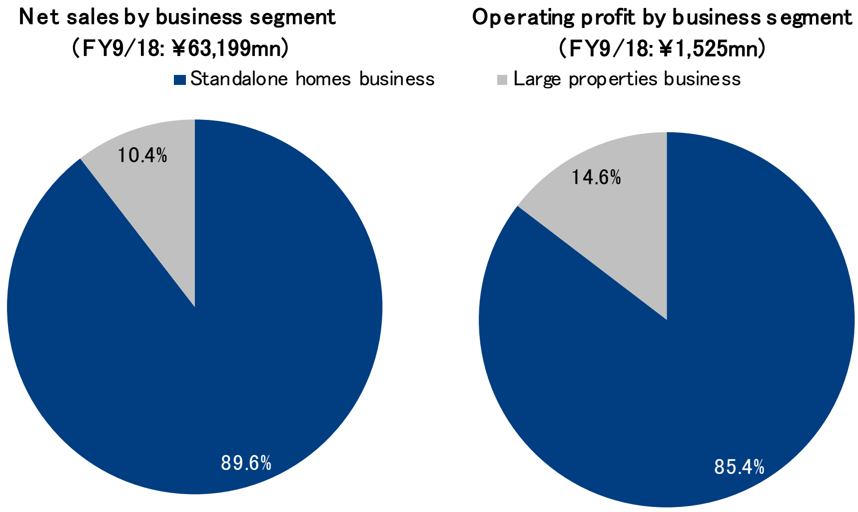
Source: Prepared by FISCO from the Company's financial results

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 FY9/18. The company's business segments are standalone homes and large properties, and segment results in FY9/18 were ¥56,597mn for standalone homes (89.6% of overall sales) and ¥6,601mn for large properties (10.4%) in sales, and ¥2,180mn and ¥373mn, 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 almost 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.



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 (FY9/18) as shown below are 23.3% for exterior wall installations, 29.9% for home equipment installations, 18.4% for building materials sales, and 18.0% for home equipment sales under the large standalone homes business and 4.0% for tile installations and 6.5% 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 almost 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 collects part of subcontractors' turnover 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 ¥8,286 (as of the end of 2Q FY9/19) and cultivate a robust balance sheet.

Results trends

Operating profit significantly increased 54.9% YoY in 2Q FY9/19 due to higher gross margin and expense control

1. Results through 2Q FY9/19

(1) Status of profit and loss

In 1H FY9/19, the Company reported ¥35,597mn in net sales (+8.0% YoY), ¥1,547mn in operating profit (+54.9%), ¥1,684mn in recurring profit (+54.0%), and ¥1,017mn in net profit attributable to parent owners (+47.1%). Operating profit rose significantly on solid sales, a 1.2 ppt improvement in gross margin and the fact that SG&A expenses were kept within the forecasted range. Still, weak results in the previous fiscal year were one reason for the large increase in operating profit. Both segments saw an increase in profits, as profit in the standalone homes business increased 28.3% YoY, while profit in the large properties business increased 44.7% YoY.

The improvement in gross margin (+1.2 ppt) was responsible drove a ¥411mn increase in operating profit, the increase in net sales boosted operating profit by ¥107mn, while new consolidation (Imamura) had a ¥72mn positive impact on operating profit. On the other hand, the increase in SG&A expenses had a ¥41mn negative impact. As a result, operating profit increased ¥548mn YoY.

Overview of results through 2Q FY9/19

(¥mn, %)

	2Q FY9/18		2Q FY9/19		
	Value	Share of total value	Value	Share of total value	YoY change
Net sales	32,972	100.0	35,597	100.0	8.0
Gross profit	4,429	13.4	5,211	14.6	17.7
SG&A expenses	3,430	10.4	3,664	10.3	6.8
Operating profit	998	3.0	1,547	4.3	54.9
Recurring profit	1,093	3.3	1,684	4.7	54.0
Quarterly net profit attributable to parent shareholders	691	2.1	1,017	2.9	47.1

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 ¥30,642mn in net sales (+3.2% YoY) and ¥1,732mn in profit (+28.3%). Sub-segment sales were exterior wall installations at ¥7,390mn (-6.2% YoY, home equipment installations at ¥9,068mn (-18.4%), building materials sales at ¥7,423mn (+33.2%), and home equipment sales at ¥6,760mn (+31.7%).

