COMPANY RESEARCH AND ANALYSIS REPORT

Daiki Axis Co., Ltd.

4245

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Index

Summary

Advocates “promoting ESG management” in the new medium-term business plan

Daiki Axis Co., Ltd. (4245) is committed to a corporate mission of “protecting the environment and changing the future” and aims to continue advancing as an environment innovation and development company. Its new three-year medium-term business plan calls for “promoting ESG management.” The sixth goal in the United Nations’ sustainable development goals (SDGs), which have been adopted as international goals by 2030, of Clean Water and Sanitation: Ensure availability and sustainable management of water and sanitation for all” matches the creation of water-related infrastructure” promoted by the Company. The Company not only has its core water processing business, but is also widening scope to biodiesel fuel, compact wind power equipment, and solar-power electricity sales businesses.

1. Arranged production sites for Johkasou in China and India, the world’s No.1 and No.2 most populous countries

The Company started local production of Johkasou in Indonesia in 2015, and it established a joint venture and subsidiary in China and India respectively to manufacture Johkasou locally in July 2018. These two countries, which rank No.1 and No.2 as the world’s most populous countries, have low toilet proliferation rates in regions outside of tourist areas and cities. In China, demand has rapidly emerged since comments by the Chinese President Xi Jinping in 2017 that a “toilet revolution” should extend to farming villages as well. The joint venture will manufacture community Johkasou. By adding community Johkasou, the joint-venture partner, which already makes septic tanks for processing swage water, aims to enhance the water treatment capacity of sewage treatment facilities. The Company’s subsidiary will receive product supply from the joint venture. With coverage of the Taihu area, including Shanghai and Suzhou, the joint venture’s business plan targets an output capacity of up to 5,000 systems a year. This is a large amount considering the Company’s annual production of 120,000-130,000 systems a year, with 6,000-7,000 compact products. In India, which is promoting “Clean India” as a national policy, the Company created a subsidiary to handle production sales, installation, and maintenance of Johkasou and is beginning local production via consignment manufacturing.

2. Promoting ESG management

The Company helps improve the Environment through its main business. As Social measures, it promotes work style reforms with establishment of a new personnel system and cultivation of an atmosphere that inspires employees and encourages engagement of women and plans to select women directors. Governance actions include management framework reforms by moving to a company with an audit and supervisory committee and an executive officer system that separate management and execution, raising the number of outside directors, and strengthening risk management and supervisory functions of the audit and supervisory committee members. Besides the existing growth strategy, the Company aims to improve productivity through increased IT use and bolster the corporation foundation as main themes.

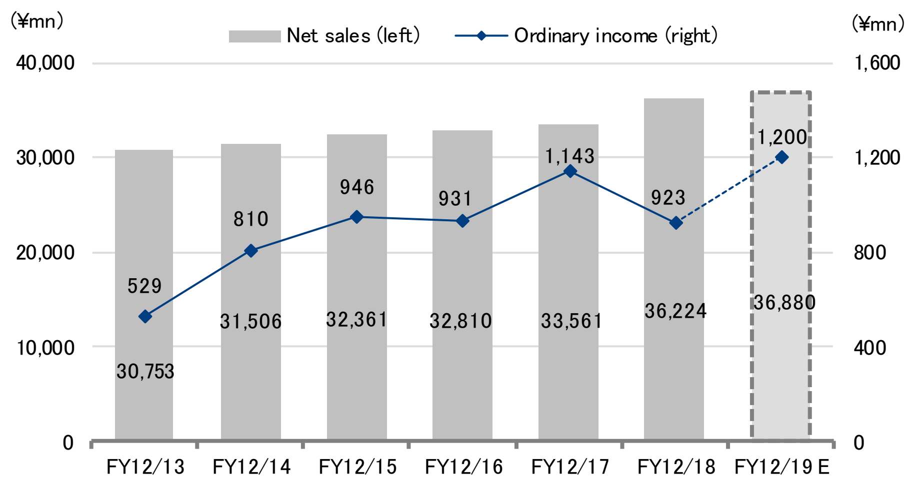
3. Numerical goals in the new medium-term business plan

Consolidated numerical goals for FY12/21, the final fiscal year of the plan, are ¥40,000mn in sales (+10.4% vs. FY12/18) and ¥1,800mn in ordinary income (+63.5%). Other goals are at least 13.2% ROE (vs. 12.7% in FY12/18) and at least 5.5% ROIC (vs. 4.2%). The Company hopes to expand overseas sales by 2.6 times and raise the overseas sales ratio from 3.2% to 7.5%. In domestic business, it wants to improve profitability through expansion of selling electricity from solar power facilities and recurrent-type businesses such as water supply business.

Key Points

- Beginning local production of Johkasou in China and India for overseas business
- Expects a 30% increase in FY12/19 operating income
- Promotes ESG management as an environmental creation development model company

Results trends



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

Company profile

Promoting ESG management is a priority measure

1. Company profile

The Company seeks to improve the quality of employee lives and contribute to advances in society through steady progress as an environmental creation development model company. It formulated the Make FOUNDATION Plan, a three-year medium-term business plan that lasts through FY12/21 and aims to promote ESG management. It also retained the existing corporate slogan PROTECT By CHANGE and group mission "Protect the environment and change the future."

The Company listed shares in the chemical sector of the Tokyo Stock Exchange's Second Section market in December 2013 and moved to the Tokyo Stock Exchange's First Section in the following year.

The Company's FY12/18 results included ¥36,224mn in sales and ¥923mn in operating income. Segment sales shares were environmental equipment business at 51.1%, household equipment business at 43.7%, renewable energy business at 0.8%, and other business at 4.4%. Segment operating income and margin results were environmental equipment business at ¥1,394mn and 7.5%, household equipment business at ¥569mn and 3.6%, renewable energy business at -¥65mn and -22.8%, and other business at ¥97mn and 6.1%.

