G-7 Holdings

7508 Tokyo Stock Exchange First Section

Company Research and Analysis Report
FISCO Ltd.
http://www.fisco.co.jp

19-Apr-12

FISCO Ltd. Analyst
Yuzuru Sato

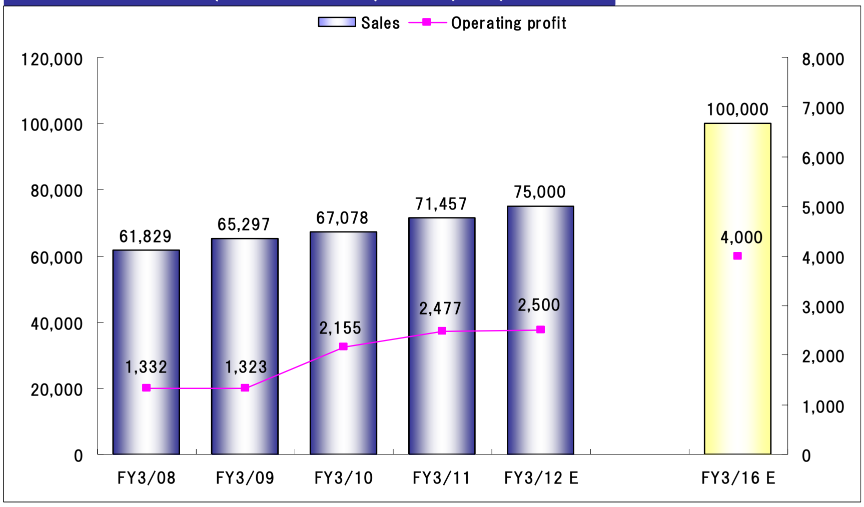
■Achieving further growth through expansion of established businesses and aggressive M&A

G7 Holdings is the largest franchisee in Japan of Autobacs stores, which sell automobile parts and supplies, and of Gyoumu supermarkets ("business supermarkets") originated by Kobe Bussan (3038). In the first three quarters of fiscal year (FY) 3/12, the company's sales grew by 6.1% year-on-year (YOY), and its operating profit increased by 0.1%. These results were broadly in line with the company's plan. The company's new business, such as Megumi no Sato stores, which sell produce grown by local farmers and picked the day it is sold, continued to suffer losses, reflecting heavy initial investment costs, but these losses were more than offset by profits earned by Autobacs stores and "business supermarkets". As these two established businesses are growing, management expects to achieve financial results in FY3/12 close to its planned figures.

The company's medium-to-long-term plan calls for building overseas business. The initial step toward the realization of this goal will be taken in April 2012, with the opening of an Autobacs store in Malaysia. Before March 2013, the company aims to open food supermarkets in China and Vietnam. Due to the initial costs of investment, the company expects its overseas business to remain unprofitable for about three years, but it expects this business to become a leading source of sales and profits over the longer term.

In Japan, the company is expanding business through aggressive acquisitions. In December 2011, it bought Ueno Shokuhin Co., an old established company in Tokyo. In April 2012, it will buy three Autobacs stores. As it will apparently take some time to turn the Megumi no Sato store business profitable, the company decided to stop opening new stores and to concentrate on improving the profitability of the existing stores. In FY 3/13, management projects sales and profit increases, as it expects the two main businesses to generate enough profits to more than compensate for the costs of expanding business overseas.

Business results, FY3/2008-2011, and company forecasts for FY3/2012 and FY3/2016 (¥mn)



Points

- Achieve further growth by tapping into expanding Asian demand
- Buy highly competitive Autobacs franchise chain stores
- Established businesses earn enough profits to cover initial losses of new businesses, allowing company to achieve its initial forecasts

Overseas Business

New stores will require minimum initial investment and become profitable in 2-3 years

The company's current mid-term plan, which ends in FY3/16, calls for overseas sales of ¥10 billion (bn) in the final year of the plan, equivalent to 10% of total targeted sales that year. The company plans to launch its first overseas operation, an Autobacs store, in Malaysia in April 2012 and to open food supermarkets in China and Vietnam before the end of FY3/13.

