Ainavo Holdings
7539 TSE JASDAQ

20-Jul.-16

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Unique company that combines installations and building materials and home equipment wholesale businesses

Ainavo Holdings <7539> (hereafter, also "the Company") is a pure holding company with three consolidated subsidiaries and one non-consolidated subsidiary. Its main businesses are installations of tile, siding, and other exterior materials, installations of kitchens and various water-related equipment, and sales of building materials and home equipment. We think it is a unique company in offering a combination of installations and building materials and home equipment wholesale businesses. While the Company primarily supplies these services to smaller general contractors and building firms, it also receives installation orders from major general contractors. Strict fund collection management and project progress management have enabled the Company to accumulate abundant net cash (cash/deposits – loans) totaling ¥6,725mn (as of end-2Q FY9/16) and cultivate a robust balance sheet.

The Company reported ¥31,337mn in net sales (+6.6% YoY), ¥1,162mn in operating profit (+3.4%), ¥1,312mn in recurring profit (+8.2%), and ¥950mn in net profit attributable to parent shareholders (+29.3%) through 2Q FY9/16. Operating profit climbed thanks to upbeat sales in the mainstay standalone homes business.

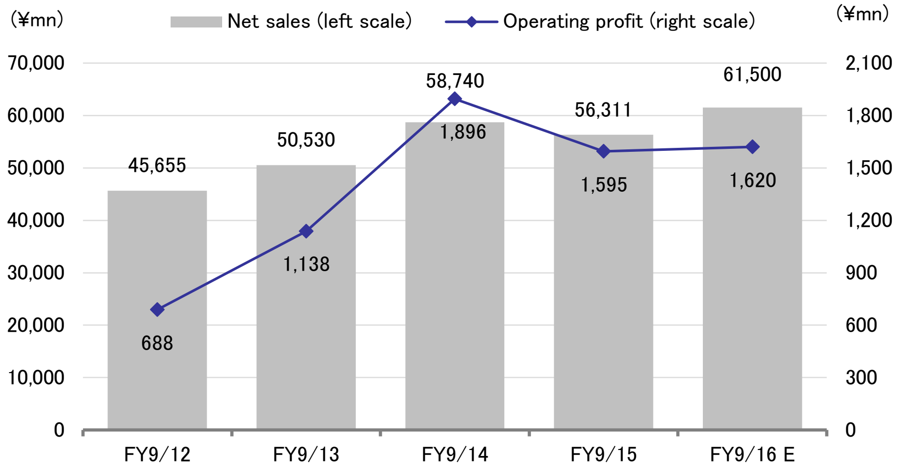
For FY9/16, the Company expects ¥61,500mn in net sales (+9.2% YoY), ¥1,620mn in operating profit (+1.5%), ¥1,800mn in recurring profit (+0.5%), and ¥1,150mn in net profit attributable to parent shareholders (+2.6%). It aims to sustain a profit increase for the full year even with an ¥83mn provision as a reserve for replacement costs related to a past faulty project.

The Company has not announced an official medium-term plan, but intends to disclose a new plan after the current fiscal year (FY9/16) finishes and is currently preparing it. We think it will fundamentally strive to maintain the same growth pace that it has achieved up to now, and we are interested in seeing the specific content of the new plan. The Company targets a 30% dividend payout ratio, though the FY9/16 payout ratio is currently slated to be 26.1%. We believe there is room for a dividend hike depending on the profit trend.

Check Point

- Expanding wholesale business for various building materials and home equipment too, in addition to tile installations
- Sales and profits climbed through 2Q FY9/16, focusing on higher-priced deals in the standalone homes business
- Projects higher sales and profits in FY9/16, on track to reaching the profit target due to improved profitability

Performance Trends



Company Overview

Expanding wholesale business for various building materials and home equipment too, in addition to tile installations

