COMPANY RESEARCH AND ANALYSIS REPORT

Daiki Axis Co., Ltd.

4245

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Index

Summary

Is working to realize 6 SDGs by promoting ESG management

Daiki Axis Co., Ltd. (4245) (hereafter, also "the Company") is committed to a corporate mission of "protecting the environment and changing the future" and aims to continue advancing as an environment innovation and development company. In the current three-year medium-term business plan, in which promoting ESG management is a management theme, the Company is working on realizing 6 of the 17 comprehensive sustainable development goals (SDGs) that the United Nations has set as international goals up to 2030. To realize the sixth goal, "Clean Water and Sanitation: Ensure availability and sustainable management of water and sanitation for all," it is accelerating overseas business development in its core business, and in the next three years, it plans to triple overseas sales. Also, in addition to the biodiesel fuel business, it will work on the fully-fledged development of the renewable energy business, which has the compact wind power equipment business and solar-power electricity sales business as its business pillars.

1. Opening-up new horizons through overseas business development

For household wastewater treatment, industrial wastewater treatment and public water purification, a feature of the Company that makes it unique compared to other companies is that is has in place an unprecedented, integrated, comprehensive structure that covers the three main water infrastructure businesses, of materials, parts, and equipment manufacturing; equipment design, assembly, installation, and operations; and business operations, maintenance, and management, and water sales. As it specializes in the small- and medium-sized product markets, it does not compete with the water majors that are developing their businesses globally, and it has a high degree of management freedom compared to Japanese companies adopting division-of-labor systems. The overseas production bases established for small- and medium-sized Japanese-style wastewater treatment systems (known as "Johkasou") are the Company's own plant in Indonesia, a joint venture in China, and a production outsourcing partner in India, and they are used for different purposes according to the shipment destination. As the sales network, it has Group companies in China, Indonesia, India, and Singapore. It also has a total of 10 agencies; 6 in India and 1 in each of Myanmar, Vietnam, Sri Lanka, and Kenya. It is focusing its efforts on maintenance training and education not only for the staff of the overseas Group companies, but also for the staff of the agencies. Through its commitment to aspects such as human resources development and securing manufacturing bases, and its collaboration with agencies that have pipelines to local government bodies, it is establishing joint ventures with agencies and entering into the Water KIOSK business in India. This is a business that came to light after entering into a country. It has been working to acquire large-scale public projects and in India, it plans to double production capacity by as early as next year. In Myanmar, in response to the steady demand, it plans to establish a subsidiary and construct a new plant. As a pioneer, it will lobby the government administration and others, such as for the establishment of public projects for a water-quality inspection system.

2. The domestic business growth strategy

For the domestic growth strategy, in the environmental equipment business, the Company will continue to accumulate recurring income-type businesses, such as the maintenance business and the clean water business. It will demonstrate its true abilities as a development-type company and cut costs through reducing parts materials and the number of parts and introduce highly efficient new products through changing structures. For the wastewater treatment systems used overseas, it will develop products tailored to the water conditions, such as for the living customs in a certain region. In the renewable energy business, the Company has conducted a business restructuring to concentrate management resources in a subsidiary. In the solar-power electricity sales business, which uses the stores of the DCM Group, it plans to complete the construction of facilities at all 130 stores during the current fiscal period.

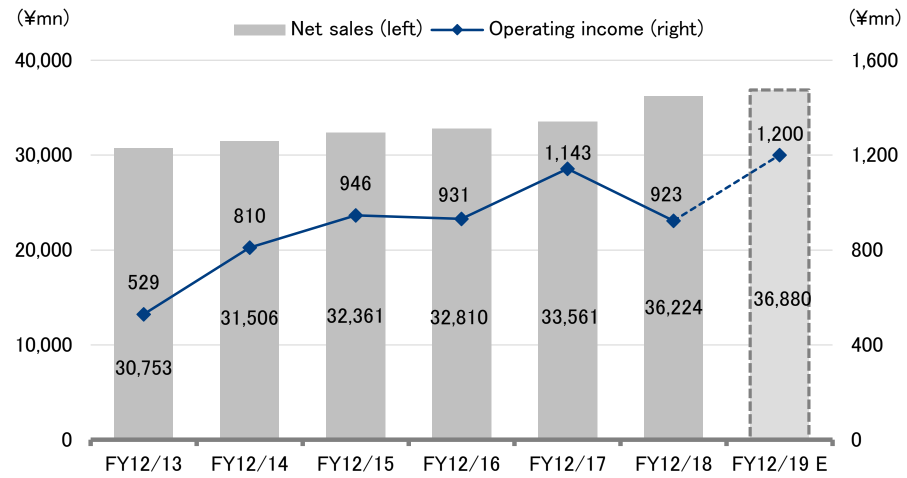
3. 1H FY12/19 results

In the FY12/19 1H consolidated results, net sales increased 2.4% year-on-year (YoY) and operating income rose 2.2%. Compared to the forecasts, sales were 1.9% below forecast and operating income was 24.8% below forecast. There was an order in the previous fiscal period for which a loss occurred as a domestic construction project in which sales were recorded by the percentage-of-completion method, and profits recorded in the previous fiscal period were reversed. In another two projects, construction-loss allowances were recorded, reflecting the increase in outsourcing costs. After excluding these three projects, the results were basically as forecast. The Company is working to reduce SG&A expenses, so it has left the full fiscal year forecasts (net sales to increase 1.8% YoY and operating income to rise 30.0%) unchanged.

