COMPANY RESEARCH AND ANALYSIS REPORT

Daiki Axis Co., Ltd.

4245

Tokyo Stock Exchange First Section

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Index

Summary

Arranged production sites for wastewater treatment tanks (Johkasou) in China and India

Daiki Axis Co., Ltd. <4245> has a half-century track record in water treatment business. It is unique in the industry with integrated operations that handle all businesses in the supply chain for household wastewater treatment, industrial wastewater treatment, and public water purification with smaller-scale targets. The sixth goal in the United Nations' sustainable development goals (SDGs), which have been adopted as international goals by 2030, of Clean Water and Sanitation: Ensure availability and sustainable management of water and sanitation for all" matches the "creation of water-related infrastructure" promoted by the Company. Japan's Ministry of the Environment outlined a policy of providing Japanese technologies to developing countries and assistance to resolve environmental issues and resulting creation of business opportunities for Japanese companies in the "Fundamental Strategy for Overseas Deployment of Environmental Infrastructure" formulated in 2017. It selected Johkasou as one of the six focus areas.

1. Arranged production sites for Johkasou in China and India, the world's No.1 and No.2 most populous countries

The Company was the first Japanese company to begin local production of Johkasou in Indonesia in 2015, and this facility currently operates at full capacity. It established a subsidiary and joint venture in India and China respectively to manufacture Johkasou locally in July 2018. These two countries, which compete for No.1 and No.2 positions as the world's most populous countries, have low toilet proliferation rates in regions outside of tourist areas and cities. In India, which is promoting "Clean India" as a national policy, the Company created a subsidiary to handle production, sales, installation, and maintenance of Johkasou. It plans to consign production of mid-sized and small tanks to local companies through provision of molds and other production facilities and technology guidance. With the start of production in fall 2018, it will replace imports from Indonesia with local output and thereby realize tariff and transport cost benefits. As market strategy, it intends to follow the existing approach of beginning with small products and then broadening to midsized and large products. In China, the Company teamed up with a local company in Yixing, which has been selected as a National Environment Protection Model City. This business will cover the Taihu area, including Shanghai and Suzhou. Demand has rapidly emerged since comments by the Chinese President in 2017 that a "toilet revolution" should extend to farming villages as well. The proposed model is installation of a septic tank to process sewage water for every 3-4 ordinary households and use of a community Johkasou made by the joint venture to handle remaining treatment. The partner company already makes septic tanks. Plans call for production capacity of up to 5,000 units a year for household community Johkasou in China. The Company has annual output of 120,000-130,000 units in Japan, including 6,000 to 7,000 units for compact products. Its Japanese production sites are distributed in multiple locations, versus having just one manufacturing location in China.

2. Missed forecast for 1H, but full-year forecast is unchanged

In 1H FY12/18, the Company missed forecast by 1.0% in net sales and 22.4% in ordinary income. Shortfalls mainly stemmed from delays in delivery, as seen in considerably higher orders backlog than usual at the end of 1H, and related business should be booked as sales in 2H. For the full year, the Company forecasts all-time highs of ¥35,600mn in net sales (+6.1% YoY) and ¥1,500mn in ordinary income (+11.7%).

