Nagaileben
7447 Tokyo Stock Exchange First Section

17-Feb.-16

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

FISCO Ltd. Analyst
Noboru Terashima

Leading manufacturer of medical gowns with a domestic market share of over 60%

Nagaileben Co., Ltd. <7447> (hereafter, "Nagaileben" or "the Company") is the leading manufacturer of medical gowns in Japan, with a domestic market share of over 60%. In the consolidated business results for Q1 (September to November 2015) FY8/16 announced by the Company, sales amounted to ¥2,579mn, a 13.8% decrease year on year ("y-o-y"); operating profit amounted to ¥544mn, a 30.5% decrease; recurring profit amounted to ¥563mn, a 44.4% decrease; and net profit amounted to ¥369mn, a 43.2% decrease. While there have been no significant changes, such as to the industry environment and market structure, some large contracts were postponed to Q2 or later. As a result there was a substantial decline in profits y-o-y, but although this should not be a cause for concern.

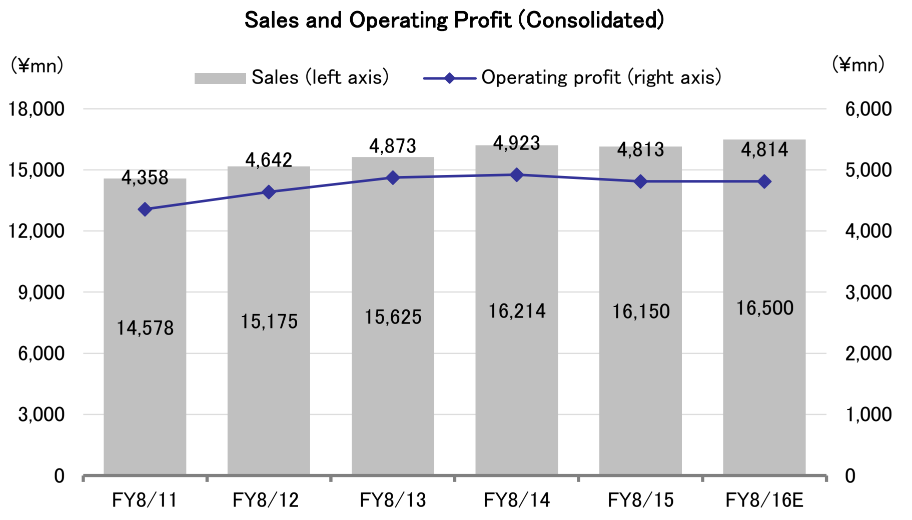
In its full-year business results for FY8/16, the current fiscal year, the Company expects to achieve ¥16,500mn in sales, a 2.2% increase y-o-y; ¥4,814mn in operating profit, unchanged from FY8/15; ¥4,869mn in recurring profit, a 4.3% decrease y-o-y; and ¥3,237mn in net profit, a 0.3% increase y-o-y. Although Q1 results were sluggish, the projection is for turnarounds in Q2 and Q3, so full-year forecasts are unchanged. While recurring profit is expected to decline amid a projected absence of foreign exchange gains, net profit could increase owing to the impact of the exchange rate at the end of the term.

The Company announced a new Mid-Term Management Plan that includes numerical targets of ¥17,500mn in sales and ¥5,300mn in operating profit by FY8/18. Management has retained these targets. The Company plans to achieve its goals by expanding overseas production and strengthening its high-margin advanced-function product range.

The Company is also upbeat on shareholder returns. In FY8/15, it augmented its normal annual dividend of ¥50 per share with an equivalent amount to commemorate its 100th anniversary. It also spent ¥1,500mn in a share buyback of 1 million shares through a takeover bid. The Company thus generated a total return ratio (non-consolidated basis) of 153.8% in that period. For FY8/16, management has pledged that it will pay an annual dividend of ¥50 per share and attaining a payout ratio (non-consolidated basis) exceeding 50%, so it merits praise for that commitment.

Check Point

- Stocking several thousand different items to accommodate diverse needs
- Planning to boost sales in all regions
- Focusing on expanding into peripheral markets by deploying new products



