

Funai Soken Holdings Incorporated

9757

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Summary

Utilizes a unique stock-type business model; posted higher sales and profits exceeding expectations in 1Q FY12/17, including contributions from M&A arrangement, and likely to beat guidance

Funai Soken Holdings Incorporated <9757> (hereafter, also “the Company”) is one of the leading firms and a pioneer in the small and medium-sized enterprise management consulting industry. It was the first consulting firm to list on the stock market back in 1988. Under current president Sakae Takashima, the company’s fourth president who assumed this position in 2010, the Company has been steadily expanding business thanks to success in organizing a membership of executives and with other initiatives. It is strengthening management consulting, expanding into related areas, and bolstering group management operations. The Company is a corporate group with six subsidiaries, including logistics, IT, and contact center consulting operations, and 873 employees (as of the end of December 2016).

1. Business overview

The Company’s consulting service utilizes a unique stock-type business model in the management consulting industry that brings together customers, deepens trust, and builds up contracts. Distinguishing features are Zubari solutions (timely business models for individual industries that could dramatically boost results if promptly implemented), industry and thematic management workshops (130 workshops for specific themes that can increase execution capabilities), and industry-specific organization and rapid personnel training operations (cultivation of team leaders in about five years through accumulated experience by industry and theme).

2. Performance trends

The Company reported 1Q FY12/17 consolidated results with ¥4,449mn in net sales (+18.2% YoY), ¥1,382mn in operating income (+42.2%), ¥1,401mn in ordinary income (+42.8%), and ¥956mn in net income attributable to parent owners (+49.4%). It recorded higher sales and sharply higher profit. Management consulting, the main business, remains upbeat, with housing and real estate, medical, nursing care, and welfare, and certified professional services, the top-three industries by sales, exhibiting strong growth. Finalization of two deals in arrangement related to M&A consulting, an area that the Company has been preparing for some time, boosted results too. Profits increased sharply with gains of over 40% YoY, and operating margin was an impressive 31.1%.

The Company forecast ¥18,000mn in net sales (+9.5% YoY) and ¥3,900mn in operating income (+1.0%) in FY12/17 consolidated results. It expects higher sales and profits. The start in 1Q was healthy with net sales at 24.7% and profits at 35-36% of full-year targets. We think that each of the profit targets are slightly conservative and expect outcomes well above these levels in light of 1Q results.

3. Growth strategies

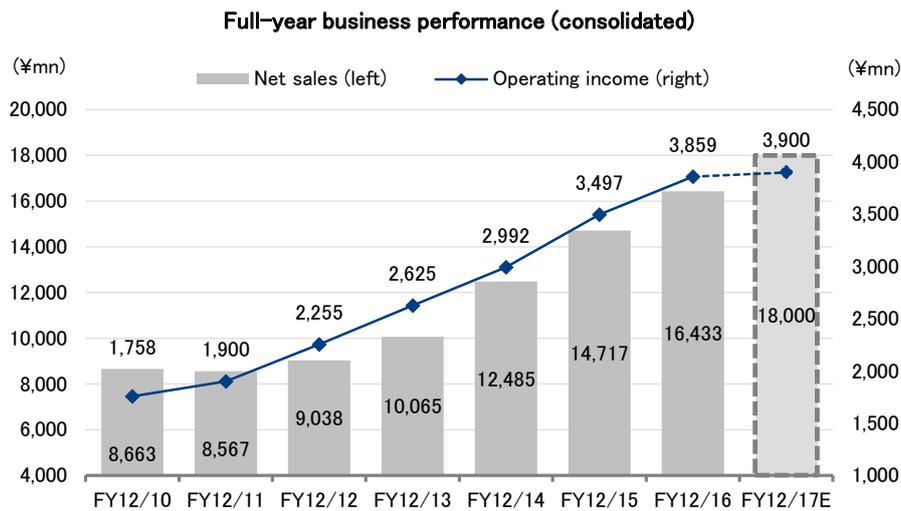
The Company is implementing the Great Value 2020 medium-term plan that starts in FY12/17 and lasts through FY12/19. The fundamental strategy aims to increase the member number in its industry-specific management workshops, a key strength, to 10,000 companies and solidify the stock-type consulting business. The Company easily surpassed net sales and operating income goals in the previous medium-term plan (2014-16) each year and attained third-year goals in the second year. The current medium-term plan appears slightly conservative as well. We think realization of the goals in the second year might be possible this time too considering results momentum and robust organizational capabilities.