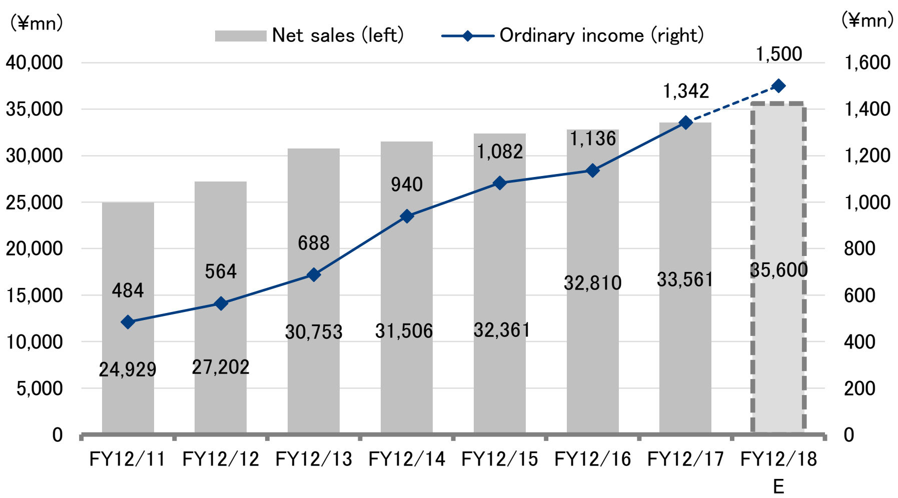
3. Management geared toward ESG

The Company clarified ESG initiatives in 2017. In environment, it targets lower CO2 emissions and acquisition of international standard approvals in water-related infrastructure and environmental management systems. The CO2 reduction effort involves biodiesel fuel business as well as compact wind power electric equipment business and solar power sales business that use renewable energy sources. Water-related infrastructure, the founding business, seeks to improve water environments on a global scale with products and services. In society, the Company received the "Second Ehime Furusato Environmental Award" in 2016 for the biodiesel fuel business. It obtained "kurumin approval" as a "child-rearing support company" in 2015 under diversity. In governance, the Company works on quick and efficient business operation, establishment and improvement of internal compliance operations, and ensuring transparency.

Key Points

- FY12/18 forecast unchanged in light of orders backlog buildup through 1H
- Opening new production sites in China and India for overseas business
- Plans to raise the dividend again in FY12/18

Results trends



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

Company profile

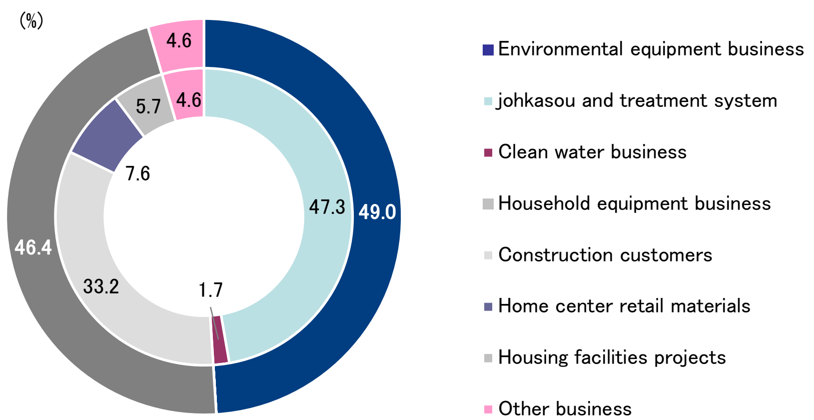
Corporate slogan is “PROTECT By CHANGE”

1. Company profile

The Company employs a corporate slogan of “PROTECT By CHANGE” and aims to “Protect the environment and change the future.” It targets balanced growth in environmental equipment, household equipment, and other businesses as an environmental creation development model company. It listed shares on the Tokyo Stock Exchange’s Second Section in December 2013 and switched to the First Section in the following year. The Company has sustained upward trends in net sales and ordinary income since going public.

Results in FY12/17 were ¥33,561mn in net sales and ¥1,342mn in ordinary income. Net sales composition by segment was environmental equipment at 49.0% (including Johkasou and treatment systems at 47.3% and clean water business at 1.7%), household equipment at 46.4% (including construction customers at 33.2%, home center retail materials at 7.6%, and housing facilities projects at 5.7%), and other business at 4.6%.

Composition of consolidated net sales (FY12/17)



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

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) by current president Hiroshi Ogame and other executives that took the company independent, though transactions are continuing.

Daiki Axis was officially founded in 2005, but has designed, manufactured, installed, and maintained and managed 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 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. The other business segment is expanding business scope to broader environment-related areas as a "development model company with emphasis on water and the environment." Biodiesel fuel refining and sales business, which was started in 2002, received the Fifth Monozukuri Japan Prize (Shikoku Economic and Industry Bureau Head's Award) in 2013. The Company also has compact wind power equipment and solar power sales businesses from M&As.

3. Group companies

The Company strengthened the environmental equipment business and entered new areas via M&As. Its group consists of 12 major subsidiaries (7 domestic and 5 overseas). During FY12/18, it established a joint venture for manufacturing Johkasou in China and a new subsidiary began production in India.