Key Points

- In FY12/19 1H, net sales increased 2.4% YoY and operating income rose 2.2%
- Is opening-up new horizons through collaborations with local agencies
- During FY12/19, will install solar power facilities in the DCM Group's 130 stores

Results trends



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

Company profile

Promoting ESG management is a priority measure

1. Company profile

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

In December 2013, the Company was newly listed shares in the chemicals sector of the Tokyo Stock Exchange's Second Section market, and in the following year its listing was upgraded to the Tokyo Stock Exchange's First Section. In March 2019, as part of its measures to enhance corporate governance, it became a company with audit and supervisory committees and introduced an executive officer system.

The Company's 1H FY12/19 results included ¥17,848mn in sales and ¥504mn in operating income. Segment sales shares were environmental equipment business at 53.3%, household equipment business at 39.6%, renewable energy business at 1.7%, and other business at 5.4%. Segment operating income and margin results were environmental equipment business at ¥489mn and 5.1%, household equipment business at ¥203mn and 2.9%, renewable energy business at ¥107mn and 35.3%, and other business at ¥87mn and 9.0%.

2. History

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

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

Through M&A deals and subsidiary establishments, the Company has strengthened the environmental equipment business, developed overseas markets, and entered new areas. Its group consists of Daiki Axis and 15 major related companies (eight domestics, seven overseas). M&A activities serve as a growth strategy. So far, it has acquired seven companies in Japan and two companies overseas. It acquired them with the aims of entering-into new commercial areas and for their expected synergies with the Company.

Business overview

Development company placing emphasis on water and the environment

The environmental equipment business handles from the manufacture and sales of plastic wastewater treatment systems to the design, construction, and maintenance of concrete large-scale wastewater treatment facilities. It deals with a wide range of applications, from the treatment of household wastewater for individual homes through to the treatment of rural wastewater and industrial wastewater.

1. Environmental equipment business

The environmental equipment business handles from manufacturing and sales of plastic Johkasou to design, installation, and maintenance of concrete large wastewater treatment facilities. It covers a wide range of applications from human waste and residential wastewater for individual homes to industrial wastewater and rural wastewater. In addition to wastewater treatment equipment, it has a clean water business that converts underground water to drinking water and wastewater recycling system for reuse of used clean water. It has built maintenance service operations as joint operations with subsidiaries. Consolidated segment sales totaled ¥18,513mn in FY12/18 with 3.9% in clean water business, 0.1% in recycled water system, 9.3% in domestic small community Johkasou (for 5-50 persons), 62.6% in wastewater treatment system and 24.1% in maintenance, etc.

(1) Strength

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

(2) Overseas business

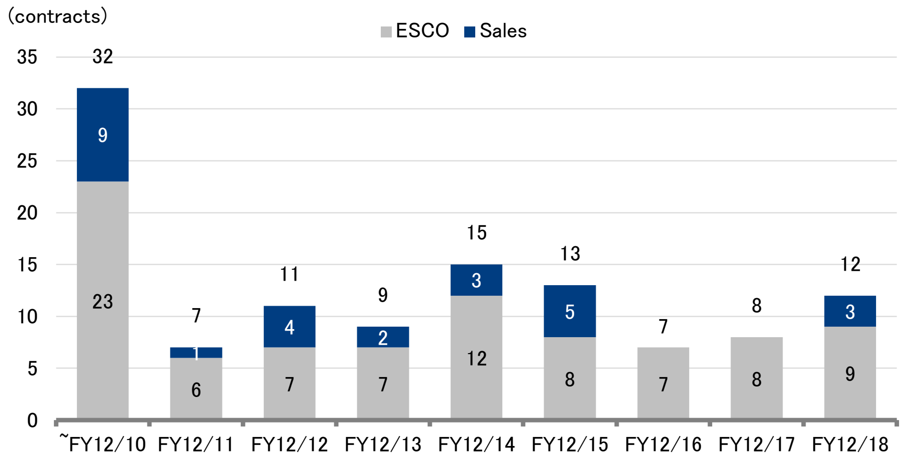
Water infrastructure business consists of three main businesses - materials, parts, and equipment manufacturing; equipment design, assembly, installation, and operation; and business operation, maintenance, and management (water sales). France-based Veolia Water Technologies and Suez environment, US-based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

For the Company, there is the high possibility of obtaining the first-move advantage with the expansions of the markets for small- and medium-scale wastewater treatment systems in ASEAN, India, and Africa. In the overseas business, net sales are growing, and they approximately doubled from ¥602mn in FY12/15 to ¥1,153mn in FY12/18. It plans for the sales growth to accelerate and approximately treble in the next three years.