Summary

A priority is reinforcement of thematic (functional) consulting initiatives. The Company has already established vertical links by industry and aims to foster matrix-style management with horizontal links by themes and functions and thereby improve cross-selling activities. Human resource development consulting, which has already been strengthened, is becoming an important driver with positive reception from customer companies struggling with hiring, education, and evaluations. The Company is steadily organizing and enhancing M&A consulting, which started delivering results in 1Q, Web marketing, productivity improvement consulting, project promotion, research business, logistics IT promotion, and IPO assistance.

Key Points

- Operates a unique stock-type business model for the management consulting industry
- Net sales and profits beat expectations in 1Q on robust management consulting and the start of contributions from M&A consulting
- Attained goals from the previous three-year medium-term plan in two years and likely to reach current medium-term plan (FY12/17-19) goals ahead of time too



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

Corporate outline

Strengthening consulting and peripheral businesses under president Takashima since 2010, accelerated growth.

1. Corporate outline and history

The Company was established by Mr. Yukio Funai in 1970, with its core business in comprehensive diagnosis of corporate management. With the founder's charismatic nature and hit publications, the Company steadily expanded operations, having succeeded in forming a member organization of small- and medium-sized enterprises focusing on the distribution industry, and was the first company in the consulting industry to list its shares in 1988 (being a Specially Designated Stock on the 2nd Section of the Osaka Stock Exchange). From the 1990s, the baton was passed to the second president, with a shift in customers from predominantly the distribution industry to the services industry. Under president Takashima, the fourth president, who was appointed in 2010, the consulting business has been strengthened and the scope of operations has been expanded to areas peripheral to consulting. The Company shifted to a holding company structure in 2014 and bolstered group management structure aimed at further growth. It is a corporate group with six subsidiaries, including logistics, IT, and contact center consulting operations and 873 employees as of the end of December 2016.

2. Business description

Management consulting is the core segment, generating 86.1% of net sales and 91.7% of operating income (1Q FY12/17 values). Monthly support consulting for small and medium-sized enterprises in over 100 industries, including 16 major industries (housing and real estate, medical, nursing care, and welfare, and certified professional services) comprise the Company's main focus. Other areas include project consulting, management workshop member fees, open seminars, and products.

In FY12/14, the Company Logistics Inc. became part of the Group, forming the logistics segment, as part of a strategy to enter businesses peripheral to consulting. It constitutes 10.0% of net sales and 4.8% of operating income of the Group (1Q FY12/17), and profit margin has greatly improved.

The "other" segment consists of Funai Soken IT Solutions Incorporated, which primarily runs an IT consulting business, and Proseed Corporation, which operates a contact center consulting business. It provides 3.9% of net sales and 3.5% of operating income (same).

Business content and composition (consolidated, 1Q FY12/17)

Business segment	Main client industries, description of business	Share of sales	Share of operating income
Management consulting	Consulting for industries such as housing and real estate, medical, nursing care, and welfare, certified professional services, amusement, food service and food.	86.1%	91.7%
Logistics	Logistics consulting, logistics operations, etc.	10.0%	4.8%
Other	IT consulting, IT outsourcing, contact center consulting, etc.	3.9%	3.5%

Source: Prepared by FISCO from Company materials

Business overview

Operates a unique stock-type business model in the consulting industry

1. Business model for management consulting

(1) On-the-mark solutions

“On-the-mark solutions” is an original term used by the Company that refers to timely business models for individual industries that could dramatically boost results if promptly implemented. Typical management consulting takes the approach of offering proposals of customized solutions after a business diagnosis. The Company does the opposite. It prepares a successful business model ahead of time and gathers clients who want to pursue the model. Some examples of the many solutions are “Specialize in low-priced mini-cars! Shop dedicated to selling minicars for ¥398,000” in the used car sales business, “model for senior housing that fills all rooms in 90 days” in the housing business, and “one-stop service including certification of aftereffects from an automobile accident” in the legal profession. These are very specific proposals. Even young consultants can handle the same solution for multiple clients and thereby accumulate experience in a short amount of time and quickly become autonomous.