(1) Autobacs Business

The company's first overseas operation will be Autobacs Klang Sentral, to be opened in Malaysia in April 2012. This will also be the first Autobacs store in Malaysia. The store will be located in a commercial complex to be developed from this year, centering on a large supermarket, about a 20-minute drive from Kuala Lumpur. It will be staffed by three Japanese and 25 local employees. Built on a lot of 5,775 square meters (62.162 square feet), the building will have two stories, of 1,320 square meters (14,208 square feet). The first floor will house the Autobacs store, while the second will contain four restaurants and shops. The building plus commercial materials will cost ¥200-300 million, and the company aims to turn the operation profitable within three years. This store will offer about the same goods and services that Autobacs stores in Japan offer, including maintenance goods, such as tires, oil and batteries, and automotive accessories and car navigation systems. The store will contain seven automobile pits for such services as oil changes and inspections.

■Overseas Business

The company decided to enter Malaysia for many reasons. The diffusion rate for autos is high in Malaysia, the country produces and sells its own brand of autos, and it hosts F-1 car races. Thus, there appears to be demand for automobile after-market goods and services there. Some companies already operate in the after-market, including ENEOS, of Japan, and Brothers, of Malaysia, but their products differ somewhat from Autobacs products, so the company sees growth potential in the market. The company will monitor the progress of its first Autobacs store before opening another, but it may open a second this year.

Achieve further growth by tapping into expanding Asian demand

(2) Food Supermarkets

The company plans to open its first food supermarket in China this year. To operate this supermarket in China, it established a subsidiary, Seven Fortune (Shanghai) Supermarket Co., in Shanghai in January 2012. This subsidiary has set up local supply routes to obtain 90% of the goods it intends to sell. Now, it is searching for a building in a good location that can be rented or acquired on good terms. It has narrowed down possible sites to Shanghai, Hangzhou, and Chengdu. The supermarket will sell high-grade groceries to economically well off consumers. The company plans to open about 10 supermarkets in China in three years and aims for sales of ¥4 billion within three years. By applying the know-how obtained from operating "business supermarkets" in Japan, it hopes to earn an operating profit margin of 6-7% on its supermarket sales in China.

The company intends to establish a subsidiary in Vietnam in May or June 2012 and to open its first food supermarket in the country before the end of March 2013. Within three years, it plans to open five food supermarkets in Vietnam. As in China, these supermarkets will cater to financially comfortable consumers. The company is considering opening supermarkets first in Hanoi and Ho Chi Minh City.

As these ventures in China and Vietnam will be the first in both countries for the company, they may require more initial investment than the company currently plans on, but the company is willing to take this risk because it considers it essential for future growth to tap into growing Asian demand.

■M & A

Aiming for synergy within the group by applying its ability to develop products

The company has grown through mergers and acquisitions in Japan. Most recently, it has completed two more acquisitions.

(1) Ueno Shokuhin Co.,

In December 2011, the company purchased Ueno Shokuhin Co., based in Tokyo, for ¥200 million. Ueno Shokuhin has grown by developing niche food products, such as miso soup in a Styrofoam cup, a rice dish called kamameshi in a ceramic bowl that can be heated in a microwave oven, and a brown sugar citric acid product. It operates a nationwide chain of bento (box lunch) shops, makes catalog sales, and operates stores at highway rest stops. In the fiscal year through September 2011, Ueno Shokuhin generated sales of ¥862 million, and achieved an operating profit margin of slightly less than 6%.

The president of Ueno Shokuhin is getting old and has no successor to run the company, so he sought a buyer of his company. He found the strategy of G7 Holdings attractive and therefore agreed to sell to G7 Holdings. The company plans to work with Ueno Shokuhin to develop private-brand foods which can be sold by group companies, including "business supermarkets", Megumi no Sato stores, and supermarkets that sell select foods. These companies will also sell Ueno Shokuhin products.

With the purchase of Ueno Shokuhin, the company acquired about ¥97 million of goodwill, which it will depreciate over five years on a straight line basis, which means it will depreciate about ¥19 million per year over five years. Despite this cost, the company estimates that Ueno Shokuhin will add ¥800 million to its sales and ¥30 million to its operating profit in FY3/13.