Company Profile

Established in 1915 as Nagai Shoten

(1) Description of businesses

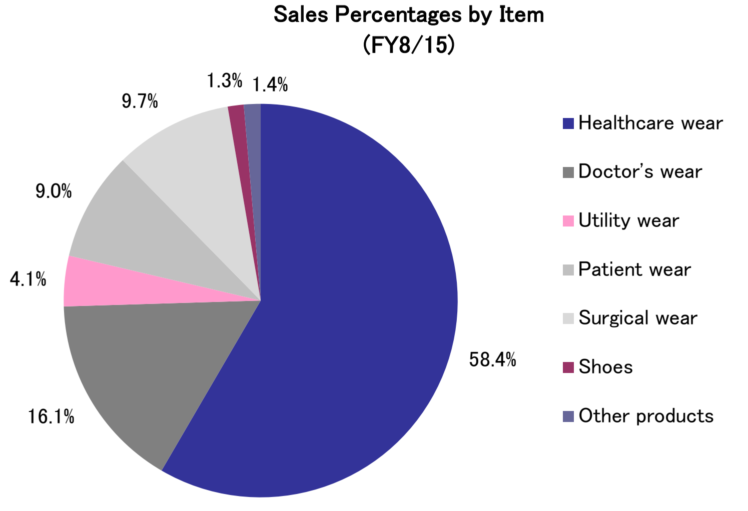
Nagaileben is a specialist manufacturer of medical gowns for nurses, doctors, patients and others. Established in 1915 as Nagai Shoten, the Company has a rich history. Since then, it has expanded its operations nationally to become a leading domestic manufacturer with a share of over 60% of the market for medical gowns for nurses.

Company History

1915	Founded business specializing in medical gowns in Kanda-Jinbocho in Tokyo, Japan, as Nagai Shoten, privately owned by Koji Nagai.
1950	Liquidated Tokyo Eisei Hakui Co. Ltd. Koji Nagai and Tatsuro Sawanobori jointly established Nagai Shoten Co. Ltd.
1969	Established a subsidiary, Nagai Hakui Kogyo Co. Ltd., in Akita Prefecture to expand the medical gowns manufacturing division. Tatsuro Sawanobori was appointed President. Shifted focus of manufacturing and sales business specialization from multi-purpose white gowns to medical gowns.
1977	Built second product center in Kameido, Tokyo. Established partnership with a US company, G.D. Searle & company; and established Japan Surgical Apparel Co. Ltd. in Hiroshima to expand sales of new surgical apparel products for hospitals.
1978	Established technology partnerships with Angelica Corp (US) and Toray Industries, Inc. Developed and released medical gowns made with new fabric for leasing.
1980	Changed name to Nagai Co. Ltd. Opened sales office in Takamatsu, Kagawa. Concluded a license agreement with designer Kansai Yamamoto.
1982	Concluded a license agreement with designer Yukiko Hanai.
1988	Established Emit Co. Ltd. as a spin-off from Nagai Co. Ltd. Thereafter, the two companies exchanged their names, with Emit Co. Ltd. becoming a group management company, and Nagai Co. Ltd. becoming a group headquarters for sales.
1989	Newly built new Nagai Luminous, a manufacturing plant for high grade products, in Akita Prefecture. Started overseas production for global division of labor.
1994	Changed name from Nagai Co. Ltd. to Nagaileben Co. Ltd. Built a new logistics center in Akita Prefecture.
1995	Started over-the-counter trading of the Company's stock. Started development and sales of a second pillar product to respond to the aging society. Vice President Ichiro Sawanobori appointed President.
1996	Concluded an agreement with French designer Andre Courreges.
1999	Opened sales office in Nagoya, Aichi Prefecture. Concluded a license agreement with designer Atsuro Tayama.
2001	Listed on the second section of Tokyo Stock Exchange.
2002	Established technology partnership with Standard Textile Company, Inc. (US) and Toray Industries, Inc. for surgical textiles. Raised the status of Nagoya sales office to a branch.
2004	Acquired ISO 9001. Listed on the first section of Tokyo Stock Exchange. Absorbed Hokkaido Nagai Co. Ltd. and established Hokkaido branch.
2005	Acquired ISO 14001. Concluded a license agreement with designer Keita Maruyama.
2006	Concluded a brand agreement with designer Minako Yokomori.
2014	Relocated to new head office building in Kajicho, Chiyoda Ward, Tokyo.

