Nagaileben
7447 Tokyo Stock Exchange First Section

20-May-14

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Flagship healthcare operations expanding steadily, and the possibility of an upward revision with sound H1 performance

Nagaileben Co., Ltd. <7447> is the leading manufacturer of medical wear, with over 60% of the domestic market share. In Q2 FY8/14 just completed sales were ¥6,775mn (+4.8% y-o-y), operating profit was ¥1,831mn (+3.3% y-o-y), and recurring profit was ¥1,925mn (−10.7% y-o-y). Its flagship healthcare operations expanded steadily due, amongst other things, to the impact from the introduction of new products, the result being that both sales and operating profit not only showed gains year-on-year, but also exceeded budget.

In FY8/14 currently underway, forecasts call for sales of ¥16,000mn (+2.4% y-o-y), operating profit of ¥4,880mn (+0.1% y-o-y), recurring profit of ¥4,923mn (−9.1% y-o-y) and net profit of ¥3,030mn (−2.8% y-o-y), which is unchanged from forecasts at the beginning of the term. From the fact that operating profit, which is representative of the underlying business performed soundly in H1, there is the potential for an upward revision. On the other hand, recurring profit is forecast to decline, however, this is premised on the absence of (special factors) such as foreign exchange gains recorded in the last term, and according to exchange rate levels there is the potential for reduction in the scale of profit declines.

The Company's financial condition is sound with the shareholders' equity ratio at the end of Q2 FY8/14 reaching 91.0%, whilst also being proactive in shareholder returns (improvements in capital efficiency). Declaring a payout ratio on a parent basis of over 50%, the Company is also astutely buying back its own shares. Further, while it has flagged sales of ¥16,800mn and operating profit of ¥5,100mn in FU8/16 in the Mid-term Management Plan, given sound performance in underlying results, there is the potential to achieve these mid-term targets (operating profit) as early as this term. As for the operating environment, in accordance with the advent of the aging society the number of care workers is also expected to increase from 1.49 million in 2012 to 2.49 million in 2025, which is a tailwind for the Company.

Check Points

- Increased revenue and earnings and sound results from stable replacement demand
- Operating profit performing soundly, at levels to exceed full-year targets even at budget
- Mid-term Management Plan targets may also be achieved this term at the earliest
- High level of awareness of shareholder returns, maintaining capital efficiency

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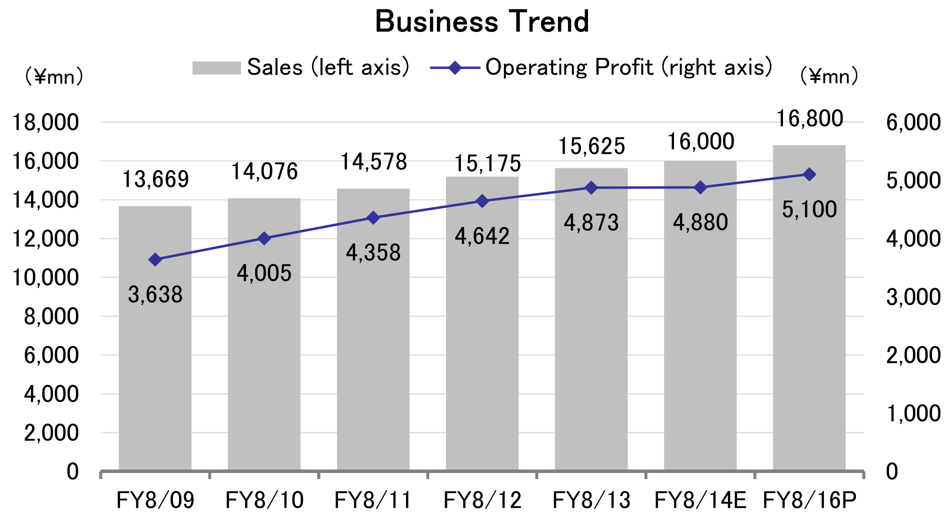


Company Outline

Specialist manufacturer of medical wear from procurement to manufacturing and sales.

(1) History

Nagaileben is a specialist manufacturer of medical gowns for, amongst others, nurses, doctors and patients. It has a rich history being established as Nagai Shoten in 1915. Subsequently it expanded operations nationally, and has become the leading manufacturer, boasting domestic market share exceeding 60%.