2. History

The company began as Ogame Shoji, which sold tiles and hygienic porcelain, in Matsuyama City, Ehime Prefecture, in 1958. It established predecessor Daiki Co., Ltd. in 1964. It started manufacturing aeration Johkasou in 1969. Daiki, which entered the home center business in 1978, formed business alliances with peers Homac Co., Ltd. and Khama Co., Ltd. and decided to merge in 2003. Ahead of the establishment of current DCM Holdings Co., Ltd. <3050> in 2006, Daiki transferred non-home center businesses to Daiki Axis as the inheriting company. Capital ties between Daiki Axis and Daiki subsequently ended due to the management buyout (MBO) that took the company independent, though transactions are continuing.

Daiki Axis was officially founded in 2005, but has designed, manufactured, installed, and maintained and managed various wastewater treatment systems over about half a century since the Daiki era when it completed the first fiber reinforced plastic (FRP) Johkasou in 1965. Household equipment business began handling TOTO <5332> products in 1971. It limits business scope to Kinki, Chugoku, and Shikoku areas and has become an important distributor for major residential facilities and equipment manufacturers. It also supplies home center retail materials to group companies under DCM Holdings and provides comprehensive store management services, including construction and cleaning of home center stores. In 2018, it launched a solar power business that leases the rooftops of DCM group stores.

3. Group companies

Through M&A deals and subsidiary establishments, the Company has strengthened the environmental equipment business, developed overseas markets, and entered new areas. Its group consists of Daiki Axis and 14 major related companies (eight domestics, six overseas).

The Company obtained environment equipment firms DAITEC Co., Ltd. and Environmental Analysis Center Co., Ltd. from Daiki in 2005. M&A activities serve as a growth strategy. The Company purchased TOBU Co., Ltd., which designs, installs, and sells water treatment facilities mainly in the Tokai area, in 2007. It acquired TOSETSU Co., Ltd., which handles maintenance and inspections of various water treatment facilities in the same area, in the following year. TOBU absorbed this subsidiary in January 2017. It purchased environmental plant business LEC Industries Co., Ltd. in 2011. The Company also acquired all shares of DA INVENT (located in Nagoya City, Aichi Prefecture), making it a subsidiary, in January 2018. This subsidiary holds multiple patents for high-temperature, high-pressure hydrothermal treatment and subcritical water reaction equipment. Its coverage of processes before and after water processing should contribute to expansion of group scope in environmental infrastructure business. The Company acquired Sylphid Co., Ltd., which conducts R&D and sales and installation of compact wind power equipment, in 2012. Its equipment utilizes a vertical axis format that is more suited to wind conditions in Japan than the horizontal axis format (propeller type) found in the US and Europe. The Company acquired civil works operator DAD Co., Ltd., which excels at the pipe jacking method, in March 2017. It is targeting group synergies through utilization of DAD's extensive customer base with nationwide civil works and construction companies. This subsidiary has a stable income source from operation of power selling business with solar panels installed at six locations in the Matsuyama City area. The Company acquired DH Aqua Co., Ltd., which handles water supply and wastewater treatment for a new-town development and housing projects in Matsuyama City (Ehime Prefecture), as a subsidiary in November 2018.

In overseas business, the Company acquired Daqi Environmental Protection Engineering (Dalian) Co., Ltd., which designs, installs, and sells polluted water treatment equipment and recycled water and filtration equipment in China, from Daiki in 2005. It purchased a local company that manufactures Johkasou in Indonesia in 2013 (now, PT DAIKI AXIS INDONESIA). It established a subsidiary in Singapore in 2016 with roles of water treatment sales activities for Johkasou and other water treatment equipment in Southeast Asia and South Asia and conducting supervision activities for overseas subsidiaries (DAIKI AXIS SINGAPORE PTE. LTD.). In July 2018, it created a subsidiary for manufacture, sales, installation, and maintenance of Johkasou in India (DAIKI AXIS INDIA Private Limited). Also, in July, it established a joint venture in China that manufactures and sells community Johkasou (Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd.) In November 2018, it purchased Crystal Clear Contractor Pte. Ltd., which provides pool cleaning and maintenance services in Singapore.

Business overview

Development company placing emphasis on water and the environment

The Company has environmental equipment and household equipment as core businesses and positions the other business segment as the growth area. It split renewable energy business from the other business segment in financial reporting from FY12/18. The Company focuses on the environmental equipment business where it can offer uniqueness, in contrast to household equipment that largely consists of wholesale transactions. In FY12/18 segment operating margin, environmental equipment at 7.5% was more than twice as high as household equipment at 3.6%. The renewable energy business is incurring modest operating losses due to being in an investment phase. Bottled water delivery, civil engineering, and other businesses generate 6.1% operating margin, but account for less than 5% of overall sales.

1. Environmental equipment business

The environmental equipment business handles from manufacturing and sales of plastic Johkasou to design, installation, and maintenance of concrete large wastewater treatment facilities. It covers a wide range of applications from human waste and residential wastewater for individual homes to industrial wastewater and rural wastewater. In addition to wastewater treatment equipment, it has a clean water business that converts underground water to drinking water and wastewater recycling system for reuse of used clean water. It has built maintenance service operations as joint operations with subsidiaries. Consolidated segment sales totaled ¥18,513mn in FY12/18 with 3.9% in clean water business, 0.1% in recycled water system, 9.3% in domestic small community Johkasou (for 5-50 persons) 62.6% in wastewater treatment system and24.1% in maintenance, etc.

(1) Strength

An important strength is integrated operations covering design, production, installation, sales, and maintenance of wastewater processing facilities. Provision of maintenance services sustains contact with customers and leads to orders for repairs and expansion projects. Knowledge of customer needs confirmed through on-site interaction is also fed back to R&D activities. The Company has maintenance operations with 24-hour monitoring and spot responses and other services that meet customer requirements handled by a dedicated division.

