Nagaileben

7447 Tokyo Stock Exchange First Section

Company Research and Analysis Report
FISCO Ltd.
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■Performance towards medium-term targets

Nagaileben is the largest manufacturer of clothing for medical use in Japan, with a market share of more than 60%. In the first quarter of the fiscal year through August 2014, i.e., in Q1 FY8/14, the company raised its sales by 7.5% year-on-year (y-o-y) to ¥3,201mn, its operating profit by 13.1% to ¥922mn, and its recurring profit by 8.5% to ¥1,000mn. Sales and operating profit surpassed the company’ s forecasts.

For FY8/14, the company forecasts a 2.4% y-o-y rise in sales to ¥16,000mn, a 0.1% upturn in operating profit to ¥4,880mn, a 9.1% decline in recurring profit to ¥4,923mn, and a 2.8% fall in net profit to ¥3,030mn. The projected decline in recurring profit reflects the expectation of an absence of special non-operating profit, such as the foreign currency exchange profit earned in FY8/13. However, if current yen exchange rates persist, the company may earn enough foreign currency exchange profit to increase its recurring profit.

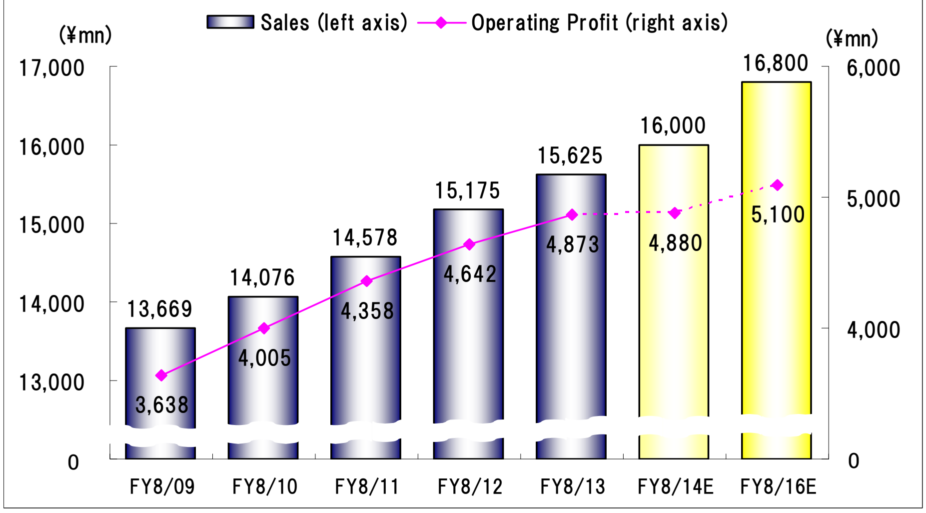
Nagaileben’ s financial position remains strong. At the end of Q1 FY8/14, its equity ratio stood at 91.0%. At the same time, the company takes a positive attitude towards shareholder returns, or improving capital efficiency. It has pledged to maintain a dividend payout ratio of 50% or more, on a parent-company basis, and it intends to buy back shares at opportune moments.

In FY8/16, the final year of the company’ s current medium-term plan, the company aims to generate sales of ¥16,800mn and earn an operating profit of ¥5,100mn. The company projects an operating profit of ¥4,880mn for FY8/14, so its operating profit target for FY8/15 appears attainable. In June 2013, the Cabinet Office announced a strategy to rebuild Japan. One goal of this strategy is to extend the healthy lifespan of Japanese people by preparing and expanding an environment conducive to this goal. Japan’ s current healthcare market is about ¥16 trillion, but the Cabinet Office forecasts that this market will grow to ¥26 trillion by 2020 and to ¥37 trillion by 2030. As the average age of residents of Japan continues to rise, the number of nursing care providers is increasing. In 2012, there were 1.49mn such providers, and the government projects that this number will grow to about 2.49mn by 2025. This trend should support Nagaileben’ s growth.

■Check Points

- Holds an unchallenged position in its industry
- Sales of healthcare wear and doctors’ wear remain brisk
- Company’ s stable financial position allows it to maintain a dividend payout ratio of at least 50%

Consolidated Sales and Operating Profit (¥mn), FY8/09-FY8/14E and FY8/16 plan



Company Outline

Largest maker of clothing for medical use in Japan, with a market share of more than 60%

(1) History

Nagaileben specializes in the manufacture of clothing for nurses, doctors and patients. The company started out in 1915 as Nagai Shoten in Tokyo, and expanded its business content and geographical coverage to all of Japan, as detailed in the table below. It is now the leading maker of medical clothing in Japan, with more than a 60% share of the market.