History

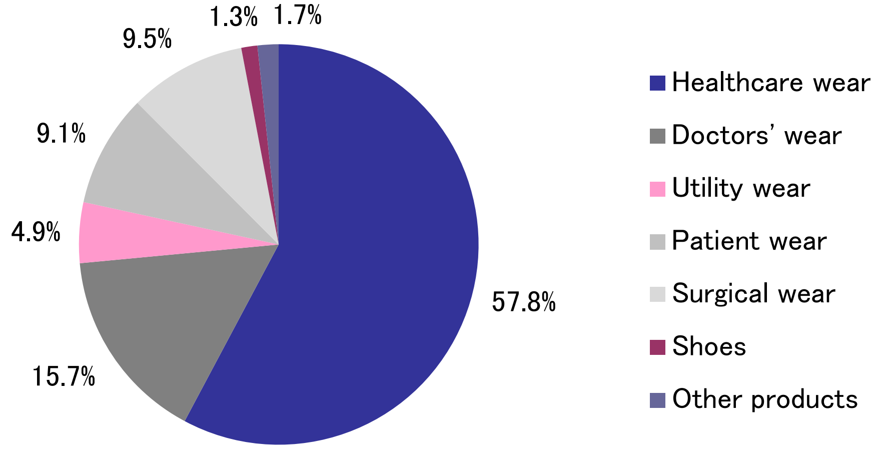
1915	Koji Nagai established Nagai Shoten, a proprietorship engaged in manufacturing white clothing, in Jimbocho-Kanda area of Tokyo. In 1942, Nagai Shoten expanded to become Tokyo Sanitary White Clothing Co.
1950	Tokyo Sanitary White Clothing Co. disbanded. Koji Nagai and Tatsuro Sawanobori established Nagai Shoten Co., Ltd.
1969	Established subsidiary Nagai White Clothing Industry Co., Ltd. in Akita Prefecture to expand production. Mr. Sawanobori became president. Company specialized in producing and selling white clothing for medical use.
1977	Constructed Goods Center 2 in Kamedo, Tokyo. Established a business alliance with GD Searle, of the US; established Nippon Surgical Apparel Co. in Hiroshima City to expand sales of new operating room apparel.
1978	Established technical agreements with Angelica Co., of the US, and with Toray, of Japan. Developed clothing made of new materials for lease.
1980	Changed company name to Nagai Co., Ltd. Set up a sales office in Takamatsu City. Concluded a license agreement with designer Kansai Yamamoto.
1982	Concluded a license agreement with designer Sachiko Hanai.
1988	Nagai Co. spun off some of its operations as a new company, Emit Co. Subsequently, these companies traded names. Emit Co. became the overall group manager, while Nagai Co. became the sales company.
1989	Built the Nagai Luminous plant in Akita Prefecture to produce high-grade goods. Started overseas production, planned to divide business internationally.
1994	Nagai Co. changed its name to Nagaileben Co., Ltd. Built a distribution center in Akita Prefecture.
1995	Nagaileben registered its shares on Japan’ s over-the-counter market. Developed a clothing line for the aged as the second main product line. Vice President Ichiro Sawanobori became president.
1996	Concluded a license agreement with French designer Courreges.
1999	Opened a sales office in Nagoya. Concluded a license agreement with designer Atsuro Utayama.
2001	Listed shares on the Second Section of the Tokyo Stock Exchange
2002	Concluded technical agreements in surgical textiles with Standard Textiles Inc., of the US, and with Toray. Upgraded Nagoya sales office to a branch office.
2004	Acquired SO 9001 certification. Listed shares on the First Section of the Tokyo Stock Exchange. Absorbed Nagai Hokkaido and opened a branch office in Hokkaido.
2005	Acquired ISO 14001 certification. Concluded a license agreement with designer Keita Maruyama.
2006	Concluded a license agreement with designer Minako Yokomori.
2013	Concluded a sub-license agreement with K.K. Dick Bruna Japan (trademark Miffy)

(2) Description of Businesses

● **Sales Contribution by Item**

All of the Company's products are medical wear and related products. The sales contribution by item (Q2 FY8/14) is healthcare wear 57.8%, doctors' wear 15.7%, surgical wear 9.5%, patient wear 9.1%, utility 4.9%, shoes and other 1.3% and other 1.7%. Profit margins for each item does not vary significantly, however, the profit shoes and other, which are purchased merchandise, are lower.