Beginning local production of Johkasou in China and India for overseas business

(2) Overseas business

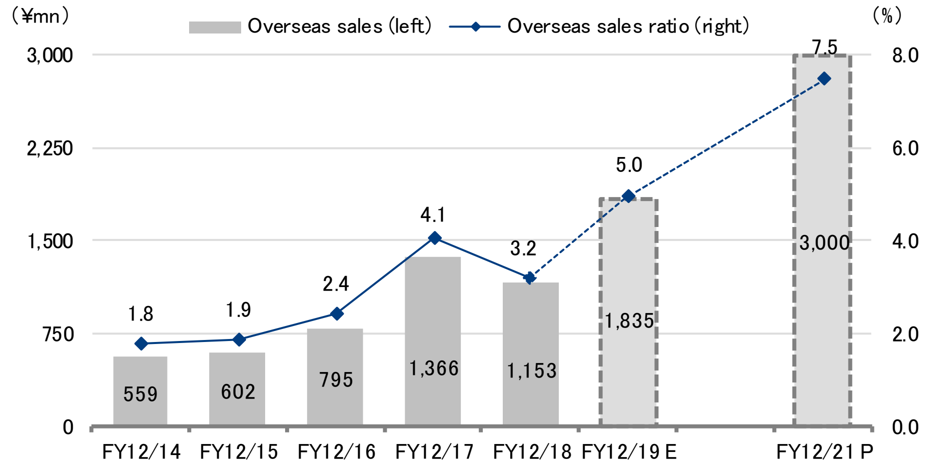
Water infrastructure business consists of three main businesses - materials, parts, and equipment manufacturing; equipment design, assembly, installation, and operation; and business operation, maintenance, and management (water sales). France-based Veolia Water Technologies and Suez environment, US-based GE Water & Process Technologies, and other majors cover all of these areas. Japanese players, meanwhile, specialize in individual areas, such as water treatment equipment, engineering, and organizer. The Company differs from the water majors because it targets smaller wastewater treatment systems. Having the ability to provide the above-mentioned three main businesses enables the Company to differentiate from other Japanese companies. It can handle household wastewater treatment, industrial wastewater treatment, and public water purification.

We expect the Company to acquire early-bird profits from expansion of markets in ASEAN countries, India, and Africa with its smaller-scale wastewater treatment. The Company created a Global Business Division with overseas subsidiaries in April 2015. This include sales efforts to customer companies in Japan with local entities that are building plants and retail facilities as well as developing real estate, such as condominiums and standalone home communities. New regulations are setting fairly high levels, and disparities might occur by country in respect to whether local companies actually move quickly in compliance. However, authorities are generally strict in application of standards to foreign-capital companies.

The Company is highly competitive in quality, cost, and delivery (QCD) because it fulfills stricter water treatment standards, develops products that meet the climate in regions where equipment is installed, and curtails manufacturing costs and transportation expenses and supplies products with shorter delivery times through local production. The plant in Indonesia, which started full-fledged operations in July 2015, has expanded production capacity to five times the previous level. Automation realized with installation of new production equipment established Japan quality and raised productivity. The Company lowered manufacturing costs by developing products to meet local specifications and narrowing product functionality. It targets individual treatment systems for homes, buildings, plants, and retail facilities that use shared Johkasou. The plant has annual output capacity of 200-250 units each for large, mid-sized, and small tanks. Inquiries are sharply increasing in the wake of concluding sales agent contracts in Myanmar, India, Vietnam, and Kenya since 2016. In 2018, it began local production of Johkasou in China and India. Water usage and pollution characteristics differ in Southeast Asia, China, and India because of lifestyle differences, and the Company analyzes these aspects in Japan in order to develop products with cost competitiveness.

The Company increased overseas business sales from ¥602mn in FY12/15 to ¥1,153mn in FY12/18. While sales dropped YoY on non-recurrence of a major project in China, the overall trend is expansion and the new medium-term business plan targets ¥3,000mn in final-year FY12/21 sales. The overseas sales ratio is likely to rise to 7.5%.

Overseas sales and overseas sales ratio trends



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

Below we review progress in individual countries.

a) Indonesia

The Company opened a branch in Surabaya, the second largest Indonesian city, in June 2015. Local production offers an advantage in competition with Japanese manufacturers because of the 15-20% tariff on products imported from Japan.

b) Myanmar

Authorities are applying regulations more aggressively amid increase in pollution volume accompanying economic development. Biochemical oxygen demand (BOD), which indicates the state of water pollution, is standardized at BOD20. While Myanmar's quality standard lists local manufacturers with suitable levels, Kubota Corporation <6326> and Daiki Axis are approved firms. The Yangon City Development Committee (YCDC), which regulates the country's largest city, required Johkasou and other treatment facilities for buildings with 7.5 floors or more in applications for new projects. New town developments are steadily advancing in surrounding areas, and estimates suggest that Yangon's population could expand from 5.5mn people to more than 10mn people in 2040. While the Company imports products from Indonesia now, it is considering a switch to local production to accommodate robust demand.

c) India

Swachh Bharat (Clean India) is a top-priority issue for the Modi government in India. The Clean India project sets a goal of installing toilets in 111mn units with an investment of about $20bn (¥2.22trn) for the five years through October 2019, the 150th anniversary of the birth of national founder Mahatma Gandhi. It will also install toilets in elementary and middle schools and public toilets. While toilet installations are advancing, the main issue is that sewage treatment facilities have not caught up yet. The Company donated Johkasou to the Indian government in July 2016 as a promotion of product quality. These tanks (with daily treatment capacity of 10 cubic meters) were installed in three locations – a park toilet in Nagpur (midwestern India), a village public toilet, and a plastics plant (industrial wastewater treatment) as test marketing.

India strengthened the regulatory level for water pollution from BOD30 previously to BOD10 for industrial properties with wastewater of 18,000 square meters or more and residential sites with total floor space of 2,000 square meters or more nationwide in April 2017. Despite massive demand just from new construction projects, regulations also apply to existing facilities. Existing septic tanks cannot satisfy strengthened regulations because they only handle polluted water and do not treat household wastewater.

The Company established a subsidiary in India in July 2018. The first phase of the business initiative in India is local production through consignment to a local manufacturer of plastic products. The Company will provide molds and other production equipment and technology guidance. Plans call for annual output capacity of 100 capsule Johkasou, mainly in the midsized and compact range. The Company currently has distributor contracts with six companies. Besides setting up the subsidiary, we expect the start of local production to further highlight the Company's commitment to the India market to distributors. It is best to locate Johkasou manufacturing sites near consumption areas because of transportation costs and other expenses. Given India's massive size and the strong authority of state governments, the Company is looking at a model of setting up production sites in various areas and developing markets from areas that it has entered. It expects to increase sales distributors.