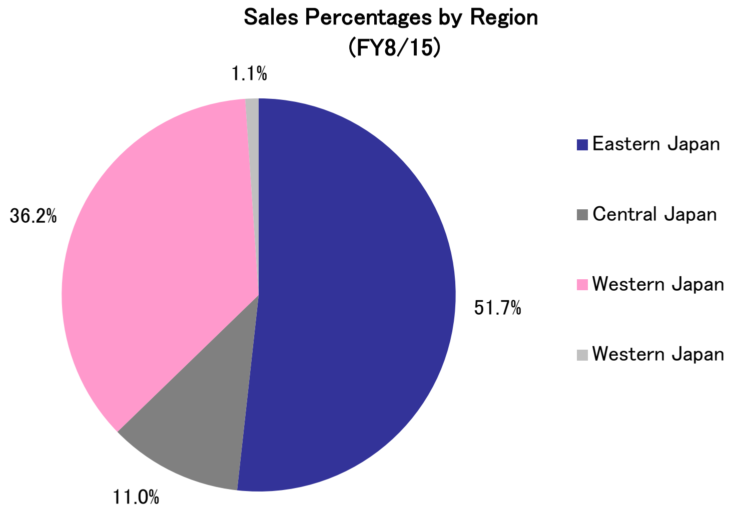
● Sales Breakdown

All of the Company's products are medical gowns and related products. The sales contribution by item (FY8/15) is healthcare wear 58.4%, doctor's wear 16.1%, surgical wear 9.7%, patient wear 9.0%, utility wear 4.1%, shoes 1.3% and other products 1.4%. Healthcare wear consists of products mainly for nurses, and utility wear consists of aprons, cardigans, and other items worn as outer garments. Profit margins for each item do not vary significantly; however, the profit margins of purchased products, such as shoes, are relatively lower.



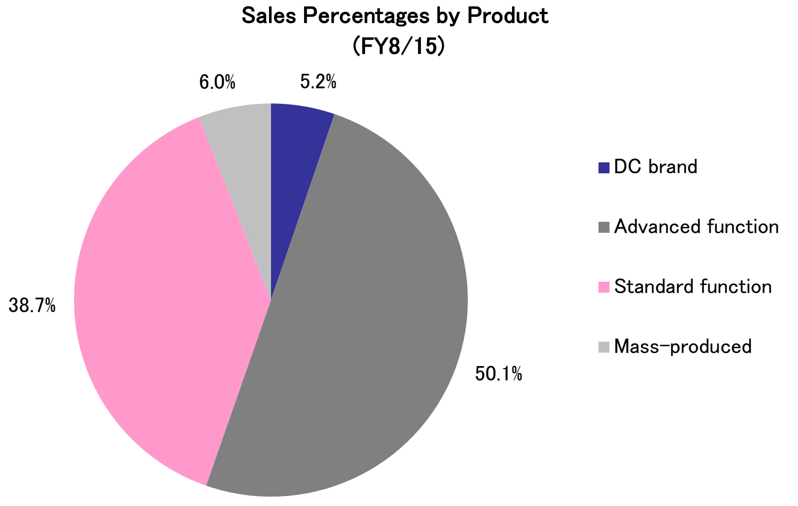
Source: Earnings presentation materials

In terms of sales contribution by region (FY8/15), eastern Japan accounts for 51.7%, western Japan 36.2%, central Japan 11.0%, and overseas 1.1%. While coverage is nationwide, sales in western Japan and overseas remain low, indicating potential for future expansion.



Source: Earnings presentation materials

In terms of sales contribution by product (function) (FY8/15), advanced-function products made up 50.1%, standard-function products 38.7%, mass-produced products 6.0%, and DC brand products 5.2%. As an example, in nursing wear products, when classified by price range, mass-produced products are under ¥5,000, standard-function products are ¥5,000-7,500, advanced-function products are ¥7,500-10,000, and DC brand products are over ¥10,000; the higher the price, the greater the profit margin. The Company plans to focus on expanding sales of advanced-function products.



Source: Earnings presentation materials

● Sales channels and production status

The Company's end users include nurses and doctors, with the purchasers of the products being mainly medical facilities such as hospitals, nursing care facilities, and other such facilities. However, the Company does not conduct direct sales, with 100% being agency sales via medical equipment wholesalers that trade with these medical and other facilities. As a result, direct sales expenses are contained; however, as sales staff is constantly in contact with large hospitals and other facilities, the Company understands customers' needs.

In most cases, medical gowns are laundered within the hospitals by the hospitals themselves, but in recent years they have been switching to leasing. The lease term is typically four years. Because this generates lease switching demand every four years, it seems to provide stable support for the Company's earnings.

Looking at the Company's production structure, based on FY8/15 performance, internal production and partner plants constitute an aggregate 98.6% (53.0% domestically and 45.6% overseas), with purchased products accounting for 1.4%. Overseas production is predominantly in Indonesia, but the Company owns no factories and the goods are produced at factories of local partners, which mitigates investment risk and reduces costs.

Stocking several thousand different items to accommodate diverse needs

(2) Distinctive characteristics and strength

The Company is a specialized manufacturer of medical gowns, and one of its strengths is that it has in place an integrated system to undertake everything, from design to raw material procurement, manufacturing and sales. In its product planning, it can accurately understand customer needs and reflect them in its products. Specifically, the Company sells products that are easy to wear and easy to work in while incorporating anti-static, antibacterial, and other functions, as well as feature excellent designs, which have earned a good reputation from its users. At the same time, it deals directly with major synthetics manufacturers and textiles traders, so it secure optimal materials and produce at low costs while selling at appropriate margins.