Company History

1915	Koji Nagai established Nagai Shoten, a proprietorship engaged in manufacturing white clothing, in Jimbocho-Kanda area of Tokyo. In 1942, Nagai Shoten expanded to become Tokyo Sanitary White Clothing Co.
1950	Tokyo Sanitary White Clothing Co. disbanded. Koji Nagai and Tatsuro Sawanobori established Nagai Shoten Co., Ltd.
1969	Established subsidiary Nagai White Clothing Industry Co., Ltd. in Akita Prefecture to expand production. Mr. Sawanobori became president. Company specialized in producing and selling white clothing for medical use.
1977	Constructed Goods Center 2 in Kamedo, Tokyo. Established a business alliance with GD Searle, of the US; established Nippon Surgical Apparel Co. in Hiroshima City to expand sales of new operating room apparel.
1978	Established technical agreements with Angelica Co., of the US, and with Toray, of Japan. Developed clothing made of new materials for lease.
1980	Changed company name to Nagai Co., Ltd. Set up a sales office in Takamatsu City. Concluded a license agreement with designer Kansai Yamamoto.
1982	Concluded a license agreement with designer Sachiko Hanai.
1988	Nagai Co. spun off some of its operations as a new company, Emit Co. Subsequently, these companies traded names. Emit Co. became the overall group manager, while Nagai Co. became the sales company.
1989	Built the Nagai Luminous plant in Akita Prefecture to produce high-grade goods. Started overseas production, planned to divide business internationally.
1994	Nagai Co. changed its name to Nagaileben Co., Ltd. Built a distribution center in Akita Prefecture.
1995	Nagaileben registered its shares on Japan’s over-the-counter market. Developed a clothing line for the aged as the second main product line. Vice President Ichiro Sawanobori became president.
1996	Concluded a license agreement with French designer Courreges.
1999	Opened a sales office in Nagoya. Concluded a license agreement with designer Atsuro Utayama.
2001	Listed shares on the Second Section of the Tokyo Stock Exchange
2002	Concluded technical agreements in surgical textiles with Standard Textiles Inc., of the US, and with Toray. Upgraded Nagoya sales office to a branch office.
2004	Acquired SO 9001 certification. Listed shares on the First Section of the Tokyo Stock Exchange. Absorbed Nagai Hokkaido and opened a branch office in Hokkaido.
2005	Acquired ISO 14001 certification. Concluded a license agreement with designer Keita Maruyama.
2006	Concluded a license agreement with designer Minako Yokomori.

■Company Outline

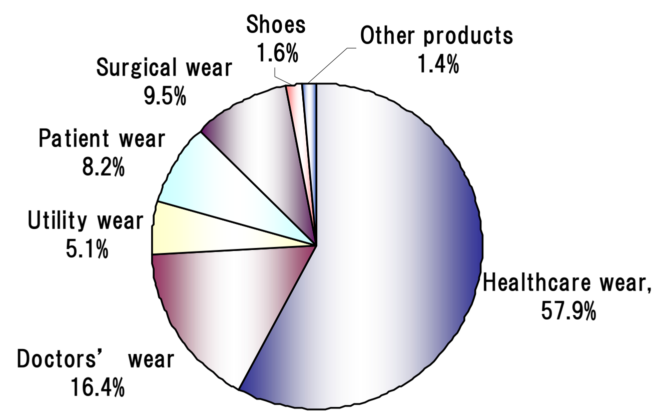
Sales representatives maintain contact with customer institutions to ascertain their needs and the needs of end-