(1) Background

The company traces its roots to Abe Umekichi Shoten, which was founded in 1924 by Umekichi Abe, a bricklayer and grandfather of current representative director and president Kazunari Abe. It shifted the business to tile installations after the war as demand moved to tiles with a brick-feel amid steel-reinforced concrete becoming the mainstream building technique. It ramped up wholesale business with the establishment of Sanwa Shokai in 1961 in response to rapid growth in tile demand during Japan's advanced growth phase. After the collapse of the bubble economy, the company expanded the presence of home equipment business amid contraction of tile demand owing to a decline in home starts volume and changes in building techniques. Installations have risen as a ratio of overall business recently, and the company has been expanding installations of siding exterior and water-related home equipment as well as wholesale business for various building materials and home equipment, in addition to tile installations. It registered as an OTC stock with the Japan Securities Dealers Association in 1997 and is currently listed on the JASDAQ market following the merger of the JASDAQ Securities Exchange and Osaka Securities Exchange. It transitioned to a holding-company format and changed its name to Ainavo Holdings in 2013.

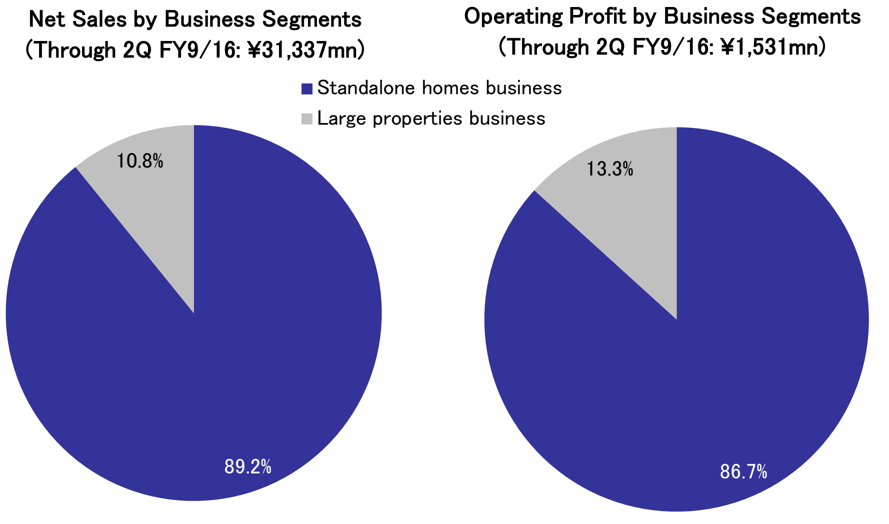
Main Background

1924	Established Abe Umekichi Shoten
1961	Established Sanwa Shokai
1968	Renamed Sanwa Shokai as Sanwa Shoji
1987	Renamed Sanwa Shoji as Avelco
1997	Registered as an OTC stock with the Japan Securities Dealers Association
2010	Listed on the JASDAQ market following the merger of the JASDAQ Securities Exchange and Osaka Securities Exchange
2013	Transitioned to a holding-company format and renamed itself as Ainavo Holdings
2014	Opened a showroom in Shinsaibashi (Osaka)