Furthermore, in addition to its large number of affiliated factories, the Company has the necessary financial resources to be able to constantly maintain product item inventories that extend into the thousands of varieties, while also being able to swiftly respond to a broad range of user needs, including for made-to-order products, through a rapid production and sales system (the Quick Response system) that delivers the desired product on a specified day. This has also helped it to earn strong trust from its customers. On the sales side, it has a network of close to 1,000 agents nationwide, and while its sales capabilities are robust, the Company itself controls its sales expenses as much as possible.

As a result, the Company's share of the domestic market for medical gowns for nurses exceeds 60%, and it maintains a firm position as the leading medical gown manufacturer in Japan. Additionally, it has maintained profitability with a gross margin of 46.6% (actual results for FY8/15). The fact that it is both highly profitable and has a high market share means that most of its customers are satisfied with its products and services, which is the Company's greatest strength.

By concentrating its business resources in the niche market of medical gowns, the Company can efficiently manage everything from design to manufacturing and sales. Moreover, although it is a niche market, room for further development remains, as it has relatively low market shares for patient wear, surgical wear and other items. The Company has explicitly stated that the medical gown business could grow for some time and it will move aggressively to develop peripheral markets.

(3) Corporate policies

The Company commemorated its centennial in July, 2015, by cultivating a corporate culture called Nagaism that champions interpersonal harmony, generating profits, and contributing to society. Management has undertaken the following specific initiatives in those regards, and looks to remain an enterprise that contributes to society and the healthcare industry.

● A robust management approach
The Company is pursuing stable medium- and long-term growth by exploring principles.

● Social responsibilities
(Contributing to communities through production sites)
The Company is creating employment and contributing to regional economies through its production operations in Akita Prefecture, Japan, as well as in Dalian, China, Indonesia, Vietnam, and elsewhere overseas.

(Fostering opportunities for women)
The Company is creating workplaces in which women can play key roles, including in the medical and apparel arenas.

(Environmental initiatives)
The Company secured ISO 14001 certification in 2015. It is also helping to address environmental issues by expanding sales of its COMPELPAK.

(Providing support to children)
The Company endeavors to educate and enlighten to make its business more attractive to children, including by having the mascot Miffy visit pediatric wards and by lending children's coats to medical institutions.

● Shareholder returns
Management has committed itself to generating shareholder returns by providing stable dividends and by maintaining a payout ratio of at least 50% on a non-consolidated basis.

Management is ready to repurchase shares when it concludes that the stock is undervalued.

Earnings Trends

Q1 revenues and earnings down as large projects slid

(1) Summary for the Q1 of FY8/16

● Status of profit and loss

In Q1 FY8/16, consolidated sales were down 13.8% y-o-y to ¥2,579mn, operating profit fell 30.5% to ¥544mn, recurring profit was down 44.4% to ¥563mn, and net profit fell 43.2% to ¥369mn. The steep drops in revenues and earnings were somewhat predictable, and management has said that results were basically on target. There thus seems no need for great concern about the numbers.

Summary for Q1 of FY8/16

(¥mn, %)

	Q1 FY8/15		Q1 FY8/16			
	Amount	Sales %	Amount	Sales %	Change	y-o-y
Sales	2,994	100.0	2,579	100.0	-414	-13.8
Gross profit	1,401	46.8	1,183	45.9	-217	-15.5
SG&A costs	617	20.6	639	24.9	21	+3.5
Operating profit	784	26.2	544	21.1	-239	-30.5
Recurring profit	1,013	33.8	563	21.8	-449	-44.4
Net profit	649	21.7	369	14.3	-280	-43.2

Although sales decreased 13.8% y-o-y, the decline was predictable to an extent. Management expected contract conclusions for some large projects to slide into Q2 or later. Another factor was that some customers had postponed orders because they were unsure about the impacts of revisions to medical treatment fees and drug price standards. Management thus commented that it had basically expected this result and that it was in line with projections.

The gross margin was down 0.9 point to 45.9% from 46.8% a year earlier. This was as expected from the outset, however, and reflected higher raw materials and processing charges, and the yen's depreciation. SG&A costs rose 3.5% to ¥639mn. This was as projected, as the Company increased costs related to centennial commemorations. Operating profit thus fell 30.5%, although that was in line with forecasts.