(3) Clean water business

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

ESCO business contracts and equipment sales



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

ESCO service uses a lengthy contract period of 10 years. This is a recurring income-type income business model in which Contracts with existing customers generate stable income over a lengthy period and new contracts steadily add income. Business is profitable from the first fiscal year of beginning supply at the various sites. The Company currently applies an upper limit of 15 projects a year in light of investment costs and production and installation capabilities. Supply facility depreciation employs the straight-line method. While annual depreciation value is constant throughout the contract period, operating margin rises sharply from the second year because operating expenses are no longer needed. Furthermore, profitability increases dramatically if the contract continues after the 10th year when the depreciation period finishes. The Company began the ESCO business in FY12/06 and is likely to see increase in high-profit projects already done with depreciation. In 1H FY12/19, ESCO system results were four deployment contracts and five acquisitions. ESCO deployments reached 87 sites at the end of FY12/18. The top five industries were hospitals at 25 sites, large commercial facilities and food processing plants at 13 sites each, welfare facilities at 12 sites, and sports gyms at 11 sites.

(4) Recurring-income business

The Company handles store Johkasou installations and maintenance and store management tasks (cleaning, fire prevention, electricity, and other inspections) at DCM group stores. It aims to expand bulk orders of wastewater treatment equipment and Johkasou maintenance at major convenience store chain and major restaurant chain stores and their central kitchens. While existing service firms provided coverage in local areas, the Company seeks differentiation by not only lowering costs, but also delivering uniform services on a nationwide scale. Furthermore, provision of maintenance tasks enables it to make timely proposals on renovations and facility addition projects and thereby contributes to a positive cycle.

2. Household equipment business

The household equipment business had a sales breakdown in 1H FY12/19 of construction customers at 68.7%, home center retail materials at 14.8%, housing facilities projects at 16.5%, and newly established E-commerce (EC) at 0.1%.

3. Renewable energy business

In the renewable energy business in FY12/19 1H, net sales increased by 3.3 times YoY to ¥304mn. For the operating income-loss, the loss of ¥72mn in the same period in the previous fiscal year improved and became income of ¥107mn. In the solar-power electricity sales business, sales continued to increase from facilities that are linked to the grid, which drove growth. Breaking down the net sales, they were ¥243mn in the solar-power electricity sales business and ¥60mn in the biodiesel fuel business.

4. Other business

The other business segment posted ¥87mn in operating income and ¥966mn in sales in 1H FY12/19, with 29.2% of sales from the residential drinking water business that handles home delivery of bottled water, 68.4% from civil works projects added through the DAD acquisition, and 2.5% from rent income.

Results trends

In FY12/19 1H, net sales increased 2.4% YoY and operating income rose 2.2%

1. Overview of 1H FY12/19 results

In the FY12/19 1H consolidated results, net sales increased 2.4% YoY to ¥17,848mn, operating income rose 2.2% to ¥504mn, ordinary income decreased 3.5% to ¥575mn, and profit attributable to owners of parent declined 32.4% to ¥214mn. Compared to the forecasts, net sales were 1.9% below forecast, operating income was 24.8% below, ordinary income was 20.1% below, and profit attributable to owners of parent was 51.2% below. Operating income increased YoY because the Company worked to keep down personnel expenses in SG&A expenses. In the environmental equipment business, due to the completion of a large-scale project for which a final loss was recorded, income of ¥88mn recorded in the previous fiscal period through the percentage-of-completion method was reversed. Also, in other projects in which outsourcing construction costs are expected to increase, construction-loss allowances were recorded. The subsidy income that was recorded in non-operating income in the same period in the previous fiscal year was not recorded in this fiscal period, and the percentage of tax-use expenses increased, so ordinary income and profit attributable to owners of parent declined. The effective tax rate rose from 46.3% in the same period in the previous fiscal year to 61.7%. If excluding the impact of the rise in outsourcing costs, which rose more than initially expected, overall the Company cleared the initial forecasts for profits. For new orders, it is providing estimates revised to reflect the current level of outsourcing costs to prevent the recurrence of unprofitable projects.

By business, in the environmental equipment business, sales increased 13.6% YoY and profits decreased 17.5%. Overseas (excluding maintenance), net sales grew 14.7% and overseas provided 5.9% of net sales in this business and 3.1% of total net sales. In the household equipment business, sales decreased 12.9% and profits declined 34.2%. In the renewable energy business, sales increased 227.6% and this business became profitable. In the other business, sales increased 13.6% and profits decreased slightly, down 3.1%.

2. Financial position

Total asset value at the end of 1H FY12/19 was ¥30,434mn, an increase of ¥3,397mn YoY. Current assets rose by ¥2,438mn with gains primarily in cash and deposits (+¥4,309mn), accounts receivable (-¥434mn), accounts receivable from completed construction contracts (-¥582mn), and inventory assets (-¥791mn). Non-current assets expanded by ¥959mn, mainly on an increase of ¥694mn in solar power facilities.