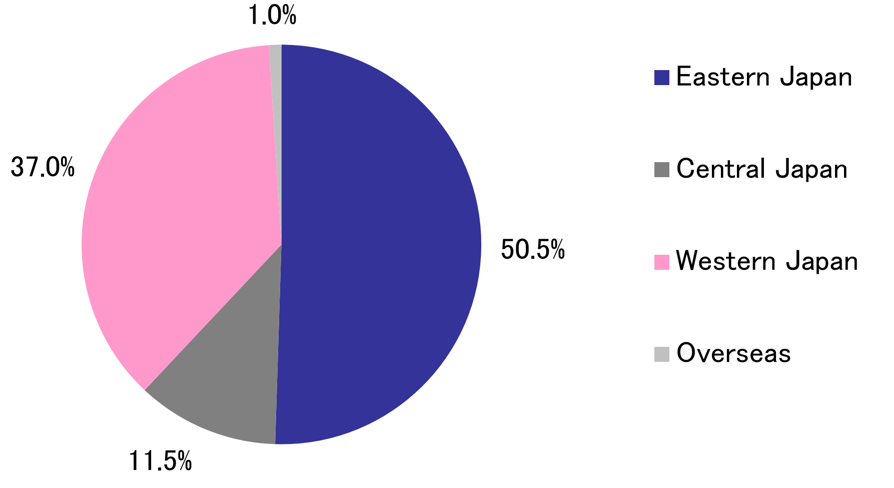
Sales Breakdown of H1 FY8/14 by Item



● **Sales Contribution by Region**

In the sales contribution by region (Q2 FY8/14), eastern Japan represents 50.5%, western Japan 37.0%, central Japan 11.5% and overseas 1.0%, with almost nationwide coverage. Overseas is still less than 1.0%, however, this leaves the potential for future expansion.

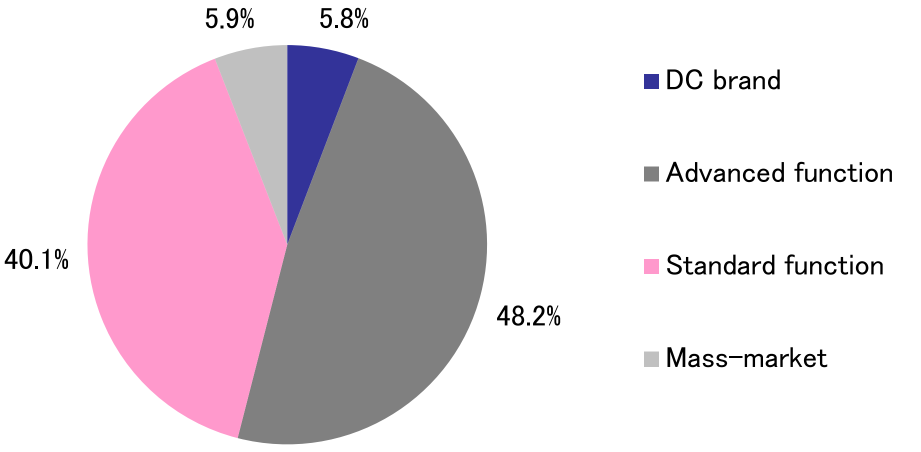
Sales Breakdown of H1 FY8/14 by Market



● Sales Contribution by Product (Function)

In the Q2 FY8/14 sales contribution by product (function), advance function products represent 48.2%, products of standard function 40.1%, mass-produced products 5.9% and DC brand products 5.8%. As an example, in nursing wear products, when classified by price range, mass-produced products are under ¥5,000, products with standard function ¥5,000-7,5000, advance function products are ¥7,500-10,000, and DC brand products over ¥10,000. The higher the price the greater the profit margin.

Sales Breakdown of H1 FY8/14 by Product Function



(3) Sales Channels & Production Status

The Company's end users included nurses and doctors, with the purchasers of the products being mainly medical, care and other facilities such as hospitals. However, direct sales are not undertaken, with 100% being agency sales via medical equipment wholesalers that trade with these medical and other facilities. As a result, direct sales expenses are contained, however, on the other hand, because the Company grasps customer needs, with sales staff are constantly in contact with hospitals and other facilities, it is a system that allows the voice (requests etc.) of the end users to reach the Company.

Medical gowns were laundered within the hospitals by the hospitals themselves, however, in recent years they have been switching to leasing. The lease term is typically four years. Given that demand to switch to four year leases has arisen, arguably it is providing stable support for the Company's results.

In respect of production, cumulative Q2 FY8/14 results showed that 98.4% were produced in-house (domestically manufactured 55.7%, 42.7% manufactured overseas) and 1.6% purchased merchandise. In overseas manufacturing, goods are produced at factories held by local partners, with the Company not possessing its own factories, facilitating both reduction in investment risks and reduced costs.

(4) Distinctive Characteristics & Strengths

The Company is a specialist manufacturer of medical wear, with one strength being that it has in place systems to undertake everything from design to raw material procurement, manufacture and sales. Due to this it is able to accurately grasp user needs, and at the same time is able to secure optimal materials, manufacture at low cost, and sell after adding an appropriate margin.