In the second phase, the Company aims to have its Indian subsidiary and local cooperating companies establish a new joint venture for the purpose of entering the large wastewater treatment system construction. New market development typically begins with compact products and then broadens to midsized and large product opportunities. The initiative in India seeks to penetrate the market using the same pattern.

d) China

In China, the Company has a wholly owned subsidiary in Dalian that operates as an engineering firm. It acquires major projects through designations from Japanese companies.

In November 2017, Chinese President Xi Jinping issued a directive to promote a "toilet revolution" of installing clean toilets. This "toilet revolution" calls for improvement in public life quality in not only tourist areas and cities, but also farming villages. The initiative supports faster rollout of sewage treatment facilities broadly. Public private partnership (PPP) has been advancing in China since 2014 to enhance the environment in villages. It is estimated that 100-200mn households from the 800mn people living in farming villages constitute a latent market for Johkasou. Opportunities for inroads by Japan-type Johkasou are growing thanks to pricing adjustments from utilization of the private sector and stricter water quality standards. Cities, towns, and other public entities are asking for integrated bids to make, install, and operate Johkasou and require a 25-year guarantee of water quality.

In July 2018, the Company participated in the establishment of Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd., a joint venture to manufacture household community Johkasou. This entity is being handled as an equity-method affiliate because Lingzhi Environmental Protection Co., Ltd. (Yixing, Jiangsu) owns 51% and Daiki Axis has a 49% stake. Yixing, the joint venture's location, has been selected as a National Environment Protection Model City and is part of the Taihu area, including Shanghai and Suzhou. The joint-venture plant intends to supply products to the investor companies. Septic tanks installed in Chinese farming villages handle polluted water treatment, but do not address residential wastewater and are not enough to meeting water-quality standards. Installations thus will involve septic tanks that cover 3-4 ordinary households per tank and subsequent treatment using community Johkasou. Joint-venture partner Lingzhi has a 20-year track record in sewage treatment facilities (septic tanks). The joint venture will build a new plant outfitted with Daiki Axis' production technology on the partner's grounds. Plans call for output capacity of up to 5,000 units a year. The Company has annual output of 120,000-130,000 units in Japan, including 6,000 to 7,000 units for compact products. Its Japanese production sites are distributed in multiple locations, versus just one manufacturing location in China.

e) Other regions

Vietnam, a farming country, is promoting stricter wastewater regulations for BOD, nitrogen, ammonia, and other substances. These conditions are likely to raise demand for products with Japanese specifications that deliver robust treatment performance. The Company selected a local partner and has started sales activities. The Company is conducting trial marketing in Kenya, Sri Lanka, and Algeria.

In November 2018, the Company acquired Crystal Clear Contractor Pte. Ltd., which handles pool cleaning and maintenance for about 200 hotels and condominium buildings in Singapore. The Company expects to install and sell filtration equipment using the Company's technology. The Company hopes that owning a business with a real presence in the country will help absorb costs and support effective management of DAIKI AXIS SINGAPORE PTE. LTD., which oversees the Asian region.

(3) Product development - High added value

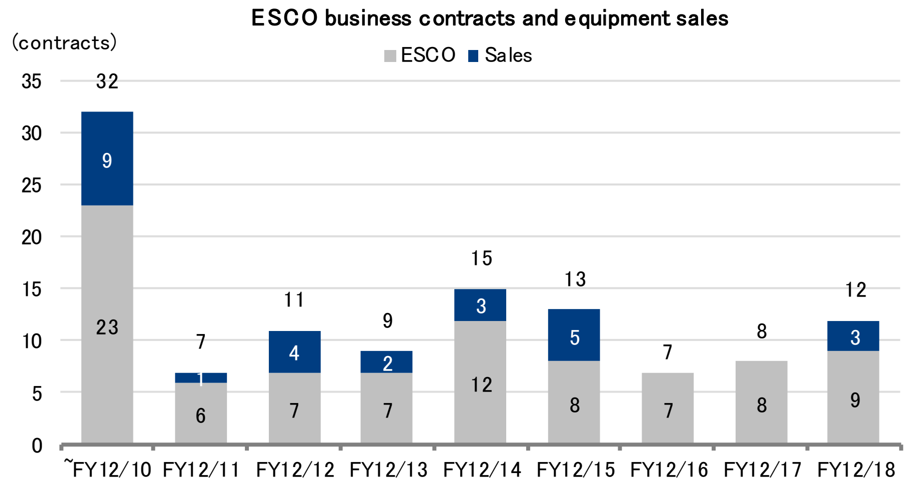
The environmental equipment business focuses on increase of added value by releasing new products. Development policy seeks to open up high value-added markets and enhance price and quality competitiveness. In FY12/18, the Company released a medium-scale Johkasou and a disposer system that is the Company's strength. The medium-scale model accommodates smaller condominium buildings and is a compact capsule-type product with enhanced biological treatment (that cleans wastewater) performance. It should help shorten delivery periods and lower costs because inventory production is possible, in contrast to previous order-based production. The Company reduced sizes in comparison with existing products by 28%, thereby improving pricing and installability. The disposer system for multi-dwelling homes lowered sizes by more than 25% (compared to the existing products) through revisions to treatment flow. Applications include large kitchens, such as those at food plants and meal supply centers, as an industrial wastewater treatment system with zero emissions through use of a disposal system for raw garbage currently disposed of externally.

DA Invent, which was acquired as a subsidiary in January 2018, holds multiple patents for high-temperature, high-pressure hydrothermal treatment and subcritical equipment. This subsidiary's Super Steam hydrothermal processing system dissolves organic wastes. The technology can be applied to lowering sludge volume. We expect synergy benefits due to the ability to expand business coverage to a new area.