Consolidated balance sheet and financial ratios

(¥mn)

	FY12/16	FY12/17	FY12/18	1H FY12/19	Change
Current assets	14,519	15,033	18,763	21,202	2,438
Cash and deposits	3,430	4,517	6,013	10,323	4,309
Trade receivables	8,329	7,490	9,230	8,172	-1,057
Inventories	2,206	2,487	2,998	2,206	-791
Non-current assets	5,504	6,592	8,272	9,232	959
Total assets	20,023	21,626	27,036	30,434	3,397
Current liabilities	12,302	13,259	18,863	20,259	1,395
Non-current liabilities	1,531	1,542	1,454	1,366	-88
Interest-bearing debt	6,911	7,670	11,010	14,578	3,567
Total net assets	6,189	6,824	6,717	8,808	2,090
[Stability]					
Current ratio	118.0%	113.4%	99.5%	104.7%	
Equity ratio	30.9%	31.6%	24.8%	22.4%	

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

Outlook

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

● **FY12/19 outlook**

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

Outlook for FY12/19

(¥mn)

	FY12/18		FY12/19 E			
	Amount	Ratio to sales	Amount	Ratio to sales	Change	%
Net sales	36,224	-	36,880	-	656	1.8%
Environmental equipment business	18,513	51.1%	19,272	52.3%	759	4.1%
Household equipment business	15,812	43.7%	15,056	40.8%	-756	-4.8%
Renewable energy business	287	0.8%	740	2.0%	453	157.7%
Other business	1,611	4.4%	1,810	4.9%	199	12.3%
Gross profit	6,887	19.0%	7,665	20.8%	778	11.3%
SG&A expenses	5,964	16.5%	6,465	17.5%	501	8.4%
Operating income	923	2.5%	1,200	3.3%	277	30.0%
Environmental equipment business	1,394	7.5%	1,363	7.1%	-31	-2.2%
Household equipment business	569	3.6%	473	3.1%	-96	-16.9%
Renewable energy business	-65	-22.8%	183	24.8%	248	Achieved profitability
Other business	97	6.1%	173	9.6%	76	78.2%
Adjustment	-1,072	-	-992	-	80	-7.5%
Ordinary income	1,100	3.0%	1,300	3.5%	200	18.1%
Profit attributable to owners of parent	861	2.4%	800	2.2%	-61	-7.1%

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

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

Medium- to long-term growth strategy

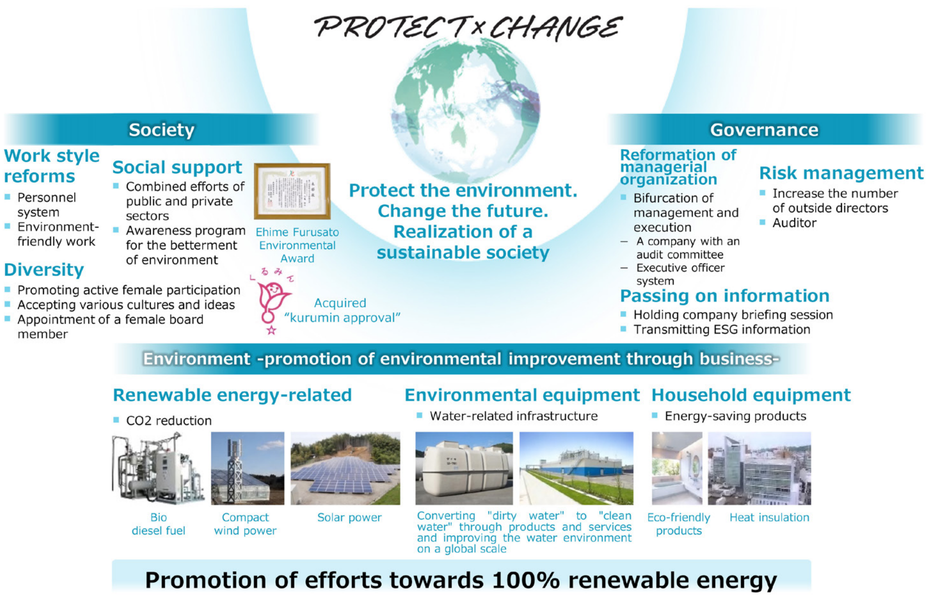
Is working to realize six SDGs by promoting ESG management

1. New medium-term business plan "Make FOUNDATION Plan – Promoting ESG Management"

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

The Company is working to achieve six SDGs by promoting ESG management. For the fifth SDG, of "Achieve gender equality," and the eighth, of "Decent work and economic growth," it is progressing "workstyle reforms" and "diversity" in Society. In its promotion of the activities of women, it has acquired the Kurumin Certification and it has also appointed women to be members of the Board. For the Environment, it is working to realize the sixth SDG, of "Ensure availability and sustainable management of water and sanitation for all," the seventh, "Ensure access to affordable, reliable, sustainable and modern energy for all," the twelfth, "Ensure sustainable consumption and production patterns, and the thirteenth, "Take urgent action to combat climate change and its impacts." To "Ensure availability and sustainable management of water and sanitation for all," it is building manufacturing bases for wastewater treatment systems in countries with large populations, of China, India, and Indonesia. For the sales network, in addition to in the above-three countries, it is concluding sales agency agreements with local companies in Vietnam, Myanmar, and Sri Lanka in Asia, and in Kenya in Africa. In places where a water quality inspection system for wastewater treatment systems and wastewater treatment facilities have not been established, it is lobbying the government administration and others toward the creation of public works projects. Moreover, the Company provides maintenance training and education not only for the staff in its own local companies, but also the staff in agencies. For the twelfth goal, each business is focusing its efforts into measures like adopting energy-saving products and materials. The Company is not a member of RE100 (Renewable Energy 100%), but it is progressing measures toward achieving 100% renewable energy. As of May 2019, there were 176 RE100 member companies throughout the world, of which, 19 are Japanese companies. Of these, only 5 are in the manufacturing industry, including Sony <6758>, Ricoh <7752>, and Fujitsu <6702>.