Further, given that it has a large number of affiliated factories, the product item line-up extends into the thousands of varieties, and the fact that it has in place systems that can respond to a broad range of user needs, place it in a superior position to its competitors. From a sales aspect, it has a network of close to 1,000 agents nationwide, and while its sales capabilities are robust, sales expenses at the Company itself are contained to the (maximum) extent possible. This is also arguably one of the Company's strengths.

As a result, it has a domestic market share exceeding 60%, and maintains its firm position as the (industry's) leading company. According to the Company, even the second player in the industry has a share of 7-8%, with all the other companies from third onwards limited to shares of several percent. As such, the Company's gross margin is 46.8% (actual results Q2 FY8/14), with it maintaining high profitability. Despite having high profitability, the reason it has been able to maintain a high market share has been that the majority of customers are satisfied with the Company's products and services, which is the Company's greatest strength.

Q2 FY8/14 Results

Increased revenue and earnings and sound results from stable replacement demand

Income Statement

(unit: ¥mn, %)

	Q2 FY8/13		Q2 FY8/14				
	Amount	Sales %	Amount	Sales %	Change	y-o-y	v.s plan
Sales	6,463	100.0	6,775	100.0	312	+4.8	+3.8
Gross profit	3,034	46.9	3,169	46.8	135	+4.5	+4.0
SG&A cost	1,262	19.5	1,337	19.8	75	+6.0	▲ 2.1
Operating profit	1,771	27.4	1,831	27.0	60	+3.3	+8.9
Recurring profit	2,157	33.4	1,925	28.4	▲ 232	▲ 10.7	+13.0
Net profit	1,321	20.4	1,264	18.7	▲ 57	▲ 4.3	+20.5

Q2 FY8/14 results showed sales of ¥6,775mn (+4.8% y-o-y), operating profit of ¥1,831mn (+3.3% y-o-y), recurring profit of ¥1,925mn (-10.7% y-o-y) and quarterly net profit of ¥1,264mn (-4.3% -o-y). Further, it arguably a solid set of results with sales up 3.8%, gross profit up 4.0%, SG&A down 2.1%, operating profit up 8.9%, recurring profit up 13.0%, and quarterly net profit up 20.5% compared with the plan at the beginning of the term.

In sales, in addition to healthcare performing soundly supported by stable replacement demand, peripheral markets such as doctor's wear, patient wear and surgical wear contributed to revenue growth due to the impact from new products.

In relation to costs, the negative impact of raw material and processing cost rises was around ¥8mn, and impact of the rise in the cost of goods from yen depreciation (as above) was around ¥53mn, however, with the ratio of overseas production rising (41.1%to 42.7% from the same time last year) and other cost reductions, the gross margin declined slightly from 46.9% the same time a year earlier to 46.8% which was within expectations.

On the other hand, while expenses related to shifting the corporate headquarters arose of around ¥50mn (¥23mn in depreciation, ¥27mn in sundry related expenses), other expenses were contained, with SG&A being ¥1,337mn or 2.1% below budget. For the full-year, in line with the plan at the beginning of the term they are expected to exceed last year (+6.8%), however, due to the progress of cost cutting in H1 it is arguably a budget with some leeway.

Non-operating income declined significantly year-on-year from ¥405mn to ¥115mn, but was still above budget. This was from a foreign exchange gain that arose in the same period last year of ¥355mn (a foreign exchange gain that arose from dollar deposits held as a hedge) was expected at the beginning of the term to disappear. However, in actual fact even in this Q2 because a gain of ¥56mn arose it exceeded the budget. However, there is the potential for this foreign exchange gain to be erased or become a loss depending on the yen exchange rate at the end of the term. Further, ¥114mn from the sale of the old headquarters was recorded as extraordinary income, and being already fixed will also be recorded in the full-year results.

■ Sales by Segment

Success in the Strategy to Increase Market Share in the Critical Western Japan Marketing Region

(1) Sales by Item

Sales by item reveal healthcare wear at ¥3,914mn (+5.1% y-o-y), doctor's wear ¥1,064mn (+8.4% y-o-y), utility wear ¥334mn (-4.9% y-o-y), patient wear ¥617mn (+6.3% y-o-y), surgical wear ¥641mn (+3.3% y-o-y), shoes ¥87mn (-13.0% y-o-y) and other ¥114mn (+14.0% y-o-y).