(2) Description of Businesses

○Consolidated Sales Breakdowns

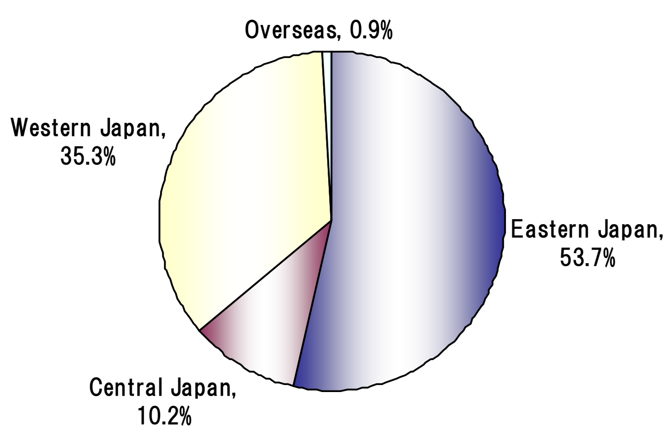
All of Nagaileben's products are medical clothing or related items. The company's sales can be broken down by item, or type of clothing, by geographical market, and by clothing classification. By item, as detailed in the pie chart below, in FY8/13, healthcare wear provided 57.9% of total sales, doctors' wear provided 16.4%, surgical wear supplied 9.5%, patient wear contributed 8.2%, utility wear provided 5.1%, shoes, etc. provided 1.6%, and other products accounted for 1.4%. Profitability does not vary much by item, but shoes and other products, which are purchased, are less profitable than the other types of clothing, which are made in-house.

Breakdown of FY8/13 Consolidated Sales by Item



By geographical market, eastern Japan accounted for 53.7% of total sales in FY8/13, western Japan, for 35.3%, central Japan, for 10.2%, and overseas for 0.9%. The overseas sales ratio could grow in coming years.

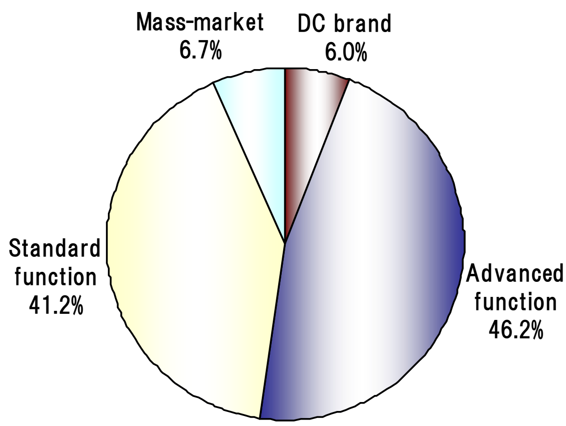
Breakdown of FY8/13 Consolidated Sales by Geographical Market



■Company Outline

By product classification, advanced function goods supplied 46.2% of total sales in FY8/13, standard function goods supplied 41.2%, mass-market goods provided 6.7%, and designer-character (DC) brand goods provided 6.0%. The price ranges of nurse wear by classification are as follows: mass-market ¥5,000 or less, standard function ¥5,000-7,500, advanced function ¥7,500-10,000, and DC brand ¥10,000 or more. The higher priced classifications are more profitable than lower priced classifications.

Breakdown of FY8/13 Consolidated Sales by Product Classification



○Sales Routes and Manufacturing

Since the end-users of Nagaileben’s products are mainly doctors, nurses and patients, the company’s main customers are hospitals, other medical facilities, and nursing homes. All of the company’s sales are made through intermediary companies. Thus, the company has no direct selling cost. However, its sales representatives maintain contact with customer institutions to ascertain their needs and the needs of the end-users.

In the past, most customer institutions purchased Nagaileben’s clothing and washed it in-house. In recent years, however, more institutions have leased the clothing, returning it to the company for washing. These leases are usually for four years and are regularly renewed, contributing to the steady growth of Nagaileben’s sales and profits.

In FY8/13, 97.4% of the products sold by Nagaileben were made in-house and 2.6% were purchased. Products made by the company in Japan accounted for 56.7% of sales, and products made overseas accounted for 40.7%. Nagaileben does not own overseas plants. Its products made overseas are manufactured at plants owned by partner companies in the host country, i.e., the country where the goods are manufactured. This arrangement minimizes Nagaileben’s costs and investment risk.

■Company Outline

Holds an unchallenged position in its industry

(3) Distinctive Features and Strengths

Nagaileben's dominance in the production of medical clothing stems in part from its integrated operations. The company performs all stages of work, from product planning to the procurement of raw materials, manufacturing, and sales. Thus, it can design products that reflect customer needs, procure the best materials for these products, manufacture cheaply, and sell at a reasonable profit margin.

Nagaileben's production system is superior to those of competitors. The company has many contracted plants that manufacture several thousand clothing items, enabling the company to respond to a wide range of customer needs. With almost 1,000 sales agents throughout Japan, the company has an extensive sales coverage at minimal cost.

As a result of these strengths, Nagaileben has gained a more than 60% share of the Japanese market for medical clothing. According to the company, the second largest seller of this clothing has only a 7–8% market share, while companies ranking third or below have shares of only a few percentage points. In FY8/13, Nagaileben earned a gross profit margin of 47.0%, which is high for any industry. The company's high market share and profitability reflect the satisfaction of its customers with its products and services. This customer satisfaction is probably the company's greatest strength.