Specific measures for ESG



Source: The Company's results briefing materials

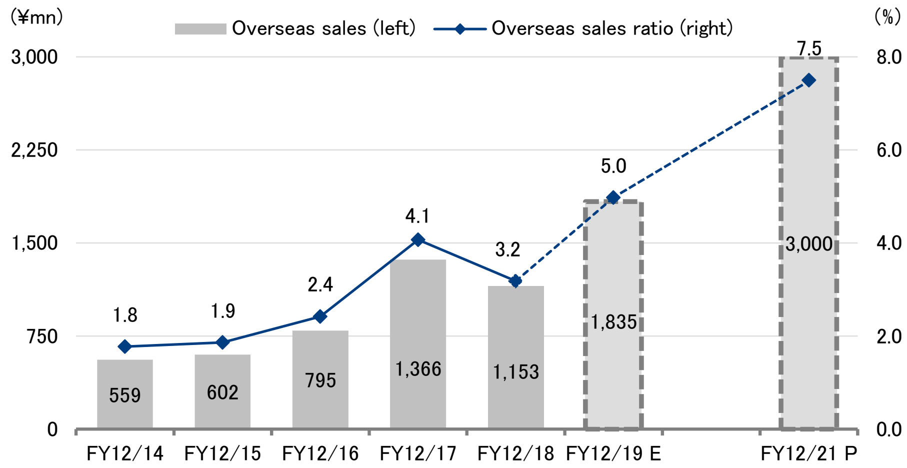
2. Growth strategy

Growth strategies are rapid expansion of overseas business with the prospect of massive demand for infrastructure related to water and continued accumulation of the recurring income-type business, such as maintenance and water supply in Japan. In household equipment business, it plans to shift from past “stability” to “growth.” Key initiatives are an area strategy to strengthen sales in undeveloped regions, recruitment of business opportunities and handling new products in the renovation market via online sales, and profit margin improvement by adopting centralized procurement. In renewable energy business, the Company expects full contributions from selling electricity generated by solar power facilities using DCM Group stores from FY12/20. The compact wind power equipment business has acquired an ID and launched new development that will become a pillar of business. The net sales target does not consider the contribution from new M&A.

(1) Overseas business development

The Company is progressing the shift to overseas local production, increasing cost competitiveness and stimulating demand, with the target of approximately trebling overseas net sales in three years, to net sales of ¥3bn in FY12/21. To develop new markets, in April 2015 it newly established the overseas sales supervisory department. It is also working to recruit customer companies from among Japanese companies that are entering into local markets, establishing plants and commercial facilities, and that are engaged in real estate developments in residential areas for condominiums and single-family detached housing in Japan. To accelerate growth, it has relocated the overseas sales supervisory department to be based in Tokyo under the environmental equipment business headquarters, and it is strengthening collaboration between the Matsuyama technology business department and the production business department. In accordance with the development of the overseas business, it will provide optimized support collectively for sales, technologies, and production.

Overseas sales and overseas sales ratio trends



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

a) Indonesia

In October 2013, the Company acquired an Indonesian local company (currently, PT.DAIKI AXIS INDONESIA) and made it a consolidated subsidiary, and thereby obtained a beachhead into Southeast Asia. It will construct a new plant in this country, which will expand the production capacity to 5 times the previous level, and at the same time it will progress automation by introducing new equipment and establishing Japanese-levels of product quality, while also improving productivity. In terms of products, since the weather is warm all year-round in Southeast Asia, low-temperature measures are not required, so it is able to narrow down functions and reduced costs. The production capacity will be from 200 to 250 units for each of large-, medium-, and small-sized systems.

In August 2019, President Joko of Indonesia officially announced that his government was considering moving the capital from the current capital of Jakarta to Kalimantan Island, which is located in practically the center of the country. The population of metropolitan Jakarta is more than 30 million people, so overcrowding and traffic congestion have become serious problems. Although there are many issues that must be resolved before the transfer of the capital, it is expected that an environmentally friendly city would be built, which is likely to create many business opportunities for the Company's Group.

b) China

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

In July 2018, the Company established Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd.) as a joint venture to manufacture household combination-treatment wastewater treatment systems. The investment ratios are that a local company, Lingzhi Environmental Protection Co., Ltd. (Yixing, Jiangsu) owns 51% and the Company owns 49%, so it is an equity-method affiliate for the Company. Yixing, the joint venture's location has been selected as a National Environment Protection Model City and is part of the Taihu area that includes Shanghai and Suzhou. The plant was constructed within the site of the joint-venture partner, and the products will be supplied to both of the investment companies (a maximum annual production capacity of 5,000 products). The annual production scale of all manufacturers within Japan is 120,000 to 130,00 products, within which, the Company produces 6,000 to 7,000 small-scale products. In Japan, it has production bases distributed across multiple locations, whereas its production capacity in China is in one location. Overseas, much of household wastewater contains edible oils and the living practices are different to those in Japan, such as bathing in a bathtub, so raw water concentrations are high. The Company is expected to develop and introduce wastewater treatment systems that take into consideration local living practices to achieve both low costs and high wastewater treatment capacities.