(4) Clean water business

Clean water business, a new area in the environmental equipment business, is an ESCO service that provides steady supply of safe low-cost drinking water. This service converts underground water to drinking water and reduces the cost of clean water by 10-30% compared to conventional drinking water. The usage method is exactly the same as clean water from public services with fees charged by usage volume. The Company owns the ESCO clean water facilities. It also installs a remote automated monitoring system that uses IT sensors for 24-hour, 365-day monitoring of facilities operating at customer locations from the headquarters office.

ESCO service uses a lengthy contract period of 10 years. This is a recurrent-type income business model in which Contracts with existing customers generate stable income over a lengthy period and new contracts steadily add income. Business is profitable from the first fiscal year of beginning supply at the various sites. The Company currently applies an upper limit of 15 projects a year in light of investment costs and production and installation capabilities. Supply facility depreciation employs the straight-line method. While annual depreciation value is constant throughout the contract period, operating margin rises sharply from the second year because operating expenses are no longer needed. Furthermore, profitability increases dramatically if the contract continues after the 10th year when the depreciation period finishes. The Company began the ESCO business in FY12/06 and is likely to see increase in high-profit projects already done with depreciation. In FY12/18, ESCO system results were nine deployment contracts and three acquisitions. ESCO deployments reached 87 sites at period-end. The top five industries were hospitals at 25 sites, large commercial facilities and food processing plants at 13 sites each, welfare facilities at 12 sites, and sports gyms at 11 sites.



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

(5) Recurring business

The Company is expanding recurring-type business as a growth strategy. It reported ¥4,460mn in maintenance revenue in FY12/18. This revenue has steadily risen by a 20.0% over three years. The Company handles store Johkasou installations and maintenance and store management tasks (cleaning, fire prevention, electricity, and other inspections) at DCM group stores. It aims to expand bulk orders of wastewater treatment equipment and Johkasou maintenance at major convenience store chain and major restaurant chain stores and their central kitchens. While existing service firms provided coverage in local areas, the Company seeks differentiation by not only lowering costs, but also delivering uniform services on a nationwide scale. Furthermore, provision of maintenance tasks enables it to make timely proposals on renovations and facility addition projects and thereby contributes to a positive cycle.

2. Household equipment business

The household equipment business had a sales breakdown in FY12/18 of construction customers at 70.1%, home center retail materials at 14.6%, and housing facilities projects at 15.3%.

(1) Construction customers - Strong equipment wholesale business in its areas

Predecessor Daiki started as a tile and hygienic porcelain store at its founding in 1958 and has a multiple-decade track record in home equipment wholesale business. The Company sells system kitchens, toilets, bathroom units, and other water-related home equipment to general contractors, local construction firms, and homebuilders. It limits activity to Shikoku, where the headquarters is located, and Chugoku and Kinki on the Seto Inland Sea and generates strong sales results in these areas.

(2) Home center retail materials - Strengthening ties with the DCM Group

The Company is seeking to strengthen ties with the DCM Group, which operates Japan's largest home center network. It booked ¥4,934mn in sales to the Group in FY12/18, putting sales reliance at 13.6%. The business breakdown was 73.3% in household equipment and 25.7% in environmental equipment. Household equipment includes sales of kitchens, bath units, toilets, and other home goods, sales of professional materials to renovation companies, and store construction projects. Environmental equipment sales come from store Johkasou installations and maintenance and store management activities. The Company receives direct consignments from the DCM Group for store construction projects. It originally had capital ties with the DCM Group and maintains a good relationship as an independent company.

Launching solar power business that utilizes rooftops of DCM Group stores

3. Renewable energy business

Renewable energy business booked ¥287mn in FY12/18 sales, with ¥172mn from selling electricity generated by solar power facilities and ¥114mn from biodiesel fuel business. The segment did not have any sales from compact wind power equipment.

(1) Selling power from solar-power facilities

The Company launched power sales business using solar power from facilities that lease the rooftops of 100 DCM Group stores. While the long-term feed-in tariff (FIT) is ¥18/kWh in some cases, nearly all already applied at the Japanese fiscal year (JFY) 2017 rate of ¥21/kWh. The schedule calls for finishing installations at all stores by 2Q FY12/19. Total capital investment in this project was initially budgeted at ¥5bn, but it appears that actual outlays should only amount to ¥4.3bn thanks to revision of panel purchase prices. Based on sunlight conditions in a normal year, the Company expects this business to generate ¥800mn in revenue and ¥400mn in operating income annually when operations fully ramp up. The depreciation period for solar power facilities is 20 years (straight-line method), the same length as the FIT period.

(2) Biodiesel fuel business

The Company's biodiesel fuel refining and sales business started in 2002 received the Shikoku Bureau of Economy, Trade and Industry Director Award at the Fifth Monozukuri Japan Awards in 2013.

(3) Compact wind power equipment

Electricity FIT was ¥55/kWh in JFY2017 for compact wind power equipment at less than 20kW. The price from JFY2018, however, will be revised to ¥20/kWh because this becomes the same category as 20kWh and above from April 2018. Nevertheless, sales will focus on compact wind power because of the roughly 8,000 applications already submitted through March 2018. There is strong demand for FIT-compliant products that link to the grid due to the relatively high FIT for compact wind power equipment. To meet current needs, the Company is releasing the Sylphid HS-10, which combines a horizontal-axis 10kW windmill from a Chinese company with a track record in Asian sites and a power conditioner from a major domestic electric equipment manufacturer. The Company is aware that this business is only sustainable for the next three years. Moreover, as a Group business, the Company is pursuing new possibilities in the compact wind power equipment business following acquisition of an ID from a business that has already secured an ID for Kagoshima Prefecture.

The Company promotes compact wind power equipment with a vertical axis format that is more suited to wind conditions in Japan commercialized by a group subsidiary to public entities and companies as an auxiliary or independent power sources for public facilities and commercial facilities that provides on-site power, rather than for selling power to the grid. It currently supplies a product with 3kW of power capacity and is also developing a 10kW version that is more useful as well as a scaled-down 1kW version.