Conversely, recurring profit declined 44.4% y-o-y, and while the extent of the decline was bigger than that of operating profit, this was mainly due to the decrease in non-operating profit, particularly the decrease of foreign exchange gains. To hedge against the effects of the yen's depreciation on the cost of sales, the Company holds deposits in U.S. dollars. The foreign exchange gain arising from these deposits fell from ¥215mn to ¥5mn y-o-y. There were no major extraordinary profits or losses during the term. Net profit, therefore decreased 43.2% to ¥369mn. This was within projected parameters and seems no cause for concern.

● Financial position

The Company's financial status has remained stable. Total assets at the end of Q1 FY8/16 amounted to ¥35,381mn, a decrease of ¥3,627mn compared to the previous year-end. Total current assets amounted to ¥26,188mn, a decrease of ¥3,523mn, primarily reflecting a decrease of ¥3,208mn in cash and deposits, a decrease of ¥1,227mn in notes and accounts receivable and an increase of ¥809mn in inventories. Fixed assets amounted to ¥9,192mn, a decrease of ¥104mn, due mainly to depreciation.

Total liabilities amounted to ¥3,569mn, a decrease of ¥644mn compared to the previous year-end. Its primary causes include a decrease of ¥1,001mn in corporate tax payable. Net assets amounted to ¥31,811mn, a decrease of ¥2,983mn compared to the previous fiscal year-end. This was mainly due to a decrease of ¥ 3,324mn for dividends payment. As a result of these factors, the shareholders' equity ratio was 89.9%, increasing from 89.2% at the previous year-end.

Consolidated Balance Sheet

(¥mn)

	End FY8/15	End Q1 FY8/16	Change
Cash and deposits	18,673	15,465	-3,208
Notes and accounts receivable	4,689	3,462	-1,227
Securities	1,518	1,518	+0
Inventories	4,199	5,009	+809
Current assets	29,711	26,188	-3,523
Tangible fixed assets	7,605	7,552	-53
Intangible fixed assets	71	65	-6
Investment and other assets	1,619	1,574	-45
Fixed assets	9,296	9,192	-104
Total assets	39,008	35,381	-3,627
Bills and accounts payable	1,399	1,483	+84
Corporate tax payable	1,151	149	-1,001
Total liabilities	4,213	3,569	-644
Retained earnings	35,040	32,085	-2,955
Treasury stock	-4,902	-4,902	+0
Net assets	34,795	31,811	-2,983
Total liabilities and net assets	39,008	35,381	-3,627

Planning to boost sales in all regions

(2) FY8/16 business results forecast

FY8/16 Consolidated Business Results Forecast

(¥mn, %)

	FY8/15		FY8/16 E			
	Amount	Sales %	Amount	Sales %	Change	y-o-y
Sales	16,150	100.0	16,500	100.0	349	+2.2
Gross profit	7,532	46.6	7,590	46.0	57	+0.8
SG&A costs	2,719	16.8	2,776	16.8	56	+2.1
Operating profit	4,813	29.8	4,814	29.2	+0	+0.0
Recurring profit	5,088	31.5	4,869	29.5	4,306	-4.3
Net profit	3,225	20.0	3,237	19.6	2,868	+0.3

For the consolidated full-year business results for FY8/16, the Company expects to achieve ¥16,500mn in sales, a 2.2% increase y-o-y; ¥4,814mn in operating profit, unchanged from FY8/15; ¥4,869mn in recurring profit, a 4.3 % decrease; and ¥3,237mn in net profit, a 0.3% increase. As mentioned earlier, the declines in revenues and earnings in Q1 were basically as expected, and management has retained its full-year forecasts.

This is partly because one factor in the lower Q1 sales was that some large projects slipped behind. Management looks to make up for lost ground from Q2. Also, the government is raising medical treatment fees by 0.49% from spring 2016. It had been unclear what would happen in that respect. The rise should not negatively affect the operating climate. On top of that, the Company has already started negotiating price hikes with key customers, and as those increases go into effect margins should improve. So, while revenues and earnings declined in Q1 for the reasons stated earlier, there seem no particular grounds for concern about full-year forecasts.

Sales are forecast to increase due to factors including sales of new value-added offerings in the mainstay healthcare wear and doctor's wear segments, secure winning the delayed renewal demand for large scale contracts, and efforts to secure new contracts. Further, the Company continues to focus on raising its market share in central Japan and western Japan, and it is targeting sales increases in all regions for the full fiscal year.