■Business Trends

Sales of healthcare wear and doctors' wear remain strong

(1) Q1 FY8/14 Results

In Q1 FY8/14, Nagaileben increased its consolidated sales by 7.5% y-o-y to ¥3,201mn, its operating profit by 13.1% to ¥922mn, its recurring profit by 8.5% to ¥1,000mn, and its net profit by 9.3% to ¥616mn. Sales of healthcare wear and doctors' wear led overall sales growth.

The costs of raw materials and processing rose, but sales also increased, and the company limited the adverse impact of yen depreciation against the US dollar on its cost of goods sold through forward currency exchange contracts. Furthermore, the sales weighting of goods produced overseas rose, and these goods provide higher gross profit margins than goods produced in Japan. Reflecting these factors, the gross profit margin fell only marginally to 46.8% from 47.1% in FY8/13. The company had expected a decline of this size.

SGA costs fell to ¥576mn in H1 FY3/14 from ¥586mn in H1 FY3/13. These costs were lower than the company had projected, mainly because some repair costs and other costs originally budgeted for Q1 were postponed. For the full fiscal year, the company still forecasts a y-o-y increase in its SGA costs.

The net non-operating profit declined y-o-y in H1 FY3/14, but it was larger than the company had projected because the company recorded a currency exchange gain of ¥62mn on its US dollar bank deposits, whereas it had forecast no such gain.

■Business Trends

Consolidated Sales and Profit (¥mn) Breakdown for Q1 FY8/13 and Q1 FY8/14

	Q1 FY8/13		Q1 FY8/14			
	Amount	Sales %	Amount	Sales %	Change amount	y-o-y
Sales	2,978	100.0%	3,201	100.0%	222	7.5%
Gross profit	1,402	47.1%	1,499	46.8%	96	6.9%
SGA cost	586	19.7%	576	18.0%	-10	-1.8%
Operating profit	816	27.4%	922	28.8%	106	13.1%
Recurring profit	921	30.9%	1,000	31.2%	78	8.5%
Net profit	563	18.9%	616	19.3%	52	9.3%

Sales Breakdowns

Sales in Q1 FY8/13 and Q1 FY8/14 are broken down by item in the following table. The market for healthcare wear was stable in H1 FY8/14, and many leases of this wear were renewed. Thus, sales surpassed the company’s expectation. Sales of doctors’ wear were supported by strong sales of new products. Sales of utility wear were static as the market for such wear continued to deteriorate. Utility wear is worn over aprons, doctors’ coats, and other wear, and utility wear has been supplanted in recent years by apparel serving the functions of both utility wear and the wear beneath it, but the market for utility wear appears to be bottoming out. Sales of patient wear and surgical wear increased reflecting the company’s greater penetration of the markets for this wear.

Breakdown of Consolidated Sales (¥mn) by Item, Q1 FY8/13-Q1 FY8/14

	Q1 FY8/13	Q1 FY8/14	
	Amount	Amount	y-o-y
Healthcare wear	1,654	1,776	7.3%
Doctors’ wear	455	504	10.7%
Utility wear	170	171	0.7%
Patient wear	304	314	3.3%
Surgical wear	295	334	13.0%
Shoes	44	36	-16.9%
Other products	53	63	18.7%
Total	2,978	3,201	7.5%

Financial Condition

Cash and deposits declined by ¥1,525mn in Q1 FY8/14 (see balance sheet below), notes and accounts receivable shrank by ¥769mn, and inventories grew by ¥484mn. Thus, current assets decreased by ¥1,657mn to ¥24,589mn. Tangible fixed assets fell by ¥30mn to ¥7,609mn, intangible fixed assets dropped by ¥1mn to ¥86mn, and long-term investments and other assets grew by ¥78mn to ¥3,157mn. Thus, total fixed assets increased by ¥46mn to ¥10,853mn. Total assets declined by ¥1,611mn to ¥35,443mn.

Corporate taxes payable decreased by ¥999mn, contributing to a ¥810mn drop in current liabilities to ¥2,545mn. Fixed liabilities increased by ¥25mn to ¥635mn, and total liabilities decreased by ¥785mn to ¥3,180mn.

Q1 FY3/14 net profit of ¥616mn accrued to retained earnings, but the company paid ¥1,541mn in dividends. Consequently, its total equity decreased by ¥826mn in Q1 to ¥32,262mn.