The Company obtained environment equipment firms DAITEC Co., Ltd., Environmental Analysis Center Co., Ltd., and Daqi Environmental Protection Engineering (Dalian) Co., Ltd. from Daiki in 2005. It aims to bolster the business foundation in environmental equipment that offers sustainable growth potential with M&As and purchased TOBU Co., Ltd., which designs, installs, and sells water treatment facilities mainly in the Tokai area, in 2007. It acquired TOSETSU Co., Ltd., which handles maintenance and inspections of various water treatment facilities in the same area, in the following year. TOBU absorbed this subsidiary in January 2017. It purchased environmental plant business LEC Industries Co., Ltd. in 2011. The Company also acquired all shares of DA INVENT (located in Nagoya City, Aichi Prefecture) for ¥65mn, making it a subsidiary, in January 2018. This subsidiary holds multiple patents for high-temperature, high-pressure hydrothermal treatment and subcritical water reaction equipment. Its coverage of processes before and after water processing should contribute to expansion of group scope in environmental infrastructure business.

Outside of Japan, the Company acquired a local company that manufactures Johkasou in Indonesia in 2013. It established a subsidiary in Singapore in 2016 with roles of selling activities for Johkasou and other water treatment equipment in Southeast Asia and South Asia and conducting supervision activities for overseas subsidiaries. In July 2018, it created a subsidiary for production, sales, installation, and maintenance of Johkasou in India. Also in July, it established a joint venture in China that manufactures and sells community Johkasou. The Company intends to handle this subsidiary as an equity-method entity. This entity should begin production of compact Johkasou during 2018.

In other businesses, the Company acquired Sylphid Co., Ltd., which conducts R&D and sales and installation of compact wind power equipment as a renewable energy business, in 2012. Its equipment utilizes a vertical axis format that is more suited to wind conditions in Japan than the horizontal axis format (propeller type) found in the US and Europe. It began selling 3kW-type products as an independent power source in 2016. It is developing a 10kW product, which aims for power sales by linking to the grid, and a compact 1kW product in order to meet various needs. The Company acquired civil works operator DAD Co., Ltd., which excels at the pipe jacking method but lacked a successor, in March 2017, as a subsidiary. It is targeting group synergies through utilization of DAD's extensive customer base with nationwide civil works and construction companies. This subsidiary has a stable income source from operation of power selling business with solar panels installed at six locations in the Matsuyama City area.

Group companies

Company name	Date	Format	Location	Business description
Environmental equipment business				
Japan				
DAITEC Co., Ltd.	October 2005	Transfer	Matsuyama City	Johkasou and system equipment maintenance inspections and reform plan proposals
Environmental Analysis Center Co., Ltd.	October 2005	Transfer	Matsuyama City	Analyzes water quality, air, and soil as an environment measuring certification office
TOBU Co., Ltd.	November 2007	Acquisition	Nagoya City	Designs and installs various water treatment systems mainly in the Tokai area
LEC Industries Co., Ltd.	December 2011	Acquisition	Tokyo	Environmental plant business, ESCO business, and overseas water supply business
DA INVENT Co., Ltd.	January 2018	Acquisition	Nagoya City	Possesses subcritical water reaction equipment and other technology and implements environmental infrastructure business
Overseas				
Daqi Environmental Protection Engineering (Dalian) Co., Ltd.	October 2005	Transfer	China	Overseas site for design, installation, and sales of polluted water treatment equipment and recycling and filtration equipment
PT. Daiki Axis Indonesia	October 2013	Acquisition	Indonesia	Southeast Asian site for manufacturing Johkasou
DAIKI AXIS SINGAPORE PTE.LTD.	August 2016	Established	Singapore	Water treatment sales activities and overseas subsidiary supervision
DAIKI AXIS INDIA Private Limited	July 2018	Established	India	Manufacture and sell Johkasou in India
Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd.	July 2018	Established	China	Site for manufacturing residential Johkasou (joint venture)
Other businesses				
Sylphid Co., Ltd.	April 2012	Acquisition	Tokyo	R&D on compact wind power equipment and generator sales and installations
DAD Co., Ltd.	March 2017	Acquisition	Matsuyama City	Civil works projects using the pipe jacking method and solar power sales business