Against a background of stabilization in the healthcare market, given steady expansion in lease renewals new items, as well as sound performance in the advance function product range, sales exceed the plan. Half-yearly sales set a new record high for the fifth consecutive period. Also, doctor's wear performed soundly, with scrub wear (*1) that was introduced several years ago and other new products contributing. With new products, by having doctors and nurses wear products with the same logo emblazoned on them, an effect of promoting a "medical team" consciousness has emerged. Further, the introduction of products that are colored or partially colored has contributed to increases in sales. On the other hand, the trend for utility wear that is worn over aprons and white gowns to shift from them being provided by the individual to being common property is continuing, with there being no sense of market declines halting and (thus) sales continue to stagnate. In patient wear, new products contributed to increased sales against a background of increased demand for medical examinations. In surgical wear sales grew in a stable fashion due to penetration of the scrub wear and COMPELPAK (*2) markets.

Breakdown of Sales by Item

(unit: ¥mn, %)

	Q2 FY8/13	Q2 FY8/14	
	Amount	Amount	y-o-y
Healthcare wear	3,725	3,914	+5.1
Doctors' wear	982	1,064	+8.4
Utility wear	352	334	▲ 4.9
Patient wear	580	617	+6.3
Surgical wear	621	641	+3.3
Shoes	100	87	▲ 13.0
Other products	100	114	+14.0
Total	6,463	6,775	+4.8

(2) Sales by Region

Sales by region show eastern Japan at PY3,422mn (+0.0% y-o-y), central Japan at ¥779mn (+25.1% y-o-y), western Japan at ¥2,503mn (+6.1% y-o-y) and overseas at ¥70mn (+21.6% y-o-y).

■Sales by Segment

In eastern Japan, given that the growth rate last term was high the result of focusing on expanding sales in the new product range this term was to secure sales that were on a par with the previous year. In Central Japan where marketability is weaker the impact due to the quantity of items is great, and given, in addition to replacement demand being concentrated in this H1, the acquisition of new items (sales) expanded significantly year-on-year. In western Japan, the strategy to increase market share by introducing new products succeeded, with stable sales growth being maintained.

Breakdown of Sales by Market

(unit: ¥mn. %)

	Q2 FY8/13	Q2 FY8/14	
	Amount	Amount	y-o-y
Eastern Japan	3,423	3,422	+0.0
Central Japan	623	779	+25.1
Western Japan	2,359	2,503	+6.1
Overseas	57	70	+21.6
Total	6,463	6,775	+4.8

Financial Position

Cash & deposits decline but to date still in a cash rich position

Balance Sheet

(unit: ¥mn)

	8/13	2/14	Change
Cash and deposits	17,456	16,016	▲ 1,439
Notes and accounts receivable	4,622	4,106	▲ 515
Inventories	3,524	4,330	+806
Current assets	26,247	25,144	▲ 1,103
Buildings and other structures	1,645	2,647	+1,002
Land	4,692	4,480	▲ 212
Investment	3,079	2,951	▲ 128
Fixed assets	10,807	10,951	+144
Total assets	37,054	36,095	▲ 959
Bills and accounts payable	1,385	1,570	+185
Corporate tax payable	1,344	610	▲ 733
Total liabilities	3,966	3,236	▲ 729
Retained earnings	31,886	31,609	▲ 276
Treasury stock	▲ 3,401	▲ 3,401	+0
Total equity	33,088	32,858	▲ 229
Total liabilities and equity	31,886	36,095	▲ 959

The financial position at the end of Q2 FY8/14 (balance sheet) is as set out in the table above. Total assets were ¥36,095mn a decline from the last period end of ¥959mn. Total current assets were ¥25,144mn, and decline of ¥1,103mn, with the major reasons including a decline in cash and deposits at banks of ¥1,439mn and in notes and accounts receivable of ¥515mn, with an increase in inventory of ¥806mn. Total fixed assets increased ¥144mn to ¥10,951mn. A breakdown shows an increase of ¥274mn in tangible fixed assets to ¥7,914mn. Intangible fixed assets declined ¥3mn to ¥85mn, with investments and other assets declining ¥128mn to ¥2,951mn.

*1 Scrub wear: V-neck style surgical and nursing wear that differs from traditional medical gowns (which are the short-sleeved, turtle neck variety).

*2 Converback: A system for reusing surgical linen (i.e. used in operations). A service that realizes reductions in cost and medical waste, enabling reuse by collecting, washing, pressing and sanitizing surgical linen that is normally disposed of as medical waste.

■Financial Position

Total liabilities declined ¥729mn from the period end in the previous year to ¥3,236mn. The main reasons included a decline in accrued tax payable and other items of ¥733mn. Total net assets declined ¥229mn from the period end a year ago to ¥32,858mn. The main reasons included a decline of ¥1,541mn from dividend payments and the recording of ¥1,264mn in quarterly net profit.