Source: FISCO Ltd. from company materials

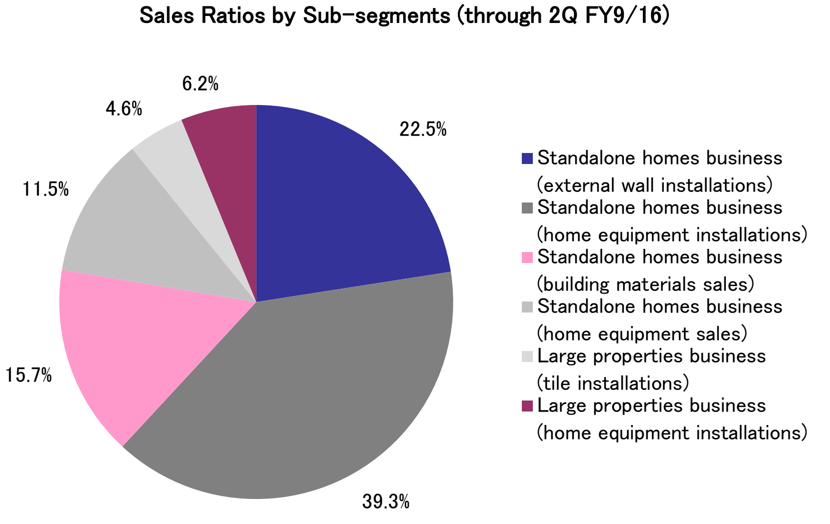
(2) Business content

Ainavo Holdings, a pure holding company, has three consolidated subsidiaries and one non-consolidated subsidiary in its group as of end-May 2016. The company's business segments are standalone homes and large properties, and segment results through 2Q FY9/16 were ¥27,943mn for standalone homes (89.2% of overall sales) and ¥3,394mn for large properties (10.8%) in sales and ¥1,327mn and ¥203mn respectively in operating profit. However, the Company simply splits these segments by the relative size of customers (in terms of orders value) and actual content of business activities is the same. The former primarily covers installations for ordinary homes with orders obtained from smaller general contractors and ordinary building firms, while the latter mainly reflects orders from large general contractors and other major customers.



Source: FISCO Ltd. from earnings materials

The standalone homes business breaks down further into sub-segments of exterior wall installations, home equipment installations, building materials and related products sales, and home equipment sales, and the large properties business consists of tile installations and home equipment installations. Sub-segment shares of overall sales (through 2Q FY9/16) as shown below are 22.5% for exterior wall installations, 39.3% for home equipment installations, 15.7% for building materials sales, and 11.5% for home equipment sales under the standalone homes business and 4.6% for tile installations and 6.2% for home equipment installations under the large properties business.



Source: FISCO Ltd. from company materials

a) Standalone homes business
These orders primarily come from local smaller general contractors and builders and home manufacturers and related builders. The Company does not receive many orders directly from the party conducting the project.

1) Exterior wall installations (22.5% of overall sales through 2Q FY9/16): This business handles installations of interior and exterior tiles, floor tiles, and exteriors for ordinary homes, small condominiums, and stores. It supports not only tiles, but also sidings and other materials.
2) Home equipment installations (39.3%): This business covers renovation installations (including kitchens as well as bath, toilet, and other water-related systems) and solar power generation system installations. While orders are fundamentally separate from exterior wall installations, they are received jointly in some cases. The Company is one of the industry's largest firms for bathroom installations with roughly 20,000 projects per year.
3) Building materials sales (15.7%): This sub-segment handles wholesale transactions for various building materials used in ordinary homes, stores, and smaller condominiums. Tile building material sales volume is relatively large. Main customers are building firms and local homebuilders, and the Company does not sell to secondary wholesale firms.
4) Home equipment sales (11.5%): This business sells home equipment to building firms and local homebuilders (similar to building materials sales).

(Note: Sales of tile materials and home equipment related to installation projects are booked under the respective installation segments.)

b) Large properties business
Business content is the same as the standalone homes business, but the Company books installations at large properties (buildings, condominiums, and others) for major general contractors in this segment. It receives a relatively large amount of orders from Obayashi <1802>, Konoike, and Haseko Corporation <1808>.

1) Tile installations (4.6%): Interior and exterior tiles, floor tiles, stone material installations
2) Home equipment installations (6.2%): Kitchens and other home equipment and air-conditioning equipment installations mainly for buildings and condominium buildings

(3) Main procurement and sales counterparts

The Company has roughly 7,000 customers, including major general contractors. Collection of accounts receivables is a key point in business operations, as explained below, because these customers are not always active and value per project varies significantly from a few million yen to over ¥100mn.

LIXIL Group <5938> is the primary procurement source for construction materials and home equipment, and the Company also purchases extensively from TOTO <5332>, Rinnai <5947>, Cleanup <7955>, and Daiken <7905>.

While the Company has about 2,000 subcontractors (large and small) handling projects, roughly half of the subcontractors work exclusively with the Company and the two sides sustain longstanding trust relationships thanks to support from the insurance framework described below.

(4) Competition, features, and strengths

Many companies are involved in exterior wall installations or selling building materials and home equipment, and the Company faces numerous rivals in its various areas of business. While it is not easy to find a clear rival as an overall business, the most likely competitors are Koizumi and Watanabe Pipe. However, rivals are declining for exterior wall installations due to the downward trend in the number of contractors in recent years. The Company promotes differentiation with rivals in the current environment leveraging the following features.