Source: Prepared by FISCO from Company materials

Business overview

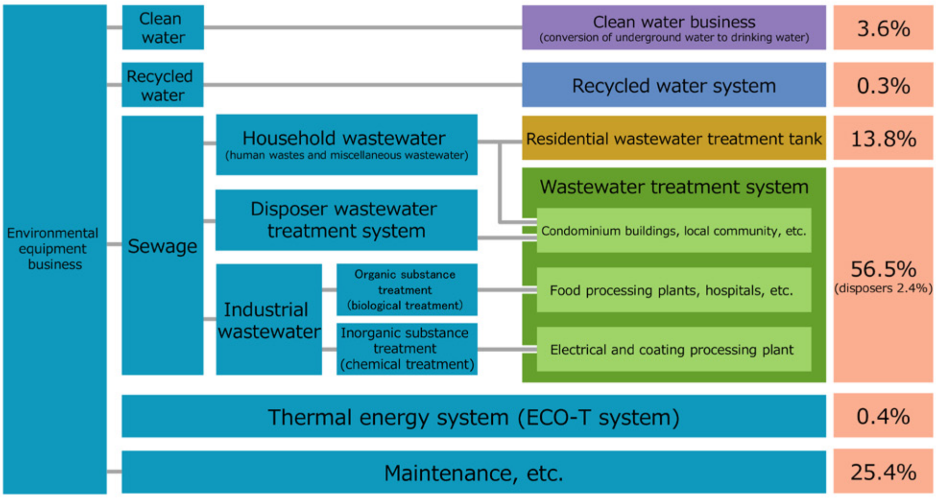
Development company placing emphasis on water and the environment

The Company has environmental equipment and household equipment as core businesses and positions the other business segment as the growth area. Operating margin is steadily climbing thanks to focus on the environmental equipment business where it can offer uniqueness, in contrast to household equipment that largely consists of wholesale transactions. In FY12/17 segment operating margin, environmental equipment at 8.3% was more than twice as high as household equipment at 3.7%. The Renewable energy business is incurring modest operating losses due to being in an investment phase. Bottled water delivery, civil engineering, and other businesses generate strong earnings with operating margin of over 10%, but account for less than 5% of overall sales.

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 ¥16,445mn in FY12/17 with 96.4% in Johkasou and wastewater treatment systems and 3.6% in clean water business.

Environmental equipment business scope



Source: The Company's results briefing materials

(1) Household Johkasou – Pioneering presence

The Company began development of Johkasou in 1964 and has been a pioneering presence in this field, including having the industry's first JIS-approved plant for fiber-reinforced plastic (FRP) Johkasou (obtained in 1976). It acquired ISO 9001 approval in June 2006 as part of strengthening quality control operations. It was the first supplier in the industry to obtain an Eco Mark certification with the XE model Johkasou in January 2014. Major homebuilders selected this product, and it is also exported. This product's success helped to improve profitability. The Company aims to be the industry leader in installation of Johkasou with disposer (raw garbage grinder) support and disposer wastewater treatment systems as a strategic effort. Its products comply with standards defined by the Japan Sewage Works Association, and package approval of the disposer and wastewater treatment system is an advantage.

(2) Wastewater treatment systems – Strength in integrated operations including maintenance

Residential Johkasou provide 13.8% of environmental equipment segment sales, while wastewater treatment systems, which handle treatment of wastewater for condominium buildings, villages, food processing plants, hospitals, and electric equipment and plating plants, are at 56.5%.

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 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. It supports products designed and installed by the group as well as equipment and facilities supplied by other companies. Maintenance sales rose 4.1% YoY to ¥4,182mn in FY12/17, which was 25.4% of environmental equipment sales.

(3) Logistics – Pursuing efficiency through business alliances

The sales network for environmental equipment covers major cities throughout Japan from Hokkaido in the north to Kagoshima in the south. Manufacturing takes place at four locations (Matsuyama and Tsushima works in Ehime Prefecture, Shinshu works in Nagano Prefecture, and Fukushima works in Fukushima Prefecture) with shipments from the plant nearest to the delivery site. Additionally, the Company utilizes the network of DAIE INDUSTRY Co., Ltd, a business alliance partner since 2010, to improve operational efficiency. DAIE INDUSTRY has five production sites with two in Aichi Prefecture and one location each in Hokkaido, Oita Prefecture, and Kagoshima Prefecture. Both companies manufacture products using the counterpart's brand and conduct mutual supply. This makes it possible to ship products from manufacturing sites near the customer and lower logistics costs. Production formats include forecast-based output and order-based production and assembly.