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■Business Trends

Summary Consolidated Balance Sheet (¥mn), at 8/13 and 11/13

	8/13	11/13	Change
Cash and deposits	17,456	15,930	-1,525
Notes and accounts receivable	4,622	3,853	-769
Inventories	3,524	4,008	484
Current assets	26,247	24,589	-1,657
Buildings and other structures	1,645	1,618	-26
Land	4,692	4,692	0
Construction in progress	768	773	5
Long-term investments, other	3,079	3,157	78
Fixed assets	10,807	10,853	46
Total assets	37,054	35,443	-1,611
Bills and accounts payable	1,385	1,467	81
Corporate taxes payable	1,344	344	-999
Total liabilities	3,966	3,180	-785
Retained earnings	31,886	30,961	-924
Treasury stock	-3,401	-3,401	0
Total equity	33,088	32,262	-826
Total liabilities and equity	37,054	35,443	-1,611

Gross profit margin projected to remain constant y-o-y

(2) Company Forecasts for FY8/14

For FY8/14, the company projects a 2.4% y-o-y rise in consolidated sales to ¥16bn, a 0.1% increase in operating profit to ¥4,880mn, a 9.1% decline in recurring profit to ¥4,923mn, and a 2.9% fall in net profit to ¥3,030mn. Reflecting uncertainty about the impact of the increase in Japan's consumption tax from April 1, 2014, the company makes a conservative forecast of its sales growth. The company foresees an increase in its US dollar cost of raw materials and an additional increase in production costs due to an expected depreciation of the yen against the US dollar. On the other hand, it foresees increased sales of higher-margin products, and it expects to reap additional gross profit by raising its overseas production ratio. On balance, the company forecasts a gross profit margin of 47.0% for FY8/14, unchanged from the margin in FY8/13.

The company projects a ¥167mn increase in its SGA cost in FY8/14, to ¥2,640mn, including ¥93mn to move into the new head office. The company foresees no non-operating profit in FY8/14 similar to the ¥500mn foreign exchange gain that it logged in FY8/14. Thus, it forecasts a 9.1% y-o-y fall in recurring profit to ¥4,923mn. However, if the current exchange rate between the yen and the US dollar persists, the company is likely to earn a foreign exchange gain and to report a larger recurring profit than it now projects. The company also foresees no extraordinary loss in FY8/14 similar to the ¥332mn asset impairment loss it declared in FY8/13. Therefore, it projects only a 2.9% y-o-y drop in net profit in FY8/14 to ¥3,030mn. However, the company may earn an extraordinary gain on the sale of its current head office building, although its forecast of net profit does not consider this possibility. Its net profit may therefore grow.

Nagaileben plans to invest ¥859mn in plant and equipment in FY8/14. Of this, ¥577mn is scheduled for the new head office, ¥95mn is for the renovation of equipment at distribution centers, and ¥50mn is for production facilities. The company estimates that its depreciation cost will come to ¥344mn in FY8/14.

■Business Trends

Consolidated Sales and Profit (¥mn) Breakdown for FY8/13 and FY8/14E

	FY8/13		FY8/14			
	Amount	Sales %	Amount	Sales %	Change amount	y-o-y
Sales	15,625	100.0%	16,000	100.0%	375	2.4%
Gross profit	7,346	47.0%	7,520	47.0%	174	2.4%
SGA cost	2,473	15.8%	2,640	16.5%	167	6.8%
Operating profit	4,873	31.2%	4,880	30.5%	7	0.1%
Recurring profit	5,418	34.7%	4,923	30.8%	-495	-9.1%
Net profit	3,119	20.0%	3,030	18.9%	-89	-2.9%

■Medium-term Management Plan

To promote sales of patient wear and surgical wear

(1) Aiming for consolidated sales of ¥16.8bn and operating profit of ¥5.1bn in FY8/15

For FY8/16, Nagaileben targets consolidated sales of ¥16.8bn and operating profit of ¥5.1bn. As the company forecasts an operating profit of ¥4.88bn for F8/14 and made significant progress toward that forecast in Q1, it should be able to achieve its operating profit target for FY8/15. To reach the sales target, the company plans the following developments.

Sales by item

Over the next two fiscal years, the company intends to promote sales of two newer items, patient wear and surgical wear. In FY8/13, these items accounted for 8.2% and 9.5% of total sales, respectively, but by FY8/15, the company hopes to raise these ratios to 9.0% and 11.0%, respectively. The company foresees sales growth for other items, too, but not as much as the growth it projects for these items.