One of the Company's unique features is the comprehensive skills training center where it provides training in highly specialized skills for its numerous subcontractors. The Company is capable of supporting a variety of project types because it implements training. The skills center also inspects whether project work is taking place properly at various sites once every half year and reduces discrepancies in completed work due to individual differences through this process.

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Another feature is the role of its own insurance program. The Company charges subcontractors a certain amount based on transaction value and pools the funds in a cooperative association for use to cover income during time off if a subcontractor (worker) is unable to work due to an accident. This program strengthens the trust relationship between the Company and subcontractors and also boosts the retention rate for skilled workers and precision of finished work.

While it is normal for companies to implement sales management, cost management, and project process management, the Company also carefully conducts billing management, deposit management, and uncollected fund management. Specifically, it manages procurement and sales for each project on an individual-line basis, even with small amounts, and applies the management (checks) to not only the income statement, but also the balance sheet. The ability to assess this type of balance-sheet management while monitoring project progress is important and not simple. There have been numerous cases in recent years of other firms in the business of selling building materials entering the installations business, though many rivals later exit the installations portion due to the difficulty (inefficiency) of unpaid funds management. This aspect serves as a "hidden barrier to entry," and the Company's ability to manage it is an important strength. These efforts have enabled the Company to accumulate abundant net cash (cash/deposits – loans) totaling ¥6,725mn (21.2% of gross asset value; as of end-2Q FY9/16) and cultivate robust finances.

Results Trends

Sales and profits climbed through 2Q FY9/16, focusing on higher-priced deals in the standalone homes business

(1) Results through 2Q FY9/16

a) Income situation

The Company reported ¥31,337mn in net sales (+6.6% YoY), ¥1,162mn in operating profit (+3.4%), ¥1,312mn in recurring profit (+8.2%), and ¥950mn in net profit attributable to parent shareholders (+29.3%) through 2Q FY9/16.

Overview of Results Through 2Q FY9/16

(Unit: ¥mn, %)

	2Q FY9/15		2Q FY9/16		
	Value	Share of total value	Value	Share of total value	YoY change
Net sales	29,404	100.0	31,337	100.0	6.6
Gross profit	4,206	14.3	4,402	14.0	4.7
SG&A expenses	3,081	10.5	3,240	10.3	5.1
Operating profit	1,124	3.8	1,162	3.7	3.4
Recurring profit	1,212	4.1	1,312	4.2	8.2
Quarterly net profit attributable to parent shareholders	734	2.5	950	3.0	29.3

Source: FISCO Ltd. from earnings materials

Although gross margin slightly declined YoY because of an impact from a new subsidiary and provisioning ¥83mn as a reserve for replacement costs related to a past faulty project, gross profit climbed 4.7% to ¥4,402mn thanks to stronger sales. Operating profit increased YoY, even with a 5.1% rise in SG&A expenses (including the new subsidiary) to ¥3,240mn, owing to higher gross profit.

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Below we review trends by segments and sub-segments.

(unit: ¥mn, %)

	2Q FY9/15		2Q FY9/16			
	Value	Share of total value	Value	Share of total value	Change in value	Change rate
Sales	29,404	100.0	31,337	100.0	1,933	6.6
Standalone homes business	25,720	87.5	27,943	89.2	2,223	8.6
Exterior wall installations	6,338	21.6	7,064	22.5	726	11.5
Home equipment installations	11,487	39.1	12,330	39.3	843	7.3
Building materials sales	4,614	15.7	4,929	15.7	315	6.8
Home equipment sales	3,280	11.2	3,619	11.5	339	10.3
Large properties business	3,683	12.5	3,394	10.8	-289	-7.9
Tile installations	1,564	5.3	1,449	4.6	-115	-7.4
Home equipment installations	2,119	7.2	1,944	6.2	-175	-8.3
Operating profit	1,124	3.8	1,162	3.7	38	3.4
Standalone homes business	1,194	-	1,327	-	133	11.1
Large properties business	261	-	203	-	-58	-22.2
(Adjustment amount)	-332	-	-368	-	-	-

Source: FISCO Ltd. from company materials

1) Standalone homes business

While the overall market (home starts volume) was modestly sluggish, the Company achieved an 8.6% YoY increase in sales to ¥27,943mn for the standalone homes business because of efforts to develop new customers and aggressive expansion in sales of new materials, lumber building materials, sashes, and other priority products. While it only added 339 new customers, compared to 381 customers in the previous year, value totaled ¥493mn (vs. ¥419mn) because of emphasis on higher-priced deals.