(4) 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 mainly to hospitals, large retail facilities, welfare facilities, and sports gyms. 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.

Characteristics of the clean water business (conversion of underground water to drinking water)

	Overview
Economical	· Dedicated water supply that provides safe and inexpensive drinking water by pumping up low-layer water flowing deeply under the ground
Stable supply volume	· Underground water is available even during dry periods and water restrictions and thus provides stable water volume
Safe water quality	· Supply quality water that removes bacteria and protozoa through a combination of membrane filtration and equipment suited to underwater quality
Lifeline	· Role as a lifeline when clean water supply cannot be delivered during disasters · Lifeline access is particularly important for hospitals
Monitoring operations	· 24-hour automated monitoring of the entire system, including residual chlorine concentration and membrane filter operation, from Daiki Axis headquarters over an NTT line

Source: Prepared by FISCO from Company materials

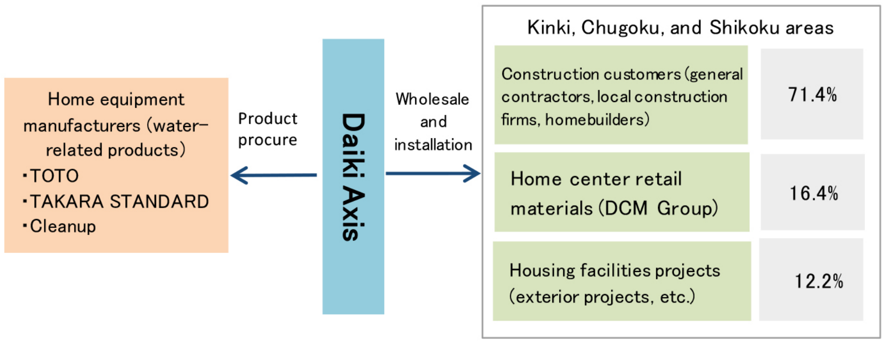
The Company reached 78 contracts cumulatively for ESCO service through the end of December 2017 including 21 hospitals (with emphasis on lifeline access), 13 welfare facilities, 13 large retail facilities, 11 sports gyms, and 11 food processing plants. It hopes to realize horizontal deployment at large retail facilities, sports gyms, and others with nationwide chain operations. Converting underground water to drinking water is not technologically difficult for the Company given its handling of treatment systems for industrial wastewater.

The Company is targeting a top position in the industry with 100 total contracts and is also considering overseas business. Its ESCO business is unlikely to face tougher competition for the time being because the market is not large enough to attract major water treatment equipment manufacturers, such as EBARA CORPORATION <6361> and Kurita Water Industries Limited <6370>, and smaller companies lack corporate resilience, including capital resources.

2. Household equipment business

The household equipment business had a sales breakdown in FY12/17 of construction customers at 71.4%, home center retail materials at 16.4%, and housing facilities projects at 12.2%.

Sales composition by channel in the household equipment business



Source: Prepared by FISCO from Company materials

(1) Construction customers – Strong equipment wholesale business in its areas

Predecessor Daiki started as a tile and hygienic porcelain store at its founding in 1958 and has a multiple-decade track record in home equipment wholesale business. The Company sells system kitchens, toilets, bathroom units, and other water-related home equipment to general contractors, local construction firms, and homebuilders. It limits activity to Shikoku, where the headquarters is located, and Chugoku and Kinki on the Seto Inland Sea and generates strong sales results in these areas.

(2) Home center retail materials – Strengthening ties with the DCM Group

The Company is seeking to strengthen ties with the DCM Group, which operates Japan's largest home center network. It booked ¥4,660mn in sales to the Group in FY12/17, putting sales reliance at 13.9%. The business breakdown was 75.8% in household equipment and 24.1% in environmental equipment. Household equipment includes sales of kitchens, bath units, toilets, and other home goods, sales of professional materials to renovation companies, and store construction projects. Environmental equipment sales come from store Johkasou installations and maintenance and store management activities. The Company receives direct consignments from the DCM Group for store construction projects. It originally had capital ties with the DCM Group and maintains a good relationship as an independent company.