(2) Industry and thematic management workshops

Industry and thematic management workshops are a central component of the business model. The Company had 6,003 paid members participating in 130 workshops, including study sessions, model company visits, and other activities, as of the end of March 2017. While executive gatherings often draw from different industries, these workshops are more practical with focus on specific industries and themes. For example, in the housing and real estate industry, the workshops are extremely specific and divided into groups such as “FAST-Reform Workshop,” “Rental Management Business Workshop,” “Home and Land Utilization for Senior Citizens and Disabled Persons Workshop,” “Northern European Modern Housing Workshop,” and “Smart House Workshop.” Given that existing clients also participate, the contents and benefits of management consulting are easily transmitted by word of mouth. Business workshops also play an important role in advancement of On-the-mark solutions.

(3) Industry-specific organization and rapid personnel training system

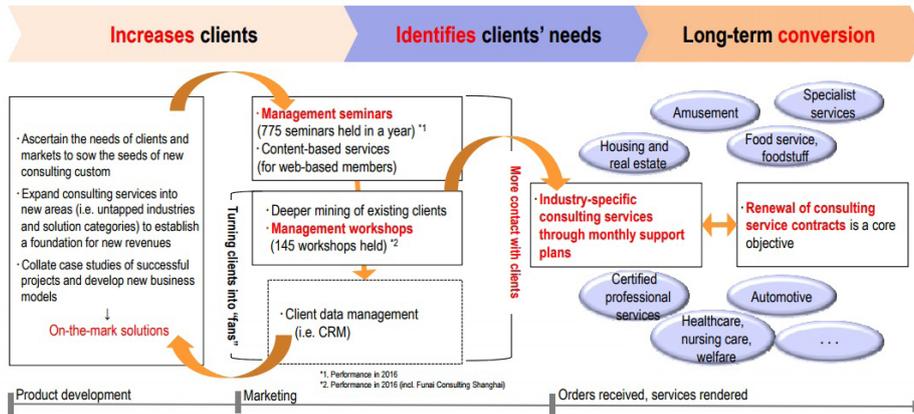
The Company fundamentally utilizes an industry-specific organization. Its many young consultants (primarily new university graduates) quickly absorb knowhow and gain autonomy by specializing in a certain industry or theme through involvement in On-the-mark solutions, management workshops, management seminars, and other activities. Consultants previously needed a period of 7.1 years to advance from being new graduates to a team leader (2013). However, The Company shortened this period to 5.4 years now (2016) by refining the framework for promptly cultivating full-fledged consultants. This is enabling it to maintain consulting contract relationships with 5,289 companies a year (+8.1% YoY in FY12/16).

These strengths jointly contribute to customer recruitment, deeper trust relations, and contract accumulation. The Company has established a highly unique stock-type business model in the management consulting industry.

Business overview

Business model

- The Funai Consulting business model stipulates that we provided targeted solutions for specific industries. We call this the Client Stock business model.
- Initiatives under the Client Stock business model are aimed at increasing clients, ascertaining their needs, and converting them into long-term clients. In this way, we seek to continually develop and improve the model.



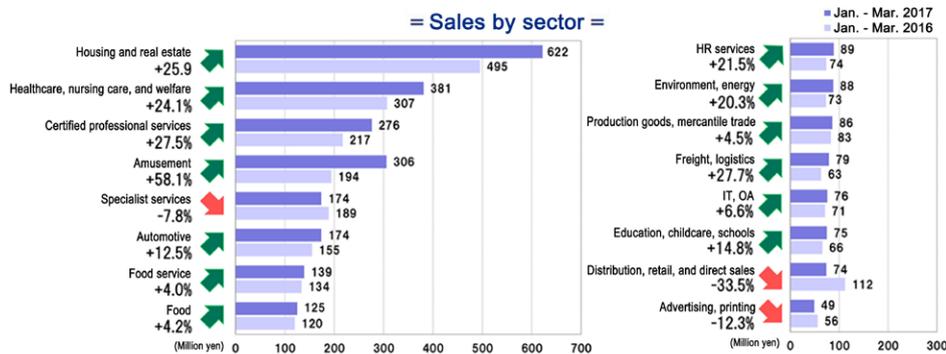
Source: The Company's summary of financial results

2. Trends by industry and business area

Looking at management consulting trends by industry, the three core areas of housing and real estate, healthcare, nursing care, and welfare, and certified professional services are steadily increasing sales. The amusement industry itself has been sluggish in recent years, and the Company's results were moving lower. However, the trend is ending and M&A arrangement income also contributed. The Company concentrates consultants and other business resources in key industries and achieves company-wide growth through portfolio management. Human resource services, environment and energy, and transportation and logistics are industries with smaller scale, but strong growth potential. The Company holds top-class market shares in many industries where it participates, including housing and real estate, healthcare, nursing care, and welfare, certified professional services, and amusement, and has a strong lead.