Sales by geographical market

The company's strategy for promoting growth by geographical market is the same as its strategy for promoting growth by item, i.e., it will promote sales in the areas where its market share is low. Thus, the company will try to raise its sales weighting from western Japan from 35.3% in FY8/13 to 38.0% in FY8/15, but not at the expense of growth in eastern Japan.

Sales by product classification

The company has gained customer credibility in advanced function clothing and plans to build on this trust to expand the sales weighting of this classification from 46.2% in FY8/13 to 52.0% in FY8/15. As noted earlier, many hospitals now lease the company's products through three-year or four-year leases. When these leases are renewed, the company promotes new products for the new lease term. Using this approach, the company will probably be able to increase its sales weighting in advanced function clothing.

■Medium-term Management Plan

Numbers of nurses and nursing care workers to grow rapidly

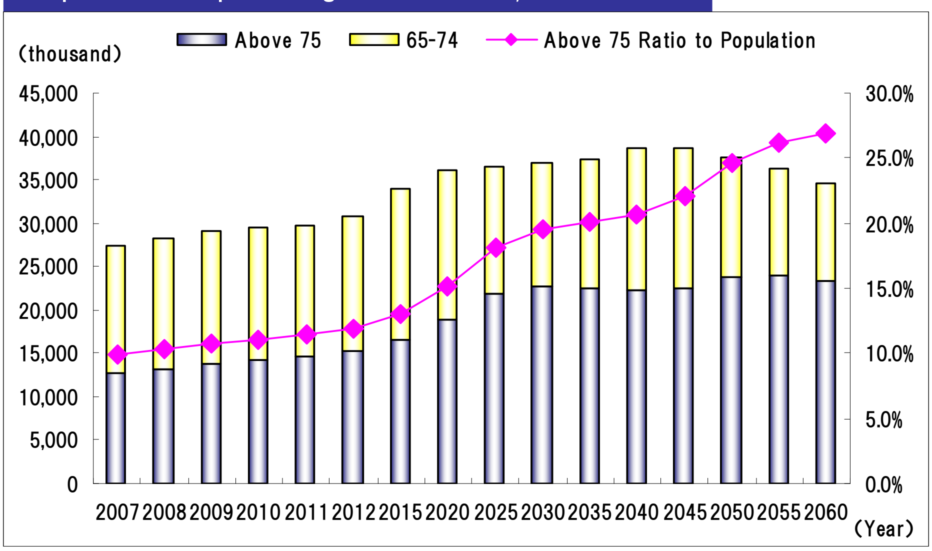
(2) Prospective Market Environment

The market environment for Nagaileben may change in the following ways.

Increases in markets for nursing and nursing care

In June 2013, the Cabinet Office announced a strategy to rebuild Japan. One goal of this strategy is to extend the healthy lifespan of Japanese people by preparing and expanding market environments conducive to this goal, including markets for healthy lifestyles, the prevention of disease, nursing care, pharmaceuticals, medical equipment, and nursing homes. Japan's current healthcare market is about ¥16 trillion, but the Cabinet Office forecasts that this market will grow to ¥26 trillion by 2020 and to ¥37 trillion by 2030. For the government's fiscal 2014, which runs from April 1, 2014 through the end of March 2015, the Ministry of Health, Labor and Welfare has requested a record-high budget of ¥30 trillion.