■M & A

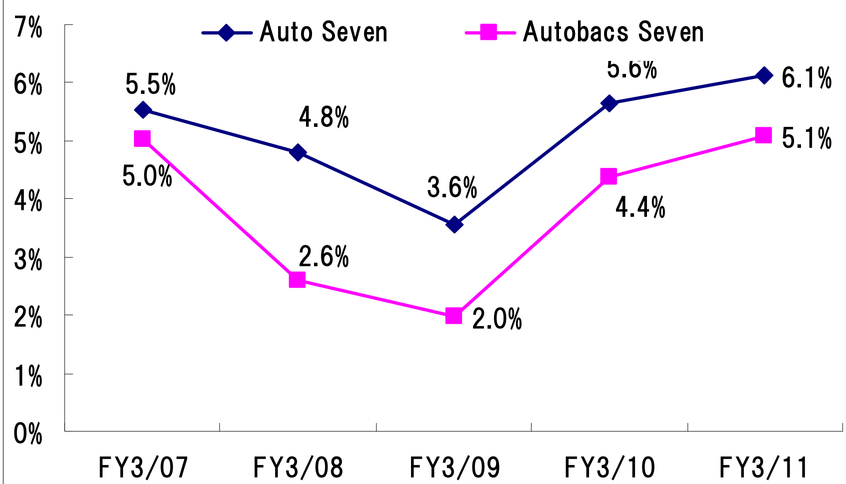
Acquiring highly competitive stores

(2) Three Autobacs stores

In February 2012, Auto Seven, a subsidiary of G7 Holdings that operates Autobacs stores, announced plans to buy three new stores in Fukuyama City, Hiroshima Prefecture. Two of these stores are operated by Autobacs Three Arrow Co., while the third is operated by Autobacs Seven (9832). The acquisition was completed on April 1, 2012.

This deal benefited Auto Seven, Autobacs Seven and Autobacs Three Arrow. Auto Seven had wanted to strengthen its operations in Hiroshima Prefecture, and Autobacs Seven has been trying to improve the profitability of its franchise operations. As shown in the graph below, the Autobacs stores operated by Auto Seven have been more profitable than those operated by Autobacs Seven for the five fiscal years through FY3/11.

Consolidated operating profit ratios for Autobacs Seven (franchiser) and Auto Seven (G-7 Holdings)



The figure for Auto Seven shows recurring profit margin

The cost of these acquisitions has not been divulged, but they apparently involved no goodwill. In aggregate, the three Autobacs stores acquired generate about ¥1.3 billion of sales annually. These sales should accrue to the company in FY3/13. The operating profitability of the acquired companies is unknown, but even if it is low, it will probably improve to the average profitability of Auto Seven under the leadership of Auto Seven.

Over the past few years, the number of Autobacs stores operated by Auto Seven has peaked at about 50, in part, due to policy by Autobacs Seven. In FY3/13, however, Auto Seven plans to acquire 8-10 new Autobacs stores, including the three it has just bought. Auto Seven expects a YOY increase in new car sales in Japan in FY3/13. Such an increase would probably promote greater sales of car accessories. This growth, plus the contribution of the new stores, is likely to support double-digit sales growth for Auto Seven in FY3/13, for the first time in several years.

■Business results in Q1-3 FY3/12

Net profit grew 8.1% YOY, to ¥1,051 million, as planned

In the first three quarters of FY3/12, G7 Holdings' sales increased by 6.1% YOY, to ¥57,179 million, operating profit grew by 0.1%, to ¥2,050 million, recurring profit fell by 3.2%, to ¥2,063 million, and net profit rose by 8.1%, to ¥1,051 million. These results were generally in line with the company's plan. The initial costs of opening new businesses such as "business supermarkets" and Megumi no Sato stores and a ¥199 million YOY increase in depreciation cost were offset by profits earned by "business supermarkets" and the Autobacs business.