Trends by industry

= Sales by sector =



*The above figures show sales of consulting contracts, grouped in accordance with the company's industry classifications, for the January-to-March period of 2016 and 2017.

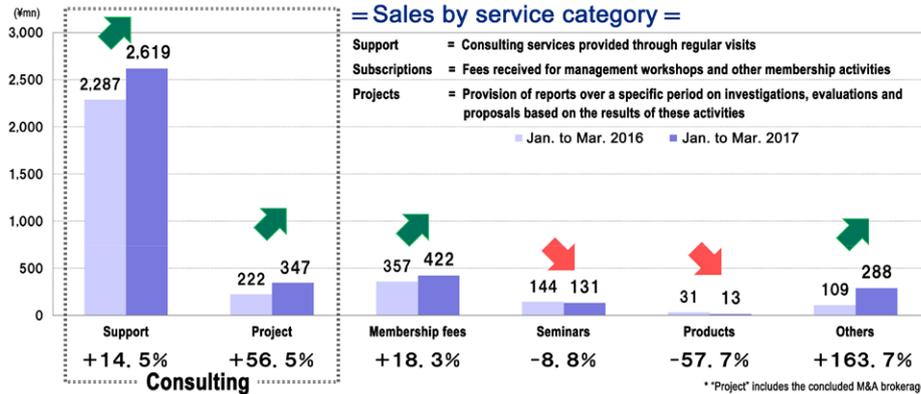
- Three core areas of housing and real estate, healthcare, nursing care, and welfare, and certified professional services continue to deliver 20% YoY growth and contribute substantially to sales.
- The Company concluded contracts for M&A arrangements this quarter in other M&A and M&A consulting (which assists and supports business successions), adding to sales in housing and real estate and amusement divisions.

Source: The Company's summary of financial results

Business overview

By operation, support (consulting) accounts for about 70% of sales as the primary income source. Many contracts last for a year, and the renewal rate is high. Project consulting conducts surveys and diagnosis and periodically issues reports with proposals based on these results. This service involves substantial customization and includes M&A deals. Non-consulting income mainly comes from “membership fees” and increases with more members. These three business areas have been growing.

Performance by segment: Consulting



- Support services, which account for more than 70% of the whole, remained strong.
- Income from membership subscriptions for industry-specific management workshops, which are one of strengths in this segment and, accordingly, one of key initiatives, increased robustly.
- Industry-specific management workshops are an effective funnel that guides attendees into monthly support contracts. The workshop-contract system is working well, and has become a major contributor to the increase in sales.

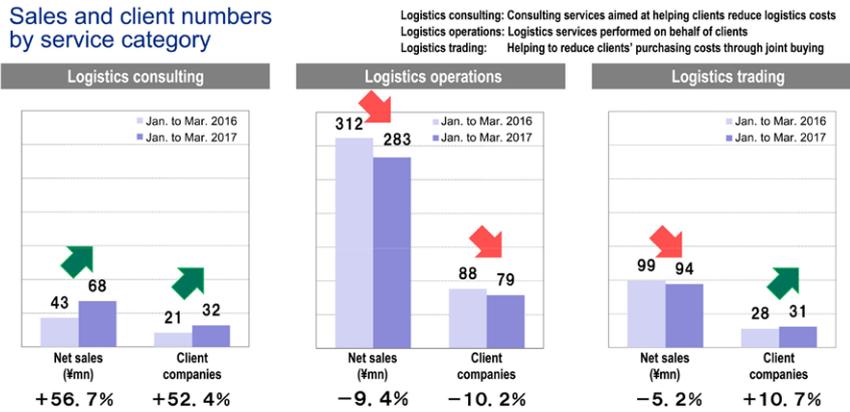
Source: The Company's summary of financial results

3. Logistics

Logistics business largely consists of “logistics operations” (¥283mn in sales in 1Q FY12/17; -9.4% YoY) to handle operation of logistics tasks at customer firms. While sales and customer volume dropped because of the Ichikawa warehouse closure, we think this business has growth potential. Logistics consulting (¥68mn in sales in 1Q FY12/17; +56.7% YoY), a high-margin business, contributed to improved profitability in the logistics business, with its steep increase in sales from healthy renewals and addition of new orders. Segment profit totaled ¥65mn (+47.3% YoY in 1Q FY12/17).