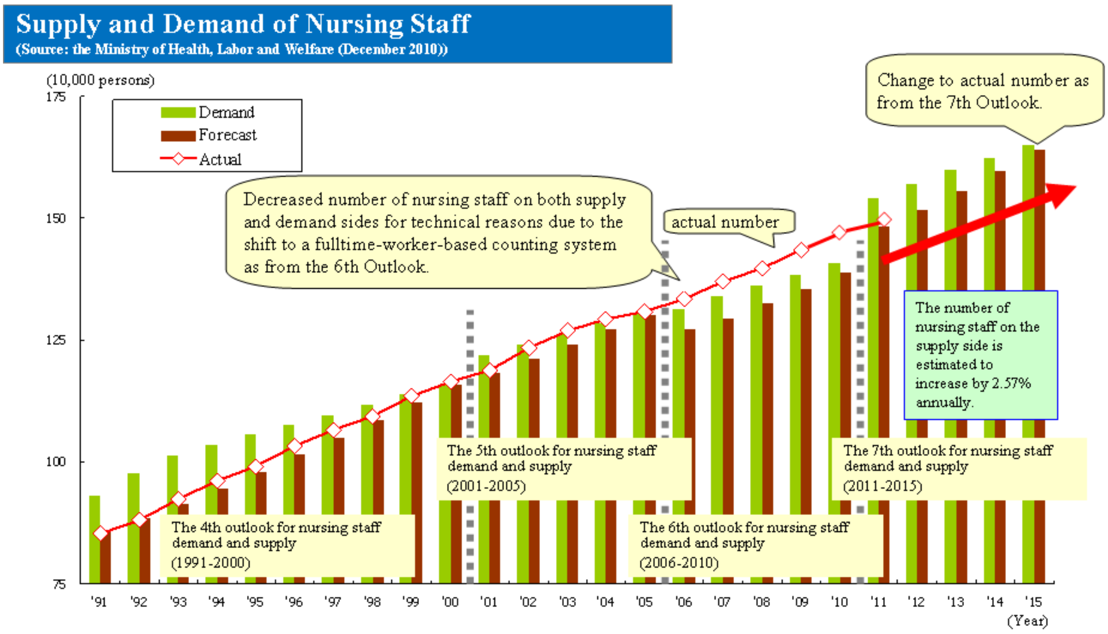
Population of Japanese Aged 65 and Older, 2007-2060F



Source: National Institute of Population and Social Security Research, Ministry of Internal Affairs and Communications

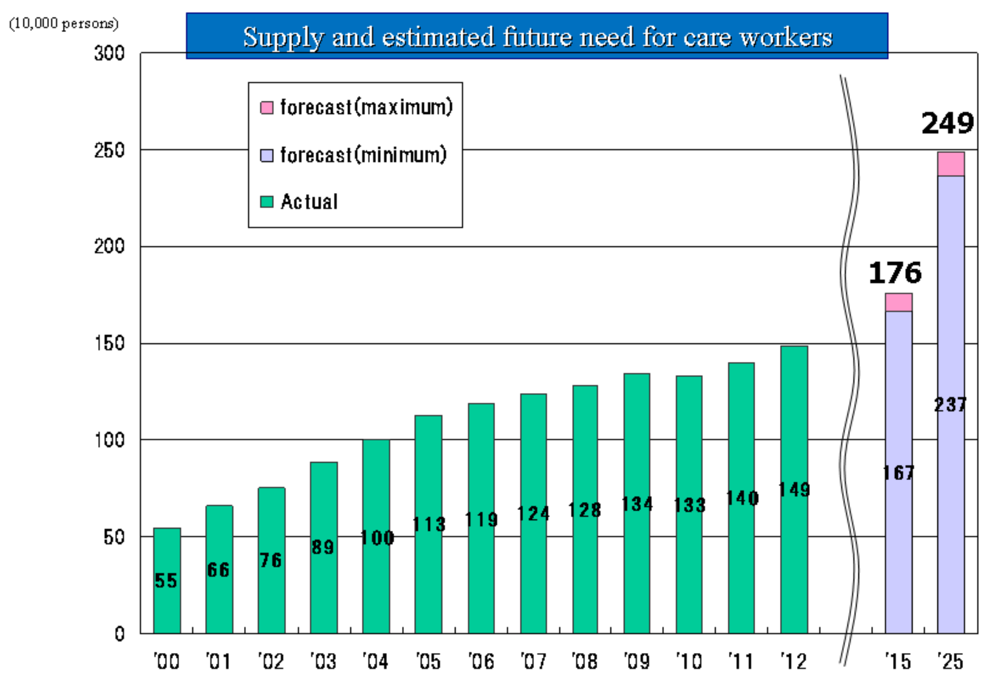
In December 2012, Japan's Ministry of Labor projected that the number of nurses in Japan would grow by an average annual rate of 2.57% between 2010 and 2015, when this number would reach 1.65mn. Similarly, the ministry forecasted that the number of nursing care workers would grow by an average annual rate of 5.1% over the same period to 1.73mn. Furthermore, the Cabinet Office has forecasted that the number of nursing care workers would increase from 1.49mn in 2012 to a maximum of 2.49mn in 2025. The growth in the numbers of these professionals is likely to support the growth of Nagaileben's business.

■Medium-term Management Plan



- The 7th outlook for nursing staff demand and supply (five-year plan from 2011 through 2015)
- Change to actual number as from the 7th Outlook.(The 6th is fulltime-worker-based counting system.)
- Outlook for nursing staff supply and demand for all medical and nursing fields

Source: Company



Since the number of track records are subject to the influence of change of an examination method, it cannot carry out annual comparison simply after 2010.