The gross margin is expected to decrease from 46.6% a year earlier to 46.0%. On the upside, the overseas production ratio should rise. On the downside, the Company will face higher raw materials and processing charges, while currency fluctuations should also be among the negative factors. While higher costs owing to the yen's decline are a concern, this should not pose immediate concerns, as the Company should minimize the impact through forward contracts. That said, the reality is that such contracts are gradually becoming less effective than they were two years ago. Increasing the overseas production ratio and hedging against a lower yen through dollar-denominated deposits has become less effective. For that reason, management has said that internal measures to combat higher expenses have their limits and that the time has come to explore boosting prices. The Company has already begun negotiating price increases. While it would not be easy to get the price hikes through, it seems highly likely that it would gradually win acceptance. That is because the Company has a high market share and solid trust for its products and because many rivals have already boosted their prices.

SG&A costs are forecast to be ¥2,776mn (a 2.1% increase y-o-y), reflecting the remaining costs related to the Company's 100th anniversary. The y-o-y decrease in recurring profit assumes that the foreign exchange gains (¥226mn) recorded in non-operating profit in FY8/14 will decline. However, if the yen weakens further by the end of FY8/16 compared to FY8/15, it is possible that the decline in profits will be less than anticipated, and depending on circumstances, recurring profit may actually increase y-o-y. Furthermore, since the extraordinary profit that was recorded in FY8/15 (the ¥30mn profit on the sale of a research center in Kameido) will not occur in FY8/16, but the effective corporate tax rates was lowered due to the tax system revision As a result, net profit is forecast to increase y-o-y.

Mid-term Management Plan and Outlook

Focusing on expanding into peripheral markets by deploying new products

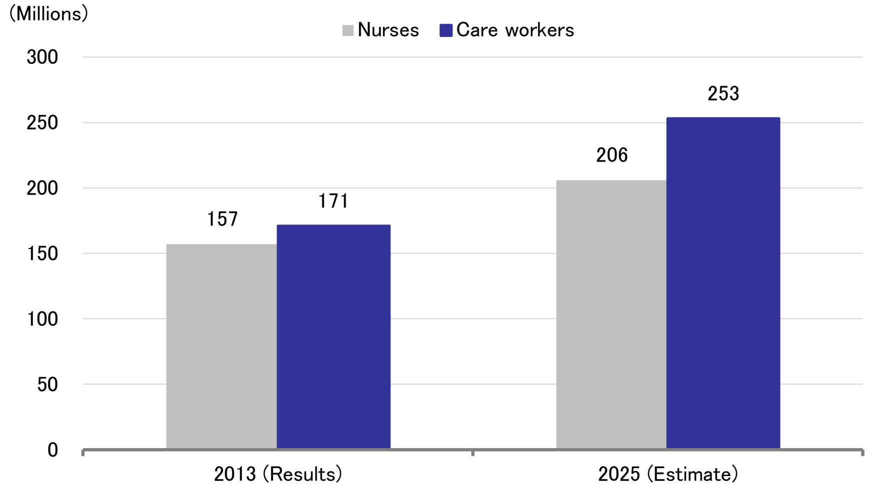
(1) Mid-term Management Plan

The Company initially targeted FY8/17 sales of ¥17,500mn and operating profit of ¥5,300mn in announcing its Mid-term Management Plan. Management decided to set those targets back to FY8/18, however, in light of prevailing results. The Company has not changed the business strategies described below.

(2) Future business strategies

The operating environment surrounding the Company should be favorable for some time. According to the material released by the Ministry of Health, Labour and Welfare, the number of nurses in Japan is projected to increase from 1.57 million in 2013 to a maximum of 2.06 million in 2025. Moreover, the number of care workers is projected to increase from 1.71 million in 2013 to 2.53 million in 2025. In this operating environment, the Company plans to achieve its Mid-Term Management Plan based on the following strategies.