FY8/14 Forecasts

Operating profit performing soundly, at levels to exceed full-year targets even at budget

Company Forecast for FY8/14

(unit: ¥mn, %)

	FY8/13		Forecast FY8/14			
	Amount	Sales %	Amount	Sales %	Change	y-o-y
Sales	15,625	100.0	16,000	100.0	375	+2.4
Gross profit	7,346	47.0	7,520	47.0	174	+2.4
SG&A cost	2,473	15.8	2,640	16.5	167	+6.8
Operating profit	4,873	31.2	4,880	30.5	7	+0.1
Recurring profit	5,418	34.7	4,923	30.8	▲ 495	▲ 9.1
Net profit	3,119	20.0	3,030	18.9	▲ 89	▲ 2.8

FY8/14 results forecast sales of ¥16,000mn (+2.4% y-o-y), operating profit of ¥4,800mn (+0.1% y-o-y), recurring profit of ¥4,923mn (-9.1% y-o-y), and net profit of ¥3,030mn (-2.9% y-o-y), unchanged from the forecast at the beginning of the term. Despite the fact that H1 results exceeded forecasts, full-year forecasts are unchanged, being arguably extremely conservative forecasts. Actually, it appears that the start to H2 is also sound, with sales in March, the month of peak demand, setting a new record, leading one to feel that sooner or later there will be an upward revision for full-year results.

From a cost perspective, negative factors in rises in raw material and processing costs (¥29mn), and (another) negative factor in yen depreciation of ¥55mn (the average USD exchange rate going from an actual ¥82.5 in the period a year ago to ¥86.0 forecast for the current period) are anticipated, however, on the other hand a positive impact of ¥75mn is expected from a rise in the ratio of overseas production (40.7% last period to 42.6% this period), with the gross margin expected to be flat with the same period a year ago at 47.0%. As a result, it is expected that gross profit will be ¥7,520mn (+2.4% y-o-y).

Further, in respect of SG&A, a total rise of ¥176mn to ¥2,640mn (+6.8% y-o-y) is expected, including ¥108mn in costs related to the relocation of the Company's headquarters (¥81mn in depreciation, sundry expenses of ¥27mn). As a result, operating profit of ¥4,800mn (+0.1% y-o-y) is forecast, however, considering that already in H1 actual SG&A was 2.1% below budget, the potential for SG&A to be below budget for the full-year also and operating profit to exceed the current forecast is great.

In respect of recurring profit, given that the non-operating income from foreign exchange gains (¥500mn) that arose in FY8/13 are not expected in this term, a decline of 9.1% y-o-y to ¥4,923mn is forecast, however, if the term end exchange rate (¥/USD) shows yen depreciation greater than the previous term end, there is the possibility that the amount of decrease in profits will be less than expected. On the other hand, in respect of net profit, given that the extraordinary loss recorded in FY8/13 (¥332mn in impairment losses) will disappear a decline of 2.9% y-o-y or ¥3,030mn is forecast. Further, ¥114mn in gains on the sale of the old headquarters, resulting from the relocation in headquarters have arisen, however, this has not been included in the above forecast.

Given the above circumstances, in respect of operating profit, which is representative of underlying business, even in the event that H2 results are in line with the budget, there is the potential to exceed full-year forecasts. In the event that H2 results exceed the budget there is a strong probability of a further upward revision. However, recurring profit is contingent on the exchange rate level at the end of the term, this is not a result of underlying business. On the other hand, in respect of net profit, given that gains on sale of the old headquarters are already fixed, to the extent that recurring profit does not significantly fall below forecasts, there is considerable potential for an upward revision from current forecasts.

Moreover, an amount of ¥859mn in capital investment expenditure (¥616mn related to the new headquarters, ¥95mn for its equipment replacement in its logistics center, ¥50mn related to production equipment), and a depreciation expense of ¥344mn was recorded.

In respect of the impact of consumption tax increases, according to the Company, the impact in Q2 was negligible. In March, which is the peak demand month, it appears there was some front-loading demand, however, when viewed over the full-year, they discern no impact. The impact on results may be considered to be neutral.

■ Mid-term Management Plan

May Achieve Mid-term Management Plan Numerical Targets as Early as this Term

The Company had adopted sales of ¥16,800mn and operating profit of ¥5,100mn as numerical targets in its Mid-Term Management Plan, and these targets remain unchanged. However, with the operating profit forecast in FY8/14 already ¥4,880mn and Q2 results performance sound as noted above, if we consider the possibility of an upward revision, attaining the mid-term targets is more than possible, with the potential for them to be achieved as early as this term (FY8/14). In order to achieve the numerical targets in the Mid-term Management Plan, the Company plans to engage as follows by item, by region and by product.