c) India

With the aim of accelerating business development in India, in August 2019 the Company increased its investment in DAIKI AXIS INDIA PRIVATE LIMITED, a Group company. In India, Swachh Bharat (Clean India) has become one of the Modi government's top priorities. The spread of toilets is rapidly progressing in India, so establishing sewage treatment facilities is an urgent requirement. In April 2017, in India as a whole, the government strengthened the regulation for BOD (Biochemical Oxygen Demand), which expresses the pollution status of water quality, from the previous value of BOD 30 to BOD 10 for commercial facilities of more than 18,000 square meters and residences with a total floor area of more than 2,000 square meters. Enormous demand is being generated only for new constructions, but the regulation also extends to existing facilities. Existing septic tanks cannot meet these strengthened regulations.

In the spring of 2019, the Company provided manufacturing equipment such as metal molds and technological guidance to Jyoti Plastics Works Pvt Ltd., its production subcontractor in India, and it began local production. The production subcontractor is also the Company's agency. It has started from an annual production capacity of 100 units, but the plan is to increase this by several times from 2020 onwards. The size of the wastewater treatment systems will correspond to use by 20 to 50 households. The Company has entered-into sales agency agreements with six companies in India, and in response to the increasing demand, it is considering enhancing the production line, decentralizing plants, and establishing joint ventures.

Overseas manufacturing of wastewater treatment systems

Japanese-type Johkasou of
Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd.

Subcontracted production plant in India

Source: The Company's results briefing materials

In September 2019, the Company established a joint venture with one of its agencies, Earth Water Limited. Daiki Earth Water Private Limited Company (the Company's investment ratio, 74%) was established with the aim of developing a wastewater treatment business and Water KIOSK, which is a business to sell drinking water, through BOT*1 and BOO*2 within India. Water KIOSK is a business to install drinking water purification equipment in public facilities, train stations, and other locations, and to sell drinking water for a fee.

*1 BOT (Build Operate Transfer) is a method to transfer the ownership of facilities that had been built, maintained, and operated by the private sector to the public after the end of the contract period.
*2 BOO (Build Own Operate) is a method in which facilities had been built, maintained, and operated by the private sector and continue as private-sector facilities even after the end of the contract period, or in which the facilities are dismantled and removed and end the business.

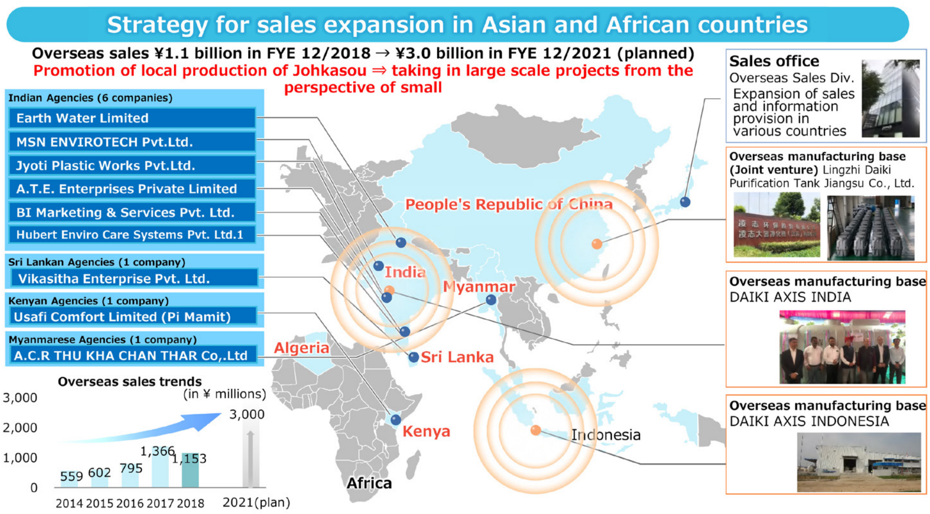
Opening-up new horizons through collaborations with local agencies

d) Agency network

The Company has a total of 10 agencies, while the agency numbers by country are 1 agency in Myanmar, 1 in Vietnam, 6 in India, 1 in Sri Lanka, and 1 in Kenya. It receives on-the-spot inquiries from ASEAN countries, while the number of inquiries via the Company's homepage is also increasing.

The Company has worked to open-up the market, including donating wastewater treatment systems to the Indian government for use for public toilets in parks and other locations in 2016 and conducting a demonstration experiment for industrial wastewater. In addition, by making agencies of local companies that already have pipelines to local governments and others, it is not only increasing the speed of market penetration, it has also come to see new horizons. The above-described Water KIOSK in India is an excellent example of this. This is a business that came to light only after the Company entered-into India. If it adhered rigidly to a self-sufficiency principle, it would have been difficult to secure the locations to install Water KIOSK, such as in train stations. In addition to the previously mentioned Water KIOSK, the joint venture is working to acquire public projects from local governments in the wastewater treatment systems-related area as well, and if it succeeds with this, the projects are likely to require a fairly large number of wastewater treatment systems.