4. Other business

The other business segment posted ¥1,611mn in sales in FY12/18, with 37.6% from the CreCla business that handles home delivery of bottled water, 59.8% from civil works projects and other business added through the DAD acquisition, and 2.7% from rent income. Segment operating income was just ¥97mn.

Results trends

Sales rose 7.9% and operating income dropped 19.3% in FY12/18

1. Overview of FY12/18 results

Consolidated results in FY12/18 totaled ¥36,224mn in sales (+7.9% YoY), ¥923mn in operating income (-19.3%), ¥1,100mn in ordinary income (-18.0%), and ¥861mn in profit attributable to owners of parent (+15.7%). Profit expanded due to booking ¥479mn in profit from selling investment securities, which the Company sold as a result of changes to the strategic shareholdings policy based on the corporate governance code, in extraordinary income. The Company reduced operating and ordinary income estimates at the 3Q results announcement, and final values were slightly higher than the updated levels.

FY12/18 consolidated results

(¥mn)

	FY12/17		FY12/18			YoY		Change versus forecasts
	Amount	Ratio to net sales	Forecast	Results	Ratio to net sales	Change	%	
Net sales	33,561	-	35,600	36,224	-	2,663	7.9%	1.8
Environmental equipment business	16,445	49.0%	17,699	18,513	51.1%	2,068	12.6%	4.6
Household equipment business	15,584	46.4%	15,807	15,812	43.7%	228	1.5%	0.0
Renewable energy business	173	0.5%	318	287	0.8%	114	65.9%	-9.7
Other business	1,356	4.0%	1,774	1,611	4.4%	255	18.8%	-9.2
Gross profit	6,558	19.5%	-	6,887	19.0%	329	5.0%	-
SG&A expenses	5,414	16.1%	-	5,964	16.5%	550	10.2%	-
Operating income	1,143	3.4%	900	923	2.5%	-220	-19.3%	2.6
Environmental equipment business	1,356	8.2%	-	1,394	7.5%	38	2.8%	-
Household equipment business	578	3.7%	-	569	3.6%	-9	-1.6%	-
Renewable energy business	-163	-94.2%	-	-65	-22.6%	98	60.1%	-
Other business	177	13.1%	-	97	6.0%	-80	-45.2%	-
Adjustment	-805	-	-	-1,072	-	-	-	-
Ordinary income	1,342	4.0%	1,030	1,100	3.0%	-242	-18.0%	6.8
Profit attributable to owners of parent	744	2.2%	960	861	2.4%	117	15.7%	-10.3

Note: Segment profit margins based on sales values for the respective businesses
Source: Prepared by FISCO from the Company's financial results and results briefing materials

Environmental equipment business booked ¥18,513mn in sales (+12.6% YoY) and ¥1,394mn in operating income (+2.8%). Overseas sales fell 15.6% (¥212mn) to ¥1,153mn because of non-recurrence of a major deal in China from the previous fiscal year (with an orders value of ¥607mn). Water supply business sales climbed by a robust 23.7% YoY to ¥723mn.

Household equipment business reported ¥15,812mn in sales (+1.5%) and ¥569mn in operating income (-1.7%). Sales to construction customers dropped slightly (-0.4%), and home center retail materials sales dropped 9.7% on removal of low-margin transactions. Housing facilities projects sales rose by a hefty 27.3%, but this boost did not improve segment operating margin because it covered a large-store project with slim margin.

Renewable energy business is still fairly small due to being in an investment phase. It booked ¥287mn in sales (+65.4%) and a ¥65mn operating loss.

Other business had ¥1,611mn in sales (+18.8%) and ¥97mn in operating income (-44.9%). While residential drinking water sales rose 6.3% and civil works project sales expanded 23.8%, margin on public projects declined.

2. Financial situation and financial ratios

Total asset value at the end of FY12/18 was ¥27,254mn, an increase of ¥5,628mn YoY. Current assets rose by ¥3,950mn with gains primarily in cash and deposits (+¥1,496mn), accounts receivable from completed construction contracts (+¥1,728mn), and inventory assets (+¥510mn). Non-current assets expanded by ¥1,678mn, mainly on an increase of ¥1,836mn in solar power facilities.

Operating cash flow had a ¥105mn deficit because of an increase in notes and accounts receivable - trade (¥1,682mn). This hence was unable to cover the ¥1,402mn decline in cash flow from investment activities, and the Company relied on a rise of ¥3,030mn in cash flow from financing activities. Interest-bearing debt, including lease liabilities, increased ¥3,420mn YoY to ¥11,093mn. As a result, the current ratio fell from 113.4% to 100.6% and the capital ratio was down from 31.6% to 24.6%. Capital investment climbed from ¥259mn in the previous fiscal year to ¥2,302mn. Depreciation costs, meanwhile, only rose ¥52mn YoY to ¥461mn. ROE stayed above the 10% level at 12.7%, thanks to increase in net margin and financial leverage.

Consolidated balance sheet and financial ratios

(¥mn)

	FY12/16	FY12/17	FY12/18	Change
Current assets	14,519	15,033	18,983	3,950
Cash and deposits	3,430	4,517	6,013	1,496
Trade receivables	8,329	7,490	9,230	1,741
Inventories	2,206	2,487	2,998	510
Non-current assets	5,504	6,592	8,270	1,678
Total assets	20,023	21,626	27,254	5,628
Current liabilities	12,302	13,259	18,863	5,604
Non-current liabilities	1,531	1,542	1,672	130
Interest-bearing debt	6,911	7,672	11,093	3,421
Total net assets	6,189	6,824	6,717	-107
[Profitability]				
ROE	10.9%	11.4%	12.7%	
ROA	5.8%	6.4%	4.5%	
Ordinary income margin	3.5%	4.0%	3.0%	
Net profit margin	2.0%	2.2%	2.4%	
Total asset turnover rate (times)	1.66	1.61	1.48	
Financial leverage (multiple)	3.31	3.20	3.61	
[Stability]				
Current ratio	118.0%	113.4%	100.6%	
Equity ratio	30.9%	31.6%	24.6%	

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

Outlook

Targeting a 30% YoY increase in FY12/19 operating income

● FY12/19 outlook

The Company's FY12/19 forecast calls for ¥36,880mn in sales (+1.8% YoY), ¥1,200mn in operating income (+30.0%), ¥1,300mn in ordinary income (+18.1%), and ¥800mn in profit attributable to owners of parent (-7.1%). Factor analysis of ordinary income changes shows companywide costs switching from a profit setback of ¥263mn in FY12/18 to a boost of ¥87mn and non-recurrence of one-time costs from the previous year, such as 60th-anniversary activity costs and M&A-related costs. In renewable energy business, the Company narrowed the segment deficit by ¥98mn in FY12/18 and aims for achievement of profitability with a ¥249mn addition to profits in FY12/19. It guides for a decline in profit due to non-recurrence of profits from selling stocks booked in FY12/18.