As environmental equipment business, the Company handles consignments for installation and maintenance of store Johkasou at DCM Group stores as well as store management activities (cleaning, fire prevention, and electrical and other inspection duties). This business covered 850 stores as of February 2018. We expect the Company to not only supply products, but also to move on to carrying out store management operations and suchlike.

3. Other business

The other business segment reported ¥1,530mn in FY12/17 sales, doubling YoY. Sales breakdown was CreCla bottled water delivery business at 37.2%, biodiesel fuel business at 6.1%, compact wind power equipment business at 1.0%, and civil works business newly added through the DAD acquisition at 55.8%. Operating income was just ¥13mn. While DAD contributed positively to earnings, inventory asset valuation losses associated with steep decline in product sales for the compact wind power equipment business weighed on profits.

Results trends

Decline in environmental equipment profit in 1H FY12/18

1. Overview of 1H FY12/18 results

The Company reported 1H FY12/18 consolidated results of ¥17,429mn in net sales (+4.8% YoY), ¥493mn in operating income (-16.5%), ¥596mn in ordinary income (-8.0%), and ¥317mn in profit attributable to owners of parent (-16.4%). Compared to initial forecast, it missed by 1.0% in net sales, 29.5% in operating income, 22.4% in ordinary income, and 36.5% in profit attributable to owners of parent. Shortfall in the environmental equipment business was the main reason for weaker earnings than planned.

(1) Trends by business segment

a) Environmental equipment business

The environmental equipment business posted declines in sales and profits at ¥8,375mn in net sales (-3.6% YoY) and ¥593mn in operating income (-22.1%), undershooting forecast by 4.6% and 24.3% respectively. Domestic sales of Johkasou and wastewater treatment systems rose 0.7% YoY to ¥7,548mn, but were 1.3% less than planned due to delay of an electronic components industrial wastewater treatment project to 3Q. The Company projected an 11.2% YoY decline in overseas sales in initial forecast because of the absence this year of a project to match a large deal worth ¥607mn in orders value in China from 1H FY12/17. Other setbacks were delays in recognizing sales on projects in Algeria and Indonesia. Maintenance of Johkasou and systems, including overseas business, booked a healthy ¥2,274mn in net sales, an 8.9% YoY increase and 3.8% more than in forecast. The clean water business performed well too with a 19.5% YoY rise in net sales and 6.3% more than in forecast with addition of three ESCO customers (including a hospital and school corporation) and a plant sale to a large retail facility.

b) Household equipment business

The housing equipment business reported ¥8,109mn in net sales (+8.9% YoY), exceeding the forecast by 1.4%, and a 14.7% YoY increase in operating income, falling short of the forecast by 0.9%. These were solid results, in our opinion. Sales to construction customers totaled ¥5,498mn (-1.6% YoY) with support from progress in developing customers, surpassing the forecast by 3.3%. Home center retail materials recorded ¥1,122mn in net sales (-2.2% YoY) amid removal of transactions with slim margins, falling short of the forecast by 14.4%. Housing facilities projects business received store construction deals and booked ¥1,488mn in net sales (+109.8% YoY), surpassing the forecast by 9.7%.

c) Renewable energy business

The renewable energy business is fairly small as it remains in an investment phase. This segment consists of power sales related to solar power output, biodiesel fuel, and compact wind power equipment. Combined sales were ¥93mn (+10.2% YoY), falling short of the forecast by 1.9%, and the segment incurred a ¥72mn operating loss. Income from power sales related to solar power output at DAD, which the Company acquired as a subsidiary in FY12/17, contributed a full six months, versus just three months a year ago.

1H FY12/18 results

(¥mn)

	1H FY12/17		1H FY12/18			YoY		Change versus forecasts
	Results	Ratio to net sales	Forecast	Results	Ratio to net sales	Change	%	
Net sales	16,637	-	17,601	17,429	-	791	4.8%	-1.0
Environmental equipment business	8,686	52.2%	8,776	8,375	48.1%	-311	-3.6%	-4.6
Household equipment business	7,447	44.8%	7,994	8,109	46.5%	662	8.9%	1.4
Renewable energy business	84	0.5%	94	93	0.5%	8	10.2%	-1.9
Other businesses	419	2.5%	736	851	4.9%	432	103.0%	15.6
Gross profit	3,272	19.7%	3,594	3,350	19.2%	77	2.4%	-6.8
SG&A expenses	2,681	16.1%	2,894	2,857	16.4%	175	6.5%	-1.3
Operating income	590	3.6%	699	493	2.8%	-97	-16.5%	-29.5
Environmental equipment business	762	8.8%	783	593	7.1%	-168	-22.1%	-24.3
Household equipment business	269	3.6%	311	308	3.8%	39	14.7%	-0.9
Renewable energy business	-28	-	-33	-72	-	-43	-	-
Other businesses	11	2.8%	76	90	10.6%	78	674.7%	17.1
Adjustment	-423	-		-426	-	-	-	-
Ordinary income	648	3.9%	769	596	3.4%	-52	-8.0%	-22.4
Profit attributable to owners of parent	379	2.3%	500	317	1.8%	-62	-16.4%	-36.5