Sub-segment results were ¥7,064mn for exterior wall installations (+11.5% YoY), ¥12,330mn for home equipment installations (+7.3%), ¥4,929mn for building materials sales (+6.8%), and ¥3,619mn for home equipment sales (+10.3%). Sales climbed in all segments.

2) Large properties business

Sales fell 7.9% YoY, though profitability improved. While segment operating profit declined 22.2% to ¥203mn, this included the above-mentioned provisioning of ¥83mn as a reserve for replacement costs related to a faulty project and profit increased in real terms excluding this item.

However, we expect demand to continue for floor tile installations in this segment. The Company is also pursuing initiatives in the renovations market. It has a history of shifting from brick to exterior wall tile sales and home equipment sales and changing the business domain from mainly wholesale business to installation consignments in recent years, and we think the Company is capable of steadily altering business content to address changes that occur in each era.

b) Fiscal situation

We review financial conditions as of end-2Q FY9/16. Current assets totaled ¥23,709mn (up ¥2,455mn from the end of FY9/15). Key item trends were cash and deposits down ¥383mn, notes receivable and unpaid funds on finished projects up ¥2,157mn, and unfinished project spending up ¥618mn. Fixed assets totaled ¥7,984mn (up ¥733mn), including tangible fixed assets at ¥5,823mn (up ¥63mn), intangible fixed assets at ¥619mn (up ¥530mn), and investments and other assets at ¥1,541mn (up ¥139mn). The ¥429mn rise in goodwill assets provided the main source of intangible fixed assets. Total assets hence climbed ¥3,188mn to ¥31,694mn.

Current liabilities totaled ¥13,215mn (up ¥2,392mn) with the main changes as increases of ¥996mn for notes payables and unpaid project costs and ¥839mn for unpaid factoring. Fixed liabilities rose ¥20mn to ¥1,366mn. Net assets amounted to ¥17,112mn (up ¥775mn), mainly on a ¥776mn gain in surplus profit from booking quarterly net profit attributable to parent shareholders.

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Balance Sheet

(unit: ¥mn)

	End-FY9/15	End-2Q FY9/16	Change in value
Cash and deposits	7,771	7,388	-383
Notes receivables and finished project unpaid funds	11,217	13,375	+2,157
Unfinished project spending	1,101	1,719	+618
Current assets (total)	21,254	23,709	+2,455
Tangible fixed assets	5,760	5,823	+63
Intangible fixed assets	88	619	+530
Goodwill	1	431	+429
Investments and other assets	1,401	1,541	+139
Fixed assets (total)	7,250	7,984	+733
Assets (total)	28,505	31,694	+3,188
Notes payables and unpaid amounts	5,877	6,873	+996
Unpaid factoring	2,765	3,604	+839
Current liabilities (total)	10,823	13,215	+2,392
Long-term loans	255	246	-8
Fixed liabilities (total)	1,345	1,366	+20
Liabilities (total)	12,169	14,582	+2,412
Net assets (total)	16,336	17,112	+775

c) Cash flow situation

We review the cash flow situation as of end-2Q FY9/16. Cash flow from operating activities totaled a net surplus of ¥362mn (vs. a net deficit of ¥818mn a year ago). Main income sources were ¥1,295mn in quarterly net profit prior to taxes and other adjustments and ¥1,626mn from a rise in procurement liabilities, while main outflows were ¥1,591mn from a rise in sales credits. Cash flow from investing activities totaled a net deficit of ¥572mn (vs. a net deficit of ¥108mn). Main outflows were ¥300mn in deposits to fixed-term deposits and ¥157mn from acquiring intangible fixed assets. Cash flow from financing activities totaled a net deficit of ¥472mn (vs. a net deficit of ¥136mn), mainly due to outflows of ¥284mn from a net decline in short-term loans and ¥173mn from dividend payments. These trends resulted in a decline of ¥683mn in cash and cash equivalents during the period to an end-quarter balance of ¥7,088mn.