Outlook for FY12/19

(¥mn)

	FY12/18		FY12/19 E			
	Amount	Ratio to sales	Amount	Ratio to sales	Change	%
Net sales	36,224	-	36,880	-	656	1.8%
Environmental equipment business	18,513	51.1%	19,272	52.3%	759	4.1%
Household equipment business	15,812	43.7%	15,056	40.8%	-756	-4.8%
Renewable energy business	287	0.8%	740	2.0%	453	157.7%
Other business	1,611	4.4%	1,810	4.9%	199	12.4%
Gross profit	6,887	19.0%	7,665	20.8%	778	11.3%
SG&A expenses	5,964	16.5%	6,465	17.5%	501	8.4%
Operating income	923	2.5%	1,200	3.3%	277	30.0%
Environmental equipment business	1,394	7.5%	1,363	7.1%	-31	-2.2%
Household equipment business	569	3.6%	473	3.1%	-96	-16.9%
Renewable energy business	-65	-22.6%	183	24.7%	248	Achieved profitability
Other business	97	6.0%	173	9.6%	76	78.2%
Adjustment	-1,072	-	-992	-	80	-7.5%
Ordinary income	1,100	3.0%	1,300	3.5%	200	18.1%
Profit attributable to owners of parent	861	2.4%	800	2.2%	-61	-7.1%

Note: Segment profit margins based on sales values for the respective businesses
Source: Prepared by FISCO from the Company's results briefing materials

Environmental equipment targets are ¥19,272mn in sales (+4.1% YoY) and ¥1,363mn in operating income (-2.2%). The Company factors in a 59.1% rise in overseas sales to ¥1,835mn, driven by new customer additions at overseas subsidiaries, and expansion of its overseas sales ratio from 3.2% to 5.0%. Household equipment targets are ¥15,056mn in sales (-4.8%) and ¥473mn in operating income (-16.9%). The Company expects the largest contribution to higher profit from renewable energy business at ¥740mn in sales (+157.7%) and ¥183mn in operating income (vs. a ¥65mn loss in the previous year). It is scheduled to complete installations on rooftops of DCM Group stores in 1H FY12/19 in the business of selling electricity from solar power facilities and projects a 233.3% YoY rise in full-year sales to ¥575mn on full-fledged operation from 2H. Other business targets are ¥1,810mn in sales (+12.3%) and ¥173mn in operating income (+78.2%), assuming recovery in civil works activity.

Medium- to long-term growth strategy

Promotes ESG management as an environmental creation development model company

● **New medium-term business plan "Make FOUNDATION Plan – Promoting ESG Management"**

Based on results from the previous medium-term business plan "V-PLAN60," the Company formulated "Make FOUNDATION Plan – Promoting ESG Management," a new three-year business plan lasting through FY12/21. It retained the existing corporate slogan PROTECT By CHANGE and a stance that "the Daiki Axis Group aims to 'protect the environment and change the future' and contributes to improvement in employee lives as well as enhancement of society through continuation of its development as an environmental creation development model company."

(1) Numerical goals

Consolidated FY12/21 numerical goals in the plan are ¥40,000mn in sales (+10.4% vs. FY12/18's result), ¥1,700mn in operating income (+84.2%), at least 13.2% in ROE (vs. FY12/18's 12.7%), and at least 5.5% in ROIC (vs. 4.2%). Segment sales goals are environment equipment at ¥20,770mn (51.9% of overall sales; +12.2% vs. FY12/18 results), household equipment at ¥16,266mn (40.7%; +2.9%), and renewable energy and other business at ¥2,963mn (7.4%; +¥56.1%). The plan targets ¥3,000mn in overseas sales (7.5%; +160.0%).

Goals in the new medium-term business plan "Make FOUNDATION Plan – Promoting ESG Management"

(¥mn)

	FY12/15		FY12/18		FY12/21 (plan)		Compare to FY12/18	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Change	%
Net sales	32,361	100.0%	36,224	100.0%	40,000	100.0%	3,775	10.4%
Environmental equipment business	15,406	47.6%	18,513	51.1%	20,770	51.9%	2,257	12.2%
(Overseas sales portion)	602	1.9%	1,153	3.2%	3,000	7.5%	1,846	160.0%
Household equipment business	16,299	50.4%	15,812	43.7%	16,266	40.7%	453	2.9%
Renewable energy business, other business	655	2.0%	1,899	5.2%	2,963	7.4%	1,064	56.1%
Operating income	946	2.9%	923	2.5%	1,700	4.3%	776	84.2%
Ordinary income	1,082	3.3%	1,100	3.0%	1,800	4.5%	699	63.5%
Profit attributable to owners of parent	332	1.0%	861	2.4%	1,100	2.8%	238	27.7%
ROE	5.9%		12.7%		13.2% At least		+0.5pt At least	-
ROIC	-		4.2%		5.5% At least		+1.3pt At least	-

Source: Prepared by FISCO from Company materials

(2) Growth strategy

Growth strategies are rapid expansion of overseas business with the already known prospect of massive demand for infrastructure related to water and continued accumulation of recurrent-type business, such as maintenance and water supply, in Japan. The sales goal does not factor in contributions from new M&A. In overseas environmental equipment business, it plans to begin local production of Johkasou at joint ventures and through consigned output in China and India, following the launch of its own plant in Indonesia. The Company aims to use smaller projects as a foundation for winning large deals. It will review expansion of production items and local sites once the business ramps up. In household equipment business, it wants to shift from past stability to “growth.” Key initiatives are an area strategy to strengthen sales in undeveloped regions, recruitment of business opportunities and handling new products in the renovation market via online sales, and profit margin improvement by adopting centralized procurement. In renewable energy business, the Company expects full contributions from selling electricity generated by solar power facilities using DCM Group stores from FY12/20. It is pursuing new possibilities in compact wind power equipment business following acquisition of ID.