Network of overseas manufacturing bases and agencies in the environmental equipment business



Source: The Company's results briefing materials

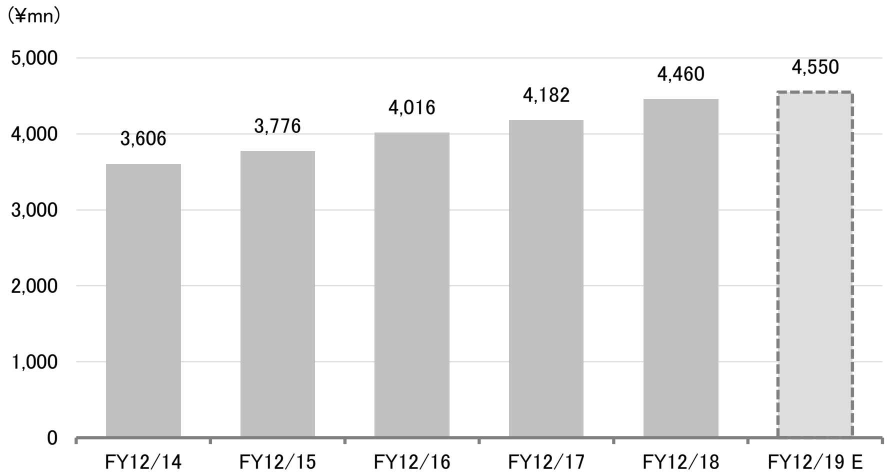
e) Myanmar

Along with the increase in pollution that has accompanied economic development, the government has strengthened regulatory operations and it has standardized the BOD value, which expresses the pollution status of water quality, as BOD 20. The Yangon City Development Committee (YCDC), which is the licensing authority in the largest city of Yangon, has made it obligatory to install wastewater treatment systems and wastewater treatment facilities in the applications for developments of new buildings with 7.5 floors or more. New town developments in the city suburbs are being progressed, and it is projected that the population of Yangon will grow from 5.5 million people to more than 10 million people by 2040. In Mandalay, environmentally improvements are being progressed to conserve tourism resources, and it has been made obligatory to install large wastewater treatment systems in multiple-dwelling residential facilities. The Company exports products from Indonesia, but in order to respond to the steady demand, it has announced the plan to establish a subsidiary, Daiki Axis Myanmar Co., Ltd., (provisional name) to realize local production.

(2) Expansion of recurring-income businesses

The company set the expansion of recurring-income business as one of its growth strategies. Maintenance net sales have been growing steadily, increasing 20.0% over 3 years to ¥4,460mn in FY12/18. Bulk orders for the installation and maintenance of wastewater treatment systems are increasing not only from DCM Group stores, but also from major convenience stores and major restaurant chains. All chain stores are required to comply with legal-inspection requirements, but there are concerns about variations in compliance among franchisee stores. The Company is building a new IT system to respond to the needs of these clients. After it is built, it will aim to reduce opportunity loss through consolidating and aggregating daily maintenance reports and providing reports to the chain's headquarters and quick proposals for renovation and facility-expansion work.

Trend in maintenance net sales



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

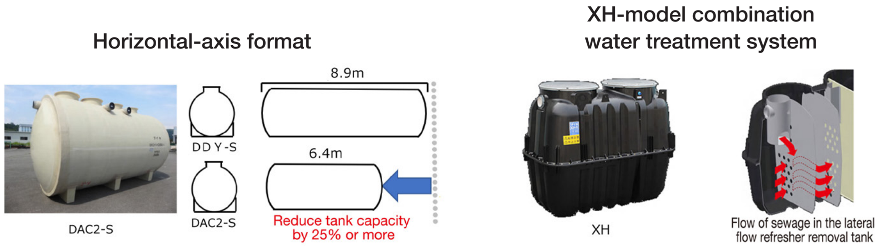
(3) Technological capabilities and product-development capabilities

The Company is increasing its competitiveness through product development that it highly cost competitive and efficient. In the overseas markets, it develops products that are optimized to the water conditions in each country, with the aims of improving quality at the same time as reducing costs.

For the domestic market, it is cutting costs through reducing parts material and the number of parts and developing highly efficient products through changing structures. DAC2-S, which is a new disposer system for use in multiple-dwelling residential facilities, has greatly improved workability because it has been made more compact. Its total length has been shortened by more than 25% compared to the previous product to 6.4m, which is the smallest size in the industry.

In July 2019, the Company released the XH-type as the standard model for household-use, advanced treatment-type wastewater treatment systems. From the viewpoint of realizing highly reliable and stable treatment performance, the Company's original "horizontal countercurrent contaminant removal method," which does not use an anaerobic filter material, is adopted for the primary treatment, while the contact aeration method, which offers stable treatment performance, is used for the secondary treatment. As it is simple to construct, the transfer is done without a transfer device (an intermittent metering pump) from the primary treatment, thus transfer and balance adjustments of the circulating water are no longer necessary. In addition, it has a simple design that does not require mechanical controls such as backwash operations, with a structure which reduces maintenance and inspection work and makes it easier to clean.