Cash Flow Statement

(unit: ¥mn)

	2Q FY9/15	2Q FY9/16
Cash flow from operating activities	-818	362
Quarterly net profit prior to taxes and other adjustments	1,195	1,295
Change in sales credits (- is an increase)	-1,577	-1,591
Change in procurement liabilities (- is a decline)	469	1,626
Cash flow from investing activities	-108	-572
Outflow from deposits to fixed-term deposits	-	-300
Cash flow from financing activities	-136	-472
Net change in short-term loans (- is a decline)	100	-284
Dividend payments	-184	-173
Change in cash and cash equivalents (- is a decline)	-1,063	-683
Quarter-end cash and cash equivalents balance	6,135	7,088

Projects higher sales and profits in FY9/16, on track to reaching the profit target due to improved profitability

(2) FY9/16 outlook

For FY9/16, the Company expects ¥61,500mn in net sales (+9.2% YoY), ¥1,620mn in operating profit (+1.5%), ¥1,800mn in recurring profit (+0.5%), and ¥1,150mn in net profit attributable to parent shareholders (+2.6%). While these levels have not changed from the period-start outlook, we think the Company modestly raised its view in real terms due to retaining profit targets even with an ¥83mn provision as a reserve for replacement costs related to a past faulty project.

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Overview of the FY9/16 Forecast

(Unit: ¥mn, %)

	FY9/15		FY9/16 (E)		
	Value	Share of total value	Value	Share of total value	YoY change
Net sales	56,311	100.0	61,500	100.0	9.2
Standalone homes business	50,019	88.8	53,728	87.4	7.4
Large properties business	6,292	1.2	7,772	12.6	23.5
Operating profit	1,595	2.8	1,620	2.6	1.5
Recurring profit	1,791	3.2	1,800	2.9	0.5
Net profit attributable to parent shareholders	1,121	2.0	1,150	1.9	2.6

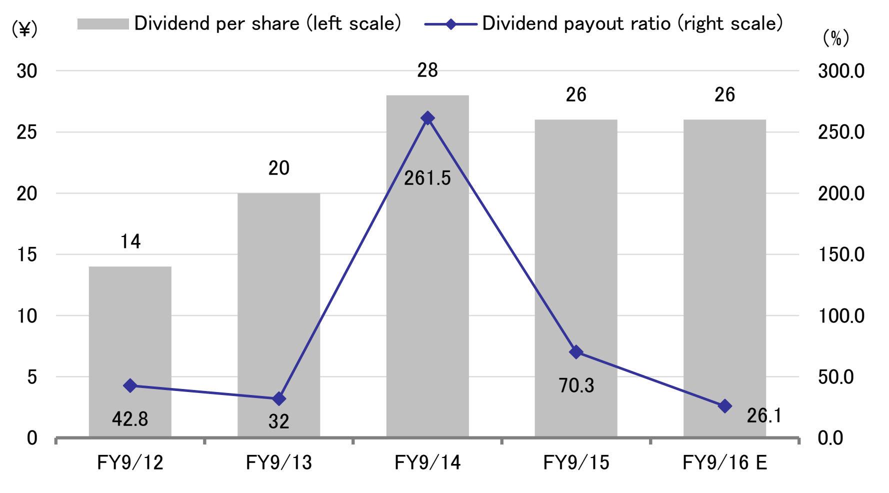
Segment sales targets are ¥53,728mn (+7.4% YoY) for the standalone homes business and ¥7,772mn (+23.5%) for the large properties business. We think the Company is well within reach of guidance for standalone homes business, but see some challenge in the target for the large properties business in light of 1H conditions. However, we believe it can attain the earnings goals because profitability is improving.

Shareholder Returns Policy

Possibility of a dividend hike depending on the profit trend

The Company fundamentally targets a 30% dividend payout ratio as its shareholder return policy, though the FY9/16 annual dividend forecast of ¥26 means the payout ratio is currently slated to be 26.1%. We believe there is room for a dividend hike depending on the profit trend.

Trends in Dividend Per Share and the Dividend Payout Ratio



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