Business overview

Performance by Segment: logistics



- Logistics consulting: Steep rise in sales and customer volume on healthy renewals by existing customers and progress in new customer contract orders
- Logistics operations: Decline in sales and customer volume due to the Ichikawa warehouse closure
- Logistics trading: Sales fell on lower transaction volume with some existing customers, but profits were stable

Source: The Company's summary of financial results

Performance trends

Sales and profits increased more than expected in 1Q thanks to upbeat consulting business and the start of M&A arrangement contributions

1. Review of 1Q FY12/17 results trends

The Company reported 1Q FY12/17 consolidated results with ¥4,449mn in net sales (+18.2% YoY), ¥1,382mn in operating income (+42.2%), ¥1,401mn in ordinary income (+42.8%), and ¥956mn in net income attributable to parent owners (+49.4%). Both net sales and profits grew at double-digit paces. Operating income and ordinary income margins exceeded 30% (vs. about 26% each a year earlier). These results reconfirmed high profitability.

Mainstay management consulting posted ¥3,823mn in net sales (+21.3% YoY) and ¥1,252mn in operating income (+37.1%), remaining upbeat. Consulting for housing and real estate, medical, nursing care, and welfare, and certified professional services industries increased sales by over 20% YoY, giving a large boost to segment income. Finalization of two M&A arrangement deals in housing and real estate and amusement industries helped expand results.

Logistics business had a slight decline in operations activity, but logistics consulting recorded sharply higher earnings on steep increases in sales and customer volume. Other business (contact center consulting) also booked higher sales and profits.

Performance trends

1Q FY12/17 results

	1Q FY12/16		1Q FY12/17		YoY change
	1Q results	vs. net sales	1Q results	vs. net sales	
Net sales	3,763	100.0%	4,449	100.0%	18.2%
Cost of sales	2,319	61.6%	2,503	56.3%	8.0%
Gross profit	1,444	38.4%	1,945	43.7%	34.7%
SG&A expenses	472	12.6%	563	12.7%	19.3%
Operating income	971	25.8%	1,382	31.1%	42.2%
Ordinary income	981	26.1%	1,401	31.5%	42.8%
Net income attributable to owners of parent	640	17.0%	956	21.5%	49.4%

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

Very sound finances

2. Financial position and management indicators

Gross asset value at end-March 2017 climbed by ¥46mn from the end of the previous period to ¥22,909mn. The main increase was the ¥261mn addition from noncurrent assets (primarily from investments and other assets), and the top decline was the ¥171mn drop in cash and deposits.

Liabilities contracted by ¥298mn from the end of the previous period to ¥3,292mn, mainly on a ¥325mn decline in current liabilities (particularly lower unpaid corporate taxes). The Company only has ¥100mn in long-term loans under outstanding bank loans and operates with almost no debt in real terms.

Business indicators show very sound finances with the current ratio at 514.9% and equity ratio at 84.8% at end-March 2017.

Consolidated balance sheet and management indicators

	As of December 31, 2016	As of March 31, 2017	Change
Current assets	12,249	12,034	-214
Cash and deposits	8,663	8,491	-171
Noncurrent assets	10,613	10,874	261
Total assets	22,862	22,909	46
Current liabilities	2,663	2,337	-325
Noncurrent liabilities	927	954	27
Total liabilities	3,590	3,292	-298
Net assets	19,272	19,617	344
Total liabilities and net assets	22,862	22,909	46
Stability			
Current ratio	460.0%	514.9%	-
Equity ratio	83.5%	84.8%	-