● Sales by Item

Going forward, the Company will focus in particular on patient wear (8.2% of sale in FY8/13) and surgical wear (9.5% of sales in FY8/13), planning to boost these to 9.0% and 11.0% of sales respectively in FY8/16. For the Company these are relatively new areas, and given that the absolute amount of sales is still low are areas where it is relatively easy to increase sales. Moreover, it is not that sales in areas other than patient and surgical wear will decline, but only that their percentage of sales will change within an increase of sales overall.

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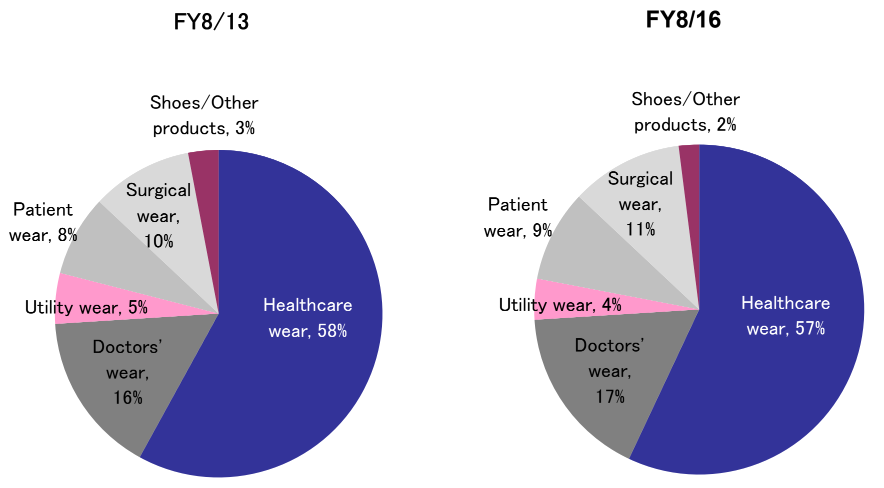
Sales and Growth Projections by Item

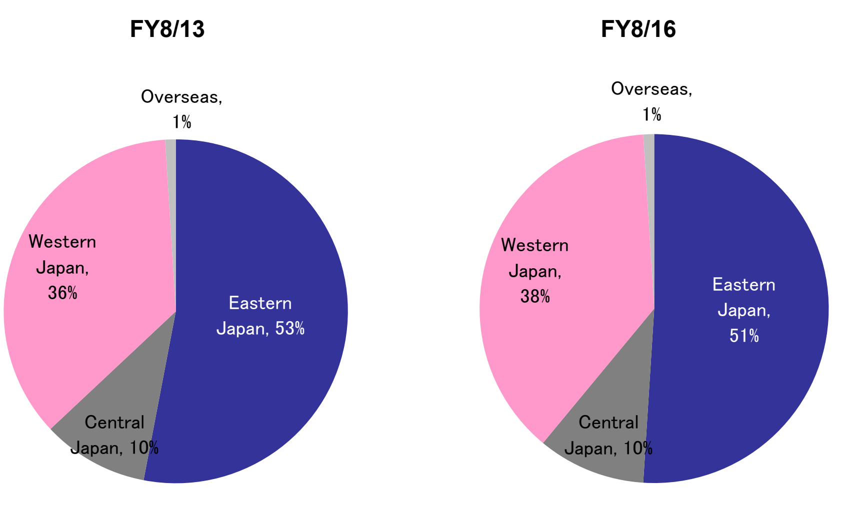


Source: Company

● **Sales by Region**

By region the Company will focus on western Japan. The sales contribution from this region in FY8/13 was 35.3%, however, the plan is to raise this to 38.0% by FY3/16. This is the same as the strategy by item, aiming to strengthen areas where the Company's sales are relatively low, and not (a signal) that core eastern Japan sales will decline.

Sales and Growth Projections by Market



Source: Company

● **Sales by Product**

By product the Company will focus on advance function products (currently 46.2%), with the plan to raise the sales contribution to 52.0% by FY8/16. The Company's advance function products are highly trusted by users, and by enhancing their appeal there is the potential for their sales contribution to be raised. As noted above, given that the majority of hospitals are engaged in 3-4 year leases, lease renewal periods overlap with product replacement periods, and by skillfully utilizing this timing there is every opportunity to increase advance function products. As a result, this should lead to improvement in gross margins.