Company results, FY3/08-FY3/2012 E (¥mn, ¥)

Fiscal Year	sales	YOY(%)	Op. profit	YOY(%)	Rec. profit	YOY(%)	Net Profit	YOY(%)	EPS (¥)	Div./ share(¥)
FY3/08	61,829	3.8%	1,332	-11.0%	1,308	-16.4%	391	-49.8%	29.38	10.00
FY3/09	65,297	5.6%	1,323	-0.7%	1,344	2.7%	259	-33.7%	19.57	10.00
FY3/10	67,078	2.7%	2,155	62.9%	2,247	67.2%	871	236.3%	66.47	22.00
FY3/11	71,454	6.5%	2,477	14.9%	2,591	15.3%	701	-19.4%	56.94	13.00
FY3/12 E	75,000	5.0%	2,500	0.9%	2,200	-15.1%	500	-28.8%	41.08	14.00

Quarterly sales and recurring profit, FY3/10 - FY3/12 E (¥mn)

	Sales					Recurring profit				
	FY3/10	FY3/11	YOY(%)	FY3/12	YOY(%)	FY3/10	FY3/11	YOY(%)	FY3/12	YOY(%)
1Q	16,309	17,058	4.6%	18,119	6.2%	563	584	3.7%	485	-17.0%
2Q	16,551	17,436	5.4%	18,360	5.3%	582	484	-16.8%	563	16.3%
3Q	18,216	19,390	6.4%	20,700	6.8%	755	1,063	40.8%	1,015	-4.5%
4Q	16,002	17,573	9.8%	-	-	347	460	32.6%	-	-

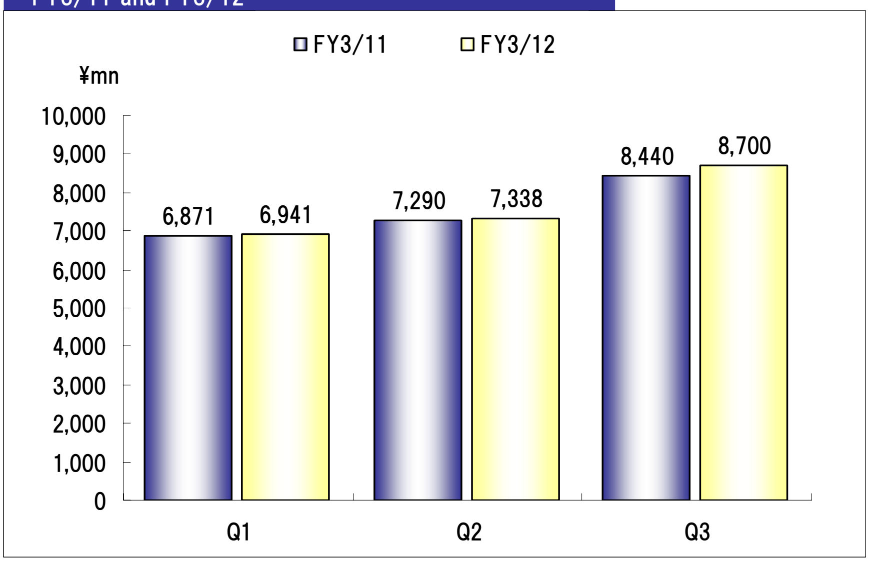
■Business results in Q1-3 FY3/12

Store renovation improved sales efficiency and supported continued profit growth

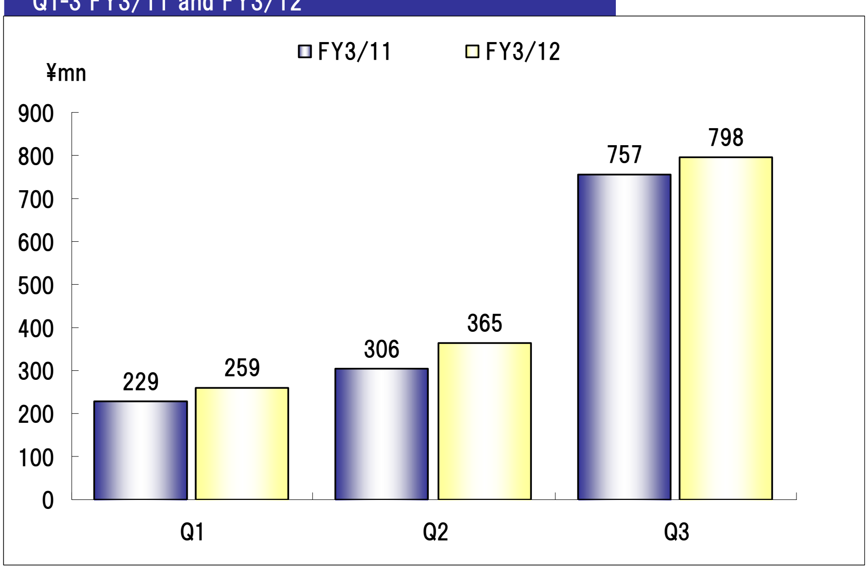
(1) Autobacs and other automotive business