(3) Promoting ESG management

The Company helps improve the Environment through its main business. As Social measures, it promotes work style reforms, social assistance for a better environment, and diversity. Governance actions include management framework reforms by moving to a company with an audit and supervisory committee and an executive officer system that separate management and execution, bolstering risk management and supervisory functions by raising the number of outside directors and auditing by audit and supervisory committee members, holding briefings, and disclosing non-financial information. The Company received the Second Ehime Furusato Environment Award for its biodiesel fuel business, a Social initiative, in 2016. In diversity, it obtained Kurumin Approval as a “company that supports child-raising” in 2015. It selected a women director at the shareholders’ general assembly in 2019. In Governance, the Company reformed the management framework with its move to a company with an audit and supervisory committee and adoption of an executive officer system.

Promoting ESG management

Environment • Promotes improvements to the environment via environmental equipment, household equipment, and renewable energy businesses
Social • Work style reforms (new personnel system, cultivation of an atmosphere that inspires employees) • Social assistance (joint initiatives with the public and private sectors to improve the environment, awareness-raising activities) • Diversity (promoting engagement of women, accepting a variety of cultures and views, selecting women board members)
Governance • Separation of management and execution roles (company with an audit and supervisory committee, executive officer system) • Risk management and supervision functions (increase outside directors, audit and supervisory committee members) • Information disclosure (briefing events, disclosing non-financial information)

Source: Prepared by FISCO from Company materials

During the previous medium-term business plan period, the Company made steady inroads with the corporate slogan and confirmed the feasibility of growth strategies. Globally, it opened local distributors, launched production companies, and completed other initiatives. As new business efforts and via M&A, it secured stable income through selling electricity generated by solar power facilities and in civil works, private-sector water supply and sewage businesses, and overseas maintenance business. Meanwhile, the Company needs to comply with rising governance standards, recruit and cultivate human resources, and improve profitability. In the final fiscal year of the previous medium-term plan, it faced one-time expenses, higher personnel costs and sustained high outsourcing costs, and some money-losing projects. Main themes of “Make FOUNDATION Plan,” the current medium-term business plan theme, are utilizing IT to enhance productivity and building a robust corporate foundation, including formulation of a new personnel system. The Company will switch the personnel system from seniority-based wages to assessing performance, including human resource cultivation, in light of mid-career hires and global initiatives. It announced an ROIC goal for measuring group performance, given emphasis on return from investments, and aims to improve governance, including group companies.

Main themes

Improve productivity (promote IT usage)
Resolve front-line issues (facility management, overseas accounting and personnel) Promote efficiency (sales) Promote growth from a new perspective (utilization of big data)
Enhance the corporate foundation (establishment of a new personnel system, etc.)
Foster a workplace that inspires employees (use of a new assessment system and updating as necessary, adoption of a framework for setting, managing, and giving feedback on goals) Promote a high level of expertise (retirement age increase from 60 to 65, expansion of the research program) Hire human resources with international qualities (acceptance of overseas personnel, group training beyond national borders)

Source: Prepared by FISCO from Company materials

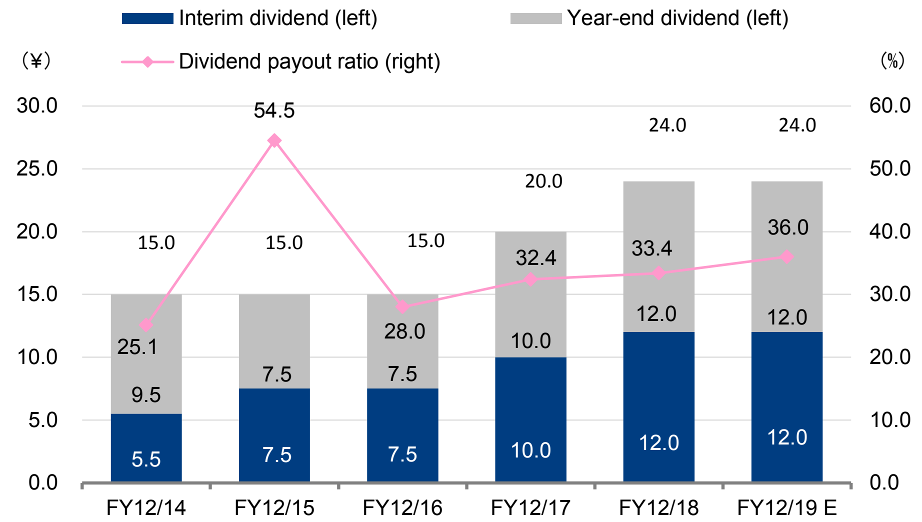
Shareholder return policy

Planning a dividend payout ratio of 36.0% for FY12/19

● **Dividend per share and dividend payout ratio**

In light of its target of 30% consolidated dividend payout as a shareholder return measure, the Company raised the FY12/18 dividend per share by ¥4 to ¥24, for a 33.4% dividend payout. It plans to pay a ¥24 dividend (unchanged) in FY12/19 too, for a 36.0% dividend payout. The Company adopted a shareholder benefit program from FY12/16. The program sends an original QUO card worth ¥1,000 to shareholders owning 100 shares (basic unit) or more at period-end.

Dividend per share (after the split) and dividend payout ratio



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

Information security measures

As information security measures, the Company prepared the information infrastructure facilities and constantly runs system operation and management software and monitors and restricts security. For employees, it has formulated an information security policy and seeks to raise awareness. Security education is given to all employees each year through e-learning and security measures are making inroads in the organization.

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