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

■ Medium to long-term growth strategy

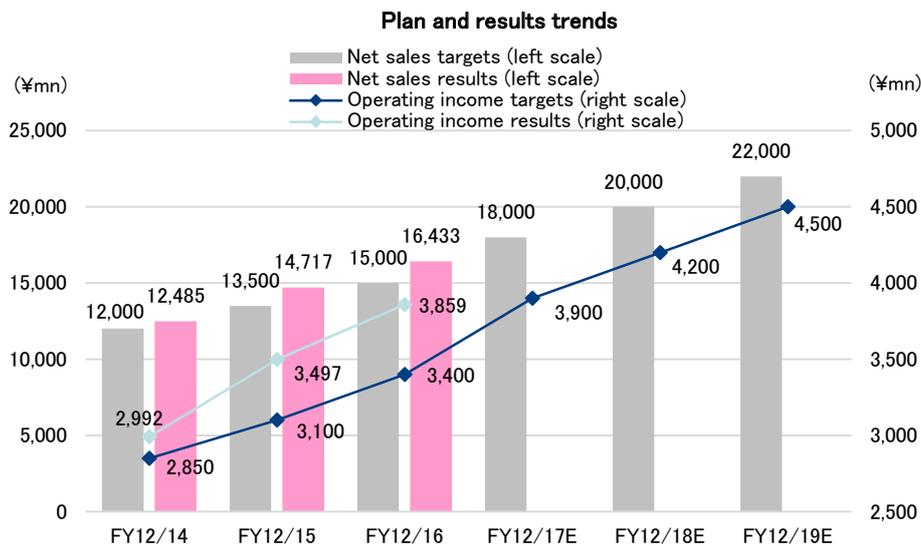
Attained goals from the previous three-year medium-term plan in two years and likely to reach current medium-term plan (FY12/17-19) goals ahead of time too

1.Review of previous medium-term plan goals and the current medium-term plan

The Company is implementing the Great Value 2020 medium-term plan that starts in FY12/17 and lasts through FY12/19. It aims to realize a “Comprehensive provider of management consulting solutions” with a trusted brand under president Takashima in the final three years of the 10-year plan (2017-2019). The fundamental strategy aims to increase the member number in its industry-specific management workshops, a key strength, to 10,000 companies and solidify the stock-type consulting business. The Company envisions having 1,400 group employees after the three years and hiring 200 consultants per year.

The Company easily surpassed net sales and operating income goals in the previous medium-term plan (2014-16) each year and attained third-year goals in the second year. It achieved average annual growth rates for the three years in double digits at 17.9% in net sales and 13.7% in operating income. The Company presents plan goals as minimum commitments and seeks to exceed the goals ahead of time.

We think it uses the same approach in the current medium-term plan. The FY12/19 goals of ¥22,000mn in net sales and ¥4,500mn in operating income work out to annual growth rates of 10.2% and 5.3% respectively. This plan appears slightly conservative. We think realization of the goals in the second year might be possible this time too considering results momentum and robust organizational capabilities.



Source: Prepared by FISCO from Company materials

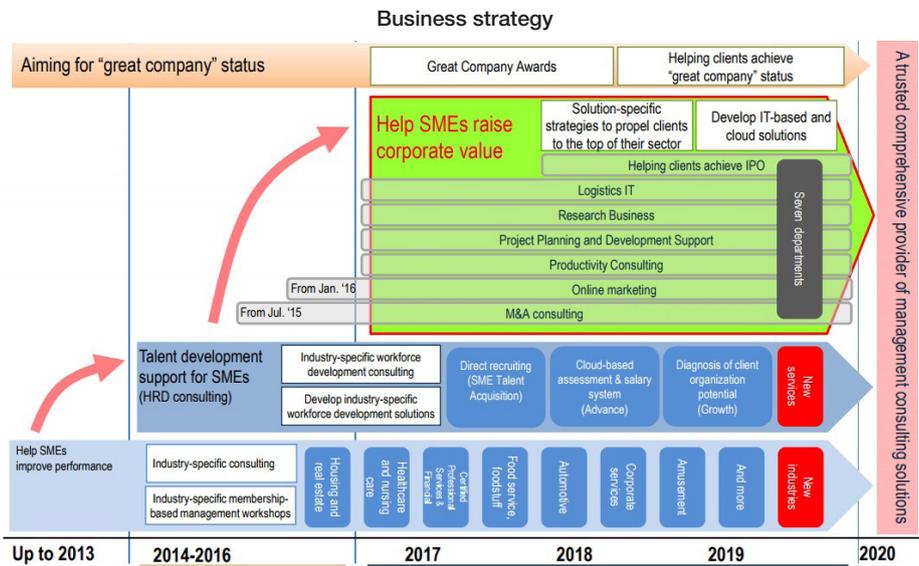
Medium-to-long-term growth strategy

2. Priority points in the medium-term business plan: Created seven business teams to bolster thematic consulting

Consulting teams with specialization by industry are an important strength. Meanwhile, the Company has been bolstering thematic (functional) initiatives since 2014 and hopes to reinforce services as a comprehensive management consulting group by having a multi-faceted approach. Consulting for development of human resources with industry expertise, which has already been ramped up, is emerging as a driver with positive reception from customer companies that struggle in hiring, education, and evaluations. The Company aims to establish and expand seven thematic teams from FY12/17 and thus assist in enhancing small and medium-sized companies. It is addressing the following seven themes.