Projected Demand for Nurses and Care Workers



Source: Ministry of Health, Labour and Welfare

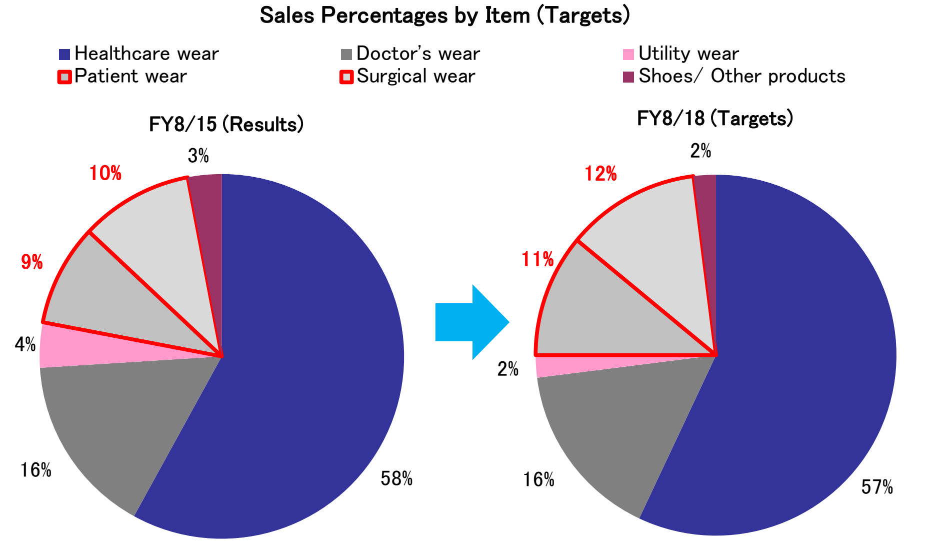
FISCO

Nagaileben
7447 Tokyo Stock Exchange First Section

17-Feb.-16

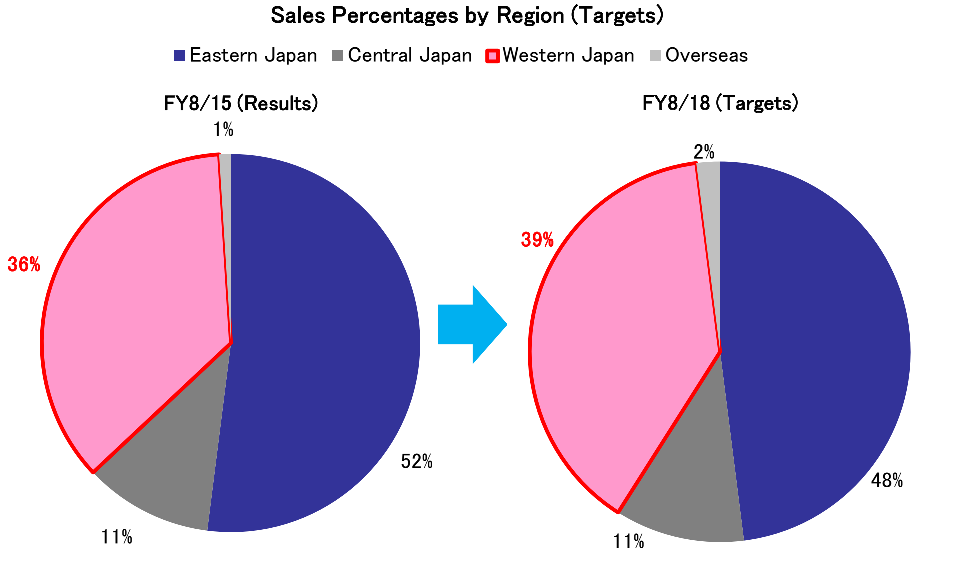
● **Expansion in patient, surgical & other peripheral market**

In its mainstay healthcare wear, the Company already maintains a high market share and can expect stable renewal demand. On the other hand, the peripheral market for patient wear and surgical wear and others still has ample development potential. The Company plans to focus on expanding the peripheral market by launching new products.



● **Increase market share in western Japan**

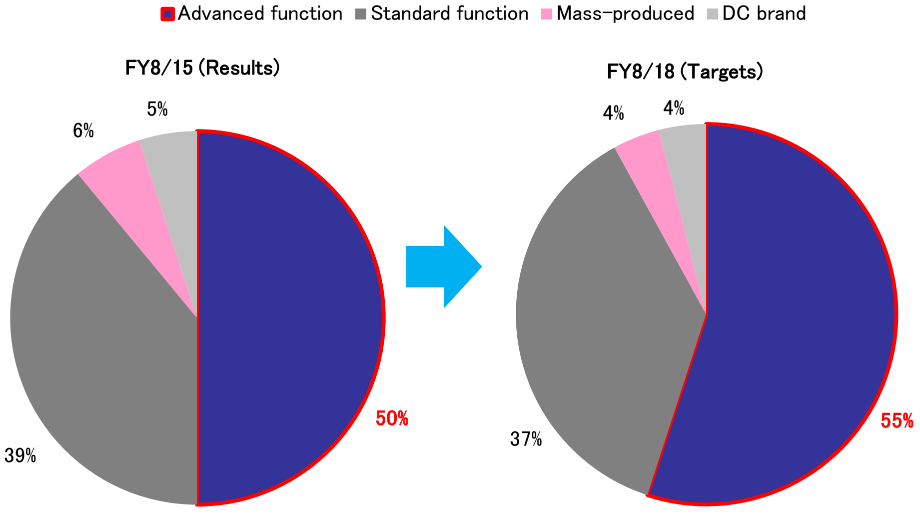
By region, the Company maintains a high market share in eastern Japan, but in central Japan and western Japan, it has relatively low market shares. In other words, these regions have potential for further market share growth. To expand its market share, the Company will not only conduct an aggressive sales campaign, but will actively launch advanced-function products and new products.