Division sales grew by 1.7% YOY, to ¥22,979 million, and operating profit rose by 10.1% to ¥1,422 million. In the first 4-5 months of the period, sales of automotive digital tuners increased, and from November, sales of studless tires and aluminum wheels grew as drivers prepared for winter. Store renovation improved sales efficiency, supporting profit growth, and the division operating profit margin improved to 6.2% from 5.7% a year earlier. In November, the Autobacs franchise bought a store in Chiba, bringing its total store number to 51.

Sales Generated by Automotive Business in Q1-3 FY3/11 and FY3/12



Operating Profit Earned by Automotive Business in Q1-3 FY3/11 and FY3/12



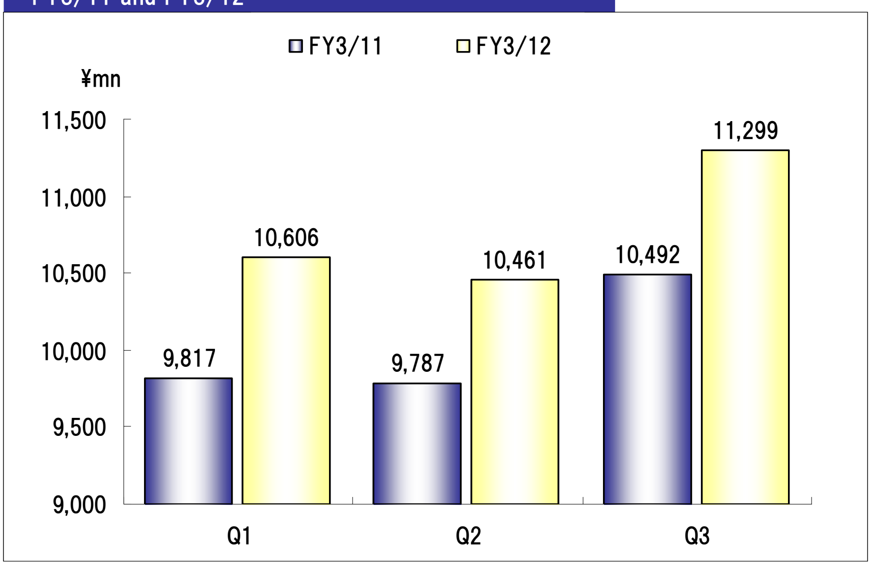
■Business results in Q1-3 FY3/12

Sales at low-priced "business supermarkets" continued to grow

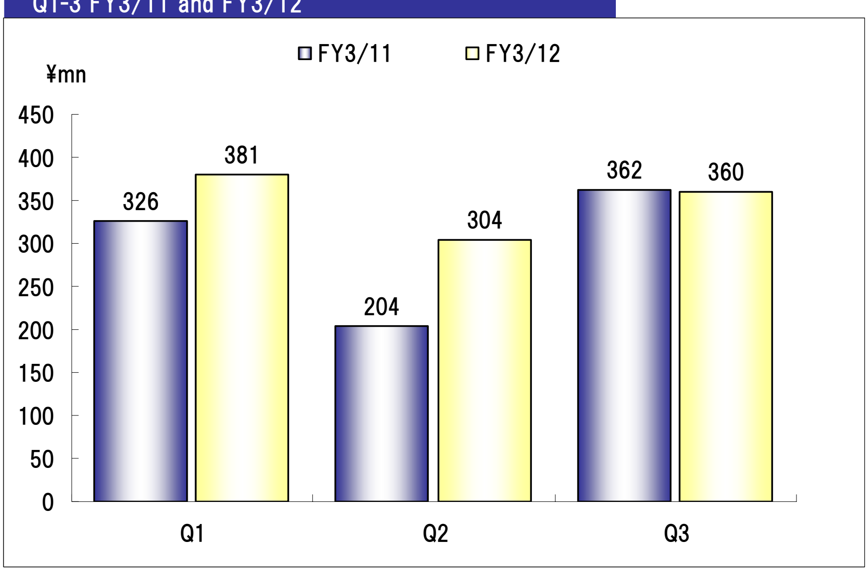
(2) "Business supermarkets" and select food supermarkets