- M&A Consulting: Started in July 2015
- Online Marketing: Started in January 2016
- Productivity Consulting: Starting in FY12/17
- Project Planning and Development Support: Starting in FY12/17
- Research Business: Starting in FY12/17
- Logistics IT: Starting in FY12/17
- Helping Clients Achieve IPO: Planned start in FY12/18

The above-mentioned value enhancement assistance measures will not be nominally apparent due to being counted in industry-level results, but cross-selling to member companies is likely to pick up and contribute to growth in management consulting. Additionally, new product development utilizing IT technology is also gaining momentum in peripheral services. We expect these activities to help in expansion of customer target segments and contribute to improved quality and efficiency in consulting services.



NB: Some additions and revisions have been made to figures in the plan released on November 4, 2016.

Source: The Company's summary of financial results

Medium-to-long-term growth strategy

3. Contributions begin from M&A arrangement, likely to contribute more in the future

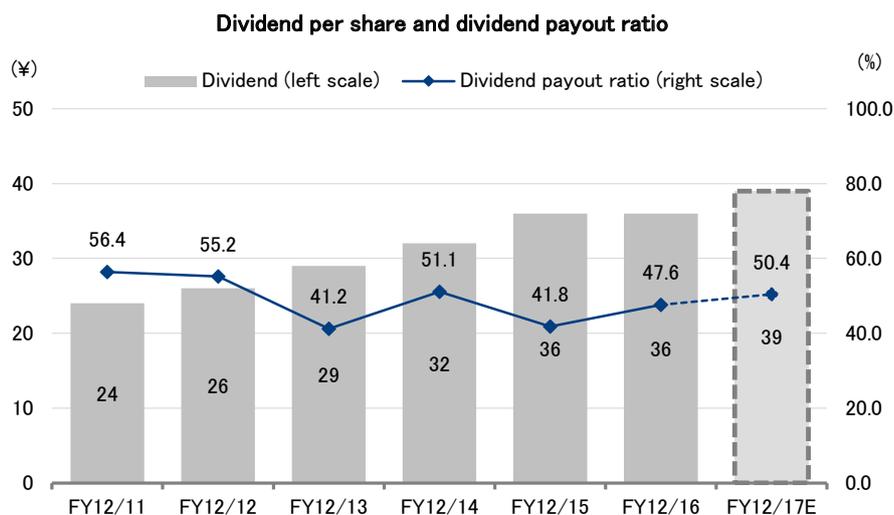
M&A arrangement business is likely to provide a substantial boost in the near term. Related efforts since July 2015 are beginning to pay off in concrete results, as seen in the two deals finalized in FY12/17 (amusement and housing/real estate). The Company's strength in this field is an ability to match sellers and buyers from its many customer firms. It already has the trust of customers and is familiar with their situation, facilitating identification of good matches and smooth transactions. We anticipate large contributions from M&A arrangement as an adjunct to business succession consulting amid growth in business successions.

Shareholder return policy

Likely to increase the dividend and exceed a 50% dividend payout ratio in FY12/17

The Company pays dividend as shareholder return. It recognizes appropriate distribution of profit to shareholders as its highest management priority, and intends to continue carrying this out through both "returns through dividends" and "returns through share buybacks" while considering business performance. Under a policy of raising the total amount of dividends sustainably, it is targeting a total return ratio of at least 50%. It paid a ¥36 dividend per share in FY12/16, a 47.6% dividend payout ratio, with an interim dividend of ¥15 and a year-end dividend of ¥21. In FY12/17, it aims to pay a ¥39 dividend per share, which corresponds to a 50.4% dividend payout ratio, with an interim dividend of ¥15 and a year-end dividend of ¥24.

With regard to shareholder rewards, the Company uses QUO card to improve convenience. It distributes QUO cards (with a value up to ¥10,000) to shareholders as of December 31, according to the number of shares held.



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



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