In conjunction with the system change from January 2018, sash sales have been moved from home equipment sales to building materials sales, and sales of delivered to the sites involving construction have been moved from home equipment installations to home equipment sales. The decrease in revenue in-home equipment sales and the increase in revenue in building materials sales were due to these reclassifications, not a deterioration in business activity. In the same period of the previous year, the gross margin declined due to looser procurement and weaker cost management with the transition to the new system, but this effect disappeared. Expenses were in the expected range, as logistics and disposal costs increased within the expected range, while there were delays in personnel hiring which had been budgeted for. As a result, segment profit increased 28.3% YoY.

b) Large properties business

The large properties business recorded ¥4,954mn in net sales (+51.5% YoY) and ¥432mn in profit (+44.7%). In subsegments, net sales for tile installations was ¥2,122mn (+65.4%) and net sales for home equipment installations was ¥2,831mn (+42.5%). The increase in segment profit was mainly due to strong performance in tile installations as well as air-conditioning installations for government and municipal offices.

Results by segment

(¥mn, %)

	2Q FY9/18		2Q FY9/19			
	Value	Share of total value	Value	Share of total value	Change in value	Change rate
Net sales	32,972	100.0	35,597	100.0	2,625	8.0
Standalone homes business	29,702	90.1	30,642	86.1	940	3.2
Exterior wall installations	7,879	23.9	7,390	20.8	-489	-6.2
Home equipment installations	11,115	33.7	9,068	25.5	-2,046	-18.4
Building materials sales	5,572	16.9	7,423	20.9	1,850	33.2
Home equipment sales	5,134	15.6	6,760	19.0	1,626	31.7
Large properties business	3,269	9.9	4,954	13.9	1,684	51.5
Tile installations	1,283	3.9	2,122	6.0	839	65.4
Home equipment installations	1,986	6.0	2,831	8.0	845	42.5
Operating profit	998	3.0	1,547	4.3	548	54.9
Standalone homes business	1,350	-	1,732	-	381	28.3
Large properties business	176	-	432	-	255	144.7
(Adjustments)	-528	-	-617	-	-	-

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 FY9/19	1,539	376	649	961
FY9/19 targets	3,990	1,000	1,800	3,500
Progress rate	38.6%	37.6%	36.0%	27.5%

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

Progress with priority issues

	Brand business		ZEH/zero energy/ certified homes (units)	New customer development	
	Maristo (tiles) (¥mn)	Artis (unit bathrooms) (¥mn)		Value (¥mn)	Number of units (units)
2Q FY9/19	904	85	15	277	289
FY9/19 targets	1,770	345	200	1,650	610
Progress rate	51.0%	24.6%	7.5%	16.8%	47.4%

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

In looking at priority issues, achievement rates for net sales of Maristo (tiles) and the number of new customers were decent, but achievement rates in other priority areas were not as good. However, these achievement rates are only comparisons with the Company’s own internal targets, and shortfalls should not immediately be causes for concern. The achievement rate for ZEH/zero energy/certified homes is quite low, but highly skilled workers are needed to install these properly, so execution is not so simple. Both government and industry have started to understand this reality, and there is a possibility that guidelines and the market themselves will change going forward.

Stable financial base. Surplus net cash of ¥8,200mn

2. Financial condition

We review financial conditions as of end-2Q FY9/19. Current assets totaled ¥27,168mn (+¥2,992mn from the end of FY9/18). Key item trends were cash and deposits down ¥642mn, notes receivable and unpaid funds on finished projects up ¥2,962mn, and unfinished project spending up ¥375mn. Fixed assets totaled ¥8,978mn (+¥549mn), including tangible fixed assets at ¥5,762mn (+¥231mn), intangible fixed assets at ¥734mn (-¥19mn), and investments and other assets at ¥2,481mn (+¥336mn). Total assets hence climbed ¥3,541mn to ¥36,146mn.

Current liabilities totaled ¥14,949mn (+¥2,796mn) with the main changes as increases of ¥1,541mn for notes payables and unpaid project costs and ¥463mn for unpaid factoring. Fixed liabilities declined ¥1mn to ¥1,396mn. As a result, total liabilities were ¥16,346mn (+¥2,794mn). Net assets amounted to ¥19,800mn (+¥747mn), mainly on a ¥844mn 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 ¥8,286mn as of end-2Q FY9/19 with ¥9,051mn in cash and deposits versus ¥765mn in total loans (long-term + short-term loans).

Consolidated balance sheet

(¥mn)

	End-FY9/18	End-2Q FY9/19	Change in value
Cash and deposits	9,693	9,051	-642
Notes receivables and finished project unpaid funds	12,192	15,155	2,962
Unfinished project spending	1,355	1,712	357
Current assets (total)	24,175	27,168	2,992
Tangible fixed assets	5,530	5,762	231
Intangible fixed assets	753	734	-19
Goodwill	317	294	-22
Investments and other assets	2,144	2,481	336
Fixed assets (total)	8,429	8,978	549
Assets (total)	32,604	36,146	3,541
Notes payables and unpaid amounts	6,090	7,631	1,541
Unpaid factoring	3,456	3,919	463
Current liabilities (total)	12,153	14,949	2,796
Long-term loans	206	198	-7
Fixed liabilities (total)	1,398	1,396	-1
Liabilities (total)	13,552	16,346	2,794
Net assets	19,052	19,800	747