Division sales increased by 7.5% YOY, to ¥32,366 million, and division operating profit grew by 17.1%, to ¥1,045 million. Sales at low-priced "business supermarkets" continued to grow, in part, because of an increased tendency among Japanese consumers to eat more meals at home and to spend less on food since the Great East Japan Earthquake and tsunami that destroyed large portions of Japan's northeastern coast on 11 March 2011. Furthermore, the division opened eight new supermarkets during the first nine months of FY3/12, mainly in Greater Tokyo and Greater Nagoya, bringing the total to 97. Seven new stores were opened in third quarter (October to December), and the costs of opening them caused operating profit to level off YOY that quarter. However, in Q1-Q3 FY3/12, operating profit grew by double digits, and the operating profit margin improved to 3.2%, from 3.0% in the first three quarters of FY3/11.

Sales Generated by Supermarket Business in Q1-3 FY3/11 and FY3/12



Operating Profit Earned by Automotive Business in Q1-3 FY3/11 and FY3/12



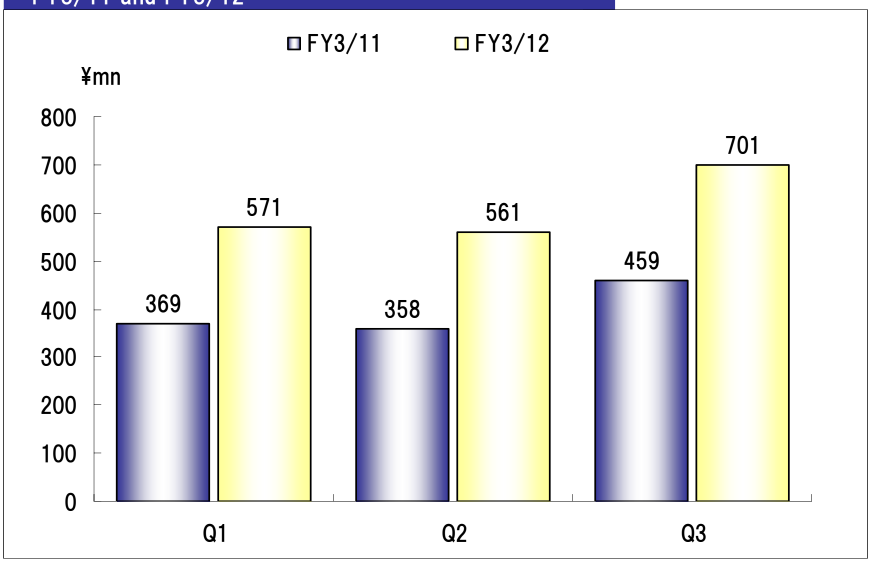
■Business results in Q1-3 FY3/12

Megumi no Sato business adversely affected by initial costs and higher depreciation cost