● Development and sales of advanced-function product

The Company is actively developing products with even greater functionality and added value to deliver added value to markets where it is already strong, and to serve as tools for its marketing strategy in markets where it seeks to increase its market share. To that end, its strategy is to collaborate more closely with material manufacturers and trading companies while further refining its Quick Response (QR) production system to raise customer satisfaction.

Sales Percentages by Product (Targets)



● Improving gross margin

In the last 20 years, the Company's profit margin has improved approximately 12 percentage points (from around 35% to 47%). In the future, although improving profitability at the same pace as before will not be easy, the Company aims to make further improvements mainly through the following measures.

The first is to increase overseas production. Currently, the Company's ratio of overseas production is still around 45.6%, which is way lower when compared to other apparel manufacturers. In other words, there is considerable room to further increase the overseas production ratio with potential for improving profitability from expansion of overseas production. However, the Company's policy is not to shift domestic production all at once to overseas, but rather to produce the portion of increased sales overseas while maintaining domestic production volumes. In February 2014, a new factory, which had been under construction in Java in central Indonesia, began operation, and by the end of 2015, the transfer of existing production from Jakarta has been completed.

The second measure to improve profitability is the development of high value-added products. If the percentage of sales of products with high profit margins, such as advanced-function products, increases, the overall gross margin will also improve. Furthermore, while there have been no official announcements, the Company continues to develop new markets, and its plans for new markets (new products) should also contribute to improving its gross margins in the future.

While a weaker yen is a major factor in deteriorating margins, management has responded by extensively using forward contracts to average out foreign exchange fluctuations, while hedging as much as possible with dollar denominated deposits. As mentioned earlier, however, the Company is nearing the limits with such measures for the yen depreciation, and seems to be approaching a time in which it should consider measures to deal with a higher yen. In any case, the Company will retain its policy of promptly leveling out the impacts of foreign exchange swings.

Shareholder Return Policy

Comprehensively returning profits to shareholders, including through share buy-backs

The Company's shareholders' equity ratio has reached 89.9% (At the end of Q1 FY8/16) and it is financially stable. Additionally, considering the Company's business conditions, it seems highly unlikely that those profits will rapidly deteriorate, so continued stable earnings are expected. As a result, as its distribution of earnings outside the Company (particularly dividend payments) is low and profits will accumulate in shareholders' equity each year, return on equity (ROE) will decline, which is to say, capital efficiency will decline. But in addition to paying dividends commensurate with the growth in profits, the Company actively and comprehensively returns profits to shareholders, including through share buy-backs, and as a result has maintained a high ROE (9.3% in FY8/15).

The Company will thus maintain a stable financial position while pursuing solid shareholder returns. In FY8/15, the Company augmented the normal dividend of ¥50 per share with an additional ¥50 per share to commemorate its centennial. This raised total dividends to ¥100 per share, for a non-consolidated payout ratio of 107.5%. Management also spent ¥1,500mn in repurchasing 1 million shares during the term, raising the total payout ratio (non-consolidated basis) to 153.8%. Over the past five years, the weighted average total payout ratio (dividends over five years plus share repurchase payments divided by net profit over five years) has reached 79.25%, which is far higher than the figures of many other listed entities

For FY8/16, management has announced that the annual dividend of ¥50 per share and the non-consolidated payout ratio will again be 50% or more. This approach merits solid praise, as it demonstrates that the Company is greatly committed to delivering shareholder returns and maintaining its capital efficiency.

Dividend Payout Ratio and Total Return Ratio

	Total dividend (¥mn)	Share buyback (¥mn)	Dividend ratio* (%)	Total return ratio* (%)
FY8/01	475	0	27.4	27.4
FY8/02	475	0	29.3	29.3
FY8/03	530	1,697	29.7	124.6
FY8/04	744	0	36.5	36.5
FY8/05	1,117	0	56.9	56.9
FY8/06	1,117	0	53.4	53.4
FY8/07	1,117	0	53.1	53.1
FY8/08	1,083	1,077	56.6	111.2
FY8/09	1,040	1,220	57.3	122.2
FY8/10	1,127	0	51.4	51.4
FY8/11	1,205	226	52.0	61.7
FY8/12	1,205	0	55.1	55.1
FY8/13	1,541	229	51.3	58.7
FY8/14	1,712	0	54.4	54.4
FY8/15	3,324	1,500	107.5	153.8

* Nonconsolidated basis

Source: Earnings presentation materials

Disclaimer