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

Business outlook

The Company's forecasts for FY9/19 are unchanged from the outlook at the start of the fiscal year, but upward revisions are highly likely

● FY9/19 outlook

For FY9/19, the Company is forecasting double-digit increases in net sales and profit, expecting net sales of ¥69,800mn (+10.4% YoY), operating profit of ¥1,850mn (+21.3%), recurring profit of ¥2,060mn (+20.5%) and net profit attributable to parent shareholders of ¥1,290mn (+15.9%). Imamura became a consolidated subsidiary during FY9/19, and the above forecasts include net sales of ¥4,000mn from Imamura, but no profits from Imamura are expected.

Overview of the FY9/19 forecast

(¥mn, %)

	FY9/18		FY9/19 E		
	Value	Share of total value	Value	Share of total value	YoY change
Net sales	63,199	100.0	69,800	100.0	10.4
Standalone homes business	56,597	89.6	62,800	90.0	11.0
Large properties business	6,601	10.4	7,000	10.0	6.0
Operating profit	1,525	2.4	1,850	2.7	21.3
Recurring profit	1,709	2.7	2,060	3.0	20.5
Net profit attributable to parent shareholders	1,113	-	1,290	1.8	15.9

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

The Company's segment sales forecasts are ¥62,800mn (+11.0% YoY) in the standalone homes business and ¥7,000mn (+6.0%) in the large properties business. It expects ¥1,450mn in operating profit (vs. ¥1,174mn in the previous year) at core subsidiary Avelco Co., Ltd. and ¥200mn at INTELGROW Corporation (¥136mn in the previous year), and ¥350mn at OnchoGiken (¥214mn in the previous year). The Company is forecasting OnchoGiken's profits to move sideways based on the expected increase in SG&A expenses and general management expenses in conjunction with the expected addition of personnel and associated training, but the number of employees has not increased considerably, so there is a possibility of an increase in profits.

The results in 1H FY9/19 and full-year forecasts for FY9/19 for each subsidiary are shown below. An increase in net sales and profits are expected for each company except for the newly consolidated Imamura. OnchoGiken, which handles air-conditioning-related installations, has been performing particularly well, and may exceed the forecast results.

1H FY9/19 results by subsidiary

(¥mn)

	Avelco	INTELGROW	OnchoGiken	Imamura (Newly consolidated)
Net sales	26,745	5,743	1,255	1,958
Operating profit	1,140	106	296	72
Operating profit ratio (%)	4.3	1.9	23.6	3.7
Recurring profit	1,199	153	296	98
Recurring profit ratio (%)	4.5	2.7	23.6	5.0
Net profit	748	139	189	46

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

Full-year results forecasts by subsidiary

(¥mn)

	Avelco		INTELGROW		OnchoGiken		Imamura (Newly consolidated)	
	FY9/19 E	FY9/18 (Actual)	FY9/19 E	FY9/18 (Actual)	FY9/19 E	FY9/18 (Actual)	FY9/19 E	FY9/18 (Actual)
Net sales	52,690	50,730	11,130	10,601	2,200	2,001	4,000	-
Operating profit	1,450	1,174	200	136	350	214	0	-
Operating profit ratio (%)	2.8	2.3	1.8	1.3	15.9	10.7	-	-
Recurring profit	1,540	1,262	290	226	350	215	20	-
Recurring profit ratio (%)	2.9	1.5	2.6	2.1	15.9	10.8	0.2	-
Net profit	950	780	190	176	227	155	10	-

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

Medium- to long-term growth strategy

The medium-term business plan target (operating profit of ¥1,900mn) is well within reach

● **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 achieved the medium-term business plan's target (¥1,900mn in operating profit) in FY9/17. Nevertheless, it is pursuing this target again in FY9/19 after some recent sluggishness in earnings as explained above. After reaching this target (¥1,900mn in operating profit), the Company will likely formulate and announce its next medium-term business plan. A high net sales target of ¥100,000mn will likely be one of the Company's goals outlined in the plan.

Shareholder return policy

Sustaining a stable dividend with a payout ratio target of 30%, with increased dividend possible.

The Company fundamentally aims for a 30% dividend payout ratio as its shareholder return policy. The FY9/18 annual dividend was ¥30, and the Company is planning to pay an annual dividend of ¥32 (interim dividend = ¥16, fiscal year-end dividend = ¥16) in FY9/19, which would work out to a payout ratio of 28.7% if the forecast profit is met. However, as mentioned above, FY9/19 forecast results will likely be revised upwards, and the Company has declared that it wants to maintain a stable payout ratio of 30%. As such, there is a high likelihood that the Company will increase the annual dividend for FY9/19.

FISCO

Disclaimer

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