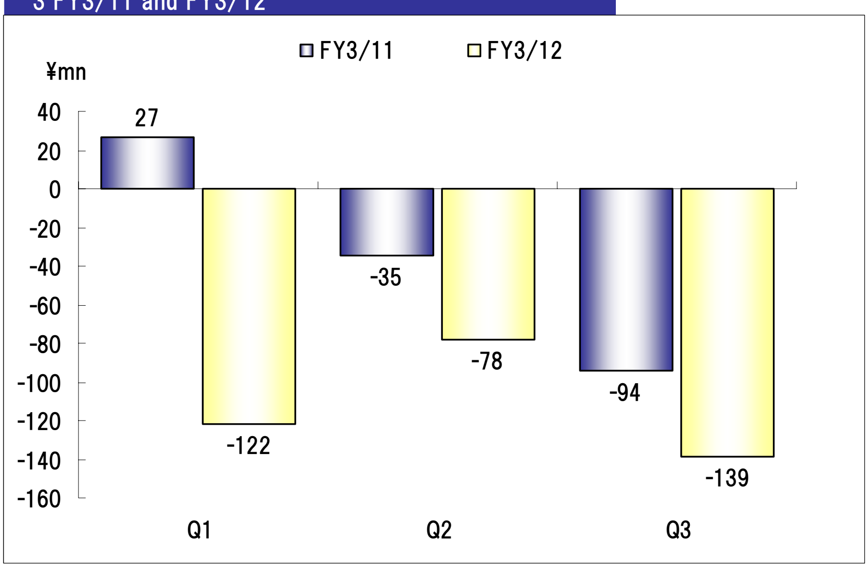
(3) Other Businesses

In Q1-3 FY3/12, other businesses increased their combined sales by 54.4% YOY, to ¥1,833 million, but they suffered a combined operating loss of ¥339 million, which was ¥237 million larger than their combined operating loss in Q1-3 FY3/11. The Megumi no Sato business added eight new stores, Teppan Buffet "Green's K" added five restaurants, and the recycling business added two Ryohin Kaikan shops. Although The sales grew significantly, the costs of opening these stores, restaurants and shops and a rise in depreciation cost led to an increase in operating losses.

Sales Generated by Other Businesses in Q1-3 FY3/11 and FY3/12



Operating Profit Earned by Other Businesses in Q1-3 FY3/11 and FY3/12



■Company Forecasts for FY3/12

Established businesses earn enough profits to cover initial losses of new businesses, allowing company to achieve its initial forecasts

For FY3/12, the company maintained its original forecasts, projecting a 5% rise in sales, to ¥75,000 million, a 0.9% increase in operating profit, to ¥2,500 million, a 15.1% drop in recurring profit, to ¥2,200 million, and a 28.8% fall in net profit, to ¥500 million. In the final quarter of the fiscal year, sales by "business supermarkets" and Autobacs stores have continued to grow, so it appears that the final results for FY3/12 will be close to the company's forecasts. The company projects a lower full-year net profit than it earned in the first three quarters because it foresees some extraordinary losses in the final quarter due to the closure of some Megumi no Sato stores.

Through 2011, the company aggressively opened new Megumi no Sato stores to help rejuvenate Japan's agricultural sector. However, it appears that expanding this business will take more time than originally projected. Therefore, at the start of 2012, the company froze the opening of new Megumi no Sato stores and began closing unprofitable stores as part of a strategy to improve the profitability of the business. In the Q4 FY3/12, it closed four Megumi no Sato stores, centered in Chiba Prefecture and Ibaraki Prefecture, where customer numbers have dwindled because of the disabled nuclear power plant in Fukushima.

■Company Forecasts for FY3/13

"Business supermarket" and Autobacs businesses to lead growth, while business development costs may decline

In FY3/13, the company will bear the costs of starting overseas operations, but its "business supermarkets" and Autobacs stores will probably generate enough sales and profits to ensure profit growth. The Autobacs business plans to open 8-10 new stores, including the three it purchased as of April 1, 2012. Furthermore, the company foresees a rise in new car sales in FY3/13 and a corresponding increase in sales of car accessories. The "business supermarkets" business intends to continue to open new supermarkets in Greater Tokyo and Greater Nagoya. Thus, it is likely to see higher sales and profits.

As the company concentrates on improving the profitability of the Megumi no Sato business, losses suffered by this business should decline. Supermarkets that sell select items should benefit from the contribution of Ueno Shokuhin.

Thus, if there are no large extraordinary losses, the company may earn a net profit of more than ¥1,000 million in FY3/13, a record high, the first in three fiscal years.

Factors expected to affect profits in FY3/13

Factors Increasing Profit	Factors Decreasing Profit
Expand Autobacs business in Japan	Costs of starting Autobacs business overseas
Expand "business supermarket" business in Japan	Costs of starting "business supermarket" business overseas
Ueno Shokuhin contributes to growth	
Profitability at Megumi no Sato business improves	

FISCO

Disclaimer