Actual record :survey of care service facilities and business, Ministry of Health, Labor and Welfare

Forecast: general politics measurement for the aged society, cabinet

Source: Company

■Medium-term Management Plan

Changes in medical costs

Nagaileben sells clothing for medical use, so its business is not directly affected by changes in official drug prices or fees for medical diagnosis and treatment. However, as these prices and fees are reduced or raised minimally, hospitals and other medical facilities cut their costs. As part of their cost-cutting, they prolong the replacement period for medical clothing. In April 2012, Japan’s official fees for medical diagnosis and treatment were raised by 0.004%. In April 2014, these fees will be raised by 0.1%.

Rise in the consumption tax to 8%

The government will raise Japan’s consumption tax from 5% to 8% in April 2014. Nagaileben expects this tax increase to have only a minor impact on the Japanese market for its products. The demand for these products is likely to increase before the tax hike and to weaken after the hike, but the net impact should be modest.

Rise in costs of raw materials and product processing

The company’s cost of polyester may increase, reflecting an upturn in the US dollar cost of crude oil and depreciation of the yen against the US dollar. Furthermore, the cost of product processing at partner manufacturers in China and Southeast Asia is likely to rise. To counter these possible cost hikes, the company plans to modify its production processes and to seek partner manufacturers in countries with lower labor costs than those at its current partners.

Increase in overseas production cost due to yen depreciation

As explained earlier, 40.7% of the products sold by Nagaileben in FY8/13 were manufactured overseas. The profits from sales of these products are reduced by yen depreciation against other currencies, mainly the US dollar. To minimize the impact of changes in yen exchange rates on profits, the company covers about 80% of its imports planned for the coming two-three years with forward currency exchange contracts. Thus, changes in these rates affect profits only gradually.

As a hedge against the impact of yen depreciation against the US dollar, the company maintains US dollar bank deposits. Because of yen depreciation against the US dollar in FY8/13, the company’s US dollar deposits earned a non-operating valuation gain of about ¥500mn, which boosted recurring profit.

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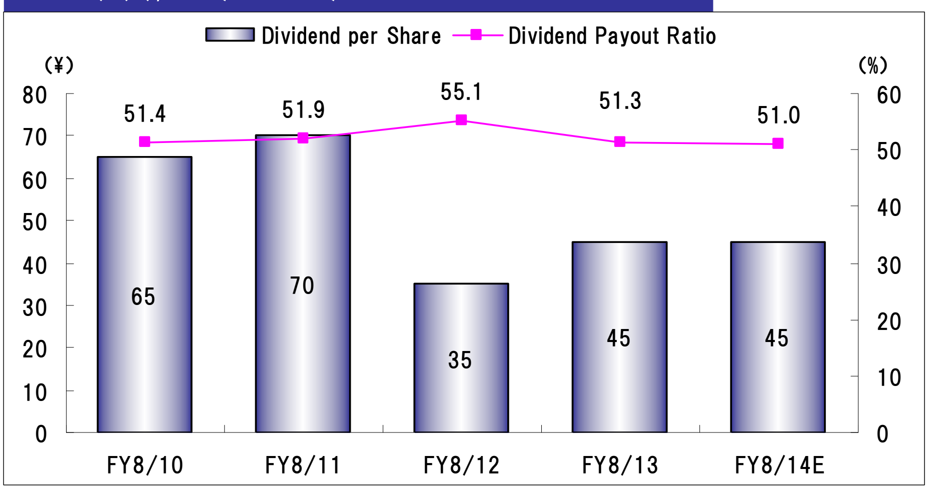
■Shareholder Returns and Improvement of Capital Efficiency

Company's stable financial position allows it to maintain a dividend payout ratio of at least 50%

As noted earlier, Nagaileben is financially stable, with an equity ratio of 91.0% at the end of Q1 FY8/14. Given its sound business, the company is likely to continue to earn steady profits. If it kept all its net profit as retained earnings, its return on equity would drop. Therefore, the company has vowed to maintain a dividend payout ratio of 50% or more against its parent-company net profit. Management has also stated that it would buy back shares if there were a promising occasion to do so. Thus, it is quite conscious of the importance of maintaining attractive shareholder returns and of using capital efficiently.

Dividends (¥) and Dividend Payout Ratio (parent basis) (%), FY8/18-FY8/14E



Note: The company made a two-for-one stock split on September 1, 2011

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