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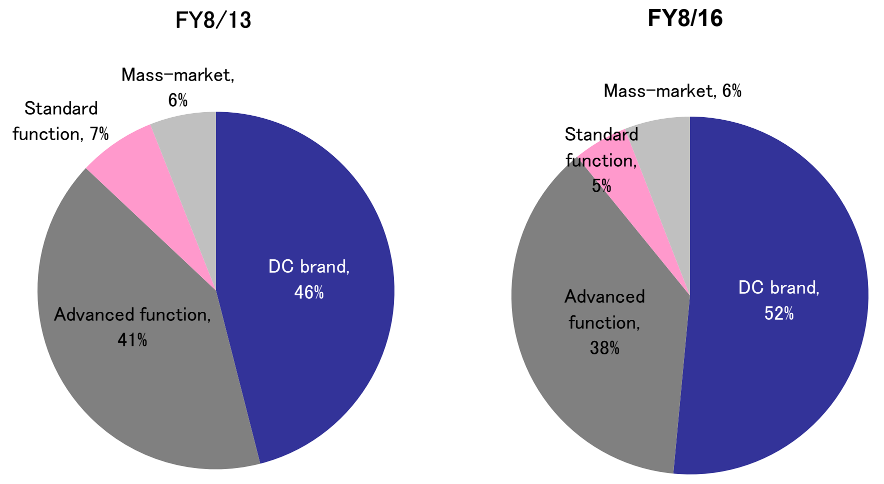
Sales and Growth Projections by Function



Source: Company

Future Business Strategies

Positive Operating Environment to Continue with a Steady Trend for (Increases in) Healthcare Practitioners

Arguably the future operating environment in which the Company finds itself will remain positive for the time being. According to the "Outlook for Nursing & Healthcare Worker Numbers" released by the Ministry of Health, Labor and Welfare in December 2012, it is forecast that in 2015 nursing staff numbers will be 1.65 million (an annual growth rate of 2.57% from 2010) and healthcare worker numbers 1.73 million (an annual growth rate of 5.10% from 2010). In this sort of operating environment the Company plans to achieve mid-term growth via the following strategies.

● Expansion in Patient, Surgical & Other Peripheral Markets

In the flagship healthcare (market) the Company already maintains a high market share, and stable replacement demand may be expected. On the other hand, patient wear, surgical wear and other peripheral clothing markets are for the Company as yet undeveloped markets with room for expansion. In the future, though, amongst other things, the introduction of new products the Company will aim to focus on expansion in these peripheral markets.

● Increasing Market Share in the Western Japan Region

In the status by region the Company already maintains a high market share in eastern Japan, however, its market share in central and western Japan is still low. In other words, it is still possible to boost market share in these regions. In order to achieve this, the plan is not just for a simple marketing blitz, but to undertake the proactive introduction of new products and advance function products.

● Advance function Product Development

In its marketing strategy arsenal, the Company is pro-actively promoting the development of products with even greater functionality and added value in order to enhance the value added in markets where it is already strong, as well as in markets where it aims to increase market share. In order to realize this, while strengthening collaboration with manufacturers of raw materials and trading houses, it also aims to brush-up its Quick Response (QR) production systems, in order to raise customer satisfaction levels.

● **Improving Gross Profit Margins**

In the last 20 years the Company's gross profit margin has improved approximately 10% (from around 35% to 47%). Going forward also, while improving profitability at the same pace is not easy, the Company sees potential for further improvement in profitability for mainly two reasons.

The first is increased overseas production. Currently, the Company's ratio of overseas production is still around 42.6%, which is very low when compared to apparel manufacturers. In other words, there is considerable room to increase the overseas production ratio, with potential for profitability improvement from expanding overseas production. However, because the Company's policy is not to suddenly shift domestic production overseas, but to produce the increased portion of sales overseas, while maintaining domestic production (volumes), it is anticipated that the increase in this ratio will progress gradually. The second profitability improvement measure will be the development of high value-added products as noted above. As a result, if the sales contribution from high value-added products rises gross profit margins overall will improve.

■ Shareholder Returns Measures & Capital Efficiency Improvement

High Level of Awareness Regarding Shareholder Returns & Maintaining Capital Efficiency

As noted above, the Company's shareholders' equity ratio has already (Q2 FY8/14) reached 91.0%, with it being extremely fiscally stable. Additionally, considering the Company's business conditions, there is little likelihood of profit declining significantly or falling into the red, with a high degree of likelihood it will record stable profits. On the other hand, given that this fact will lead to profits building up in shareholders' equity each year, return on equity (ROE) will decline, or in other words this will lead to declines in capital efficiency.

In response to this, the Company is adopting stable dividends and a payout ratio (parent basis) of over 50%. Further, it is also undertaking buybacks of its own shares according to the circumstances. The Company has a high level of awareness of shareholder returns and maintaining capital efficiency, which is a point we feel should be regarded highly.

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FISCO Ltd.