New products



Source: The Company's results briefing materials

During FY12/19, will install solar power facilities in 130 DCM Group stores

(4) Renewable energy business

The solar-power electricity sales business has been consolidated into Sylphid Co., Ltd., a consolidated subsidiary that conducts the R&D and sales of compact wind power equipment. This business, which utilizes DCM Group stores, has been separated from the main business with the aims of improving work efficiency by consolidating management operations. In June 2019, this subsidiary conducted a capital increase, a capital reduction, and a disposal of surplus. It received funding of ¥2bn from the Company and ¥2bn from a fund in the natural energy field called Shikoku Alliance Capital, which was jointly founded by 4 Shikoku banks. Sylphid's amount of loss of ¥579mn was eliminated.

a) Selling power from solar-power facilities

The Company has launched a business to sell power from solar-power facilities installed on the rented roofs of DCM Group stores. The Feed-in Tariff (FIT) long-term fixed purchase price is ¥18/kWh for one part, but the application for almost all facilities was made on the FY2017 price of ¥21/kWh. The number of facilities linked to the grid had increased from 81 facilities at the end of the previous fiscal period to 108 facilities (low pressure, 78 stores, high pressure, 30 stores) at the end of July 2019. The annual earnings of the solar-power electricity sales business are forecast to increase from ¥172mn in the previous fiscal period to ¥575mn in FY12/19. The construction of the 130 solar power facilities throughout the country will be completed during FY12/20. However, in the case of high pressure, in some cases connecting to the grid will require nearly six months, so it is possible that its full fiscal year contribution will be from FY12/21. Based on sunshine conditions in an average year and in the event of full operations throughout the year, it has been simulated that annual net sales will be ¥800mn and operating income will be ¥400mn. The total capital investment amount was initially budget at ¥5,000mn, but the profit margin is expected to rise due to the decrease in depreciation expenses following the fall in solar-panel prices. The depreciation period of solar-power facilities is 20 years (straight-line method), the same as the FIT fixed-price purchase period.

Solar panels installed on the rented roofs of DCM Group stores

DCM Daiki Yakeyama store

DCM Homac Ofunato store

Source: The Company's results briefing materials

b) Compact wind power equipment

Electricity FIT was ¥55/kWh in the Japanese fiscal year (JFY) 2017 for compact wind power equipment at less than 20kW. The price from JFY2018, however, was revised to ¥20/kWh because this becomes the same category as 20kWh and above from April 2018. Nevertheless, sales will focus on compact wind power because of the roughly 8,000 applications already submitted through March 2018. There is strong demand for FIT-compliant products that link to the grid due to the relatively high FIT for compact wind power equipment. In order to meet needs at the current time, the Company has introduced FIT-compliant machinery that is manufactured and assembled by another company and that uses Company-manufactured truss struts, and it has established the first power plant in Minamiosumi, Kagoshima Prefecture. This power sales business has an expiration date from an individual ID (¥55/kWh), but it will be in business until July 2022.

The Company's Group is acquiring ID from operators in Kagoshima Prefecture that have already acquired ID and embarking on an compact wind power sales business. Earnings from power sales will be recorded from the 2H of FY12/19. The Company determines the optimal installation sites based on wind conditions and it is utilizing the knowledge it has accumulated up to the present time. Going forward, it plans to develop the business to 70 sites nationwide.

Compact wind power equipment

Horizontal-axis format

Vertical-axis format

Source: The Company's results briefing materials

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

(5) Promoting ESG management

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

Promoting ESG management

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

Source: Prepared by FISCO from Company materials

3. Numerical goals

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

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

(¥mn)

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

Source: Prepared by FISCO from Company materials

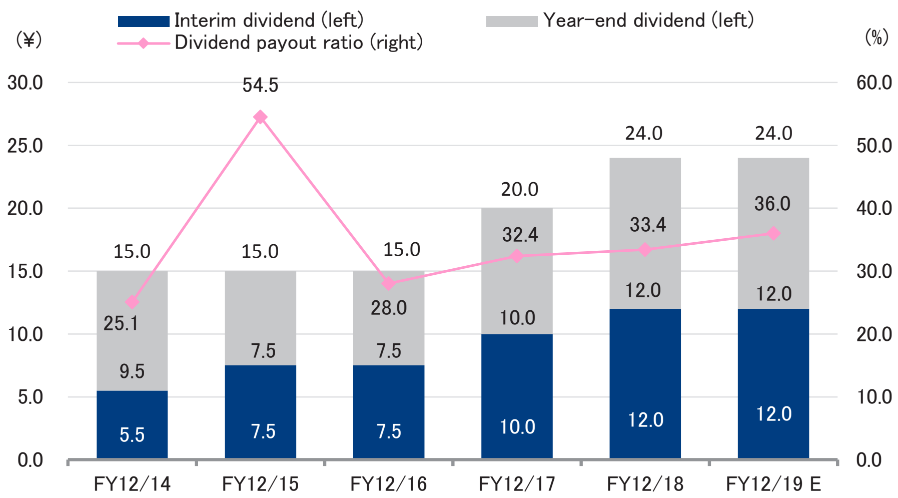
Shareholder return policy

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

● Dividend per share and dividend payout ratio

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

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



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

Information security measures

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

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