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

2. Financial position and management indicators

Total assets increased ¥1,159mn YoY to ¥22,785mn at the end of 1H FY12/18. Current assets rose by ¥507mn, and non-current assets added ¥651mn. Change in current assets included a ¥569mn decline in accounts receivable from completed construction projects and ¥455mn increase in cash and deposits. The rise in property, plant and equipment included ¥929mn from the solar power sales business. Interest-bearing debt expanded by ¥1,561mn versus the end of FY12/17 to ¥9,107mn. Furthermore, capital investment, including ¥929mn for the solar power sales business, climbed from ¥124mn at the end of 1H FY12/17 to ¥1,062mn.

In management indicators, the capital ratio, which reflects financial soundness, dropped 1.8 percentage points to 29.8%.

Consolidated balance sheet and management indicators

(¥mn)

	FY12/15	FY12/16	FY12/17	1H FY12/18	Change
Current assets	13,656	14,519	15,033	15,541	507
Cash and deposits	3,366	3,430	4,517	4,973	455
Trade receivables	6,773	8,329	7,490	7,136	-353
Inventories	1,907	2,206	2,487	2,619	131
Non-current assets	5,755	5,504	6,592	7,244	651
Property, plant and equipment	4,331	4,115	4,726	5,539	813
Intangible assets	116	84	85	162	77
Investments and other assets	1,307	1,304	1,780	1,541	-238
Total assets	19,411	20,023	21,626	22,785	1,159
Current liabilities	11,598	12,302	13,259	14,859	1,600
Non-current liabilities	2,071	1,531	1,542	1,142	-399
Interest-bearing debt	7,104	6,910	7,546	9,107	1,561
Total net assets	5,740	6,189	6,824	6,783	-40
Stability					
Current ratio	117.7%	118.0%	113.4%	104.6%	
Equity ratio	29.6%	30.9%	31.6%	29.8%	

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

Outlook

FY12/18 forecast unchanged in light of orders backlog buildup through 1H

● FY12/18 outlook

The Company kept FY12/18 consolidated results forecast at period-start levels, continuing to project higher sales and profits with net sales at ¥35,600mn (+6.1% YoY), operating income at ¥1,350mn (+18.0%), ordinary income at ¥1,500mn (+11.7%), and profit attributable to owners of parent at ¥1,000mn (+34.4%). Shortfalls mainly stem from delays in delivery for environment equipment business, and they should be booked as sales in 2H. Orders backlog at the end of 1H expanded from ¥2bn a year earlier to ¥5.5bn in the environmental equipment business and from ¥1.1bn to ¥1.35bn in the household equipment business. Major environment equipment project delays should disappear in 2H.

Outlook for FY12/18

(¥mn)

	FY12/17		FY12/18 E			
	Amount	Ratio to net sales	Amount	Ratio to net sales	Change	%
Net sales	33,561	-	35,600	-	2,038	6.1%
Environmental equipment business	16,445	49.0%	17,590	49.4%	1,144	7.0%
Household equipment business	15,584	46.4%	16,011	45.0%	426	2.7%
Renewable energy business	173	0.5%	338	0.9%	165	94.5%
Other businesses	1,356	4.0%	1,660	4.7%	304	22.4%
Gross profit	6,558	19.5%	7,319	20.6%	760	11.6%
Selling, general and administrative expenses	5,414	16.1%	5,969	16.8%	554	10.2%
Operating income	1,143	3.4%	1,350	3.8%	206	18.0%
Environmental equipment business	1,356	8.3%	1,554	8.8%	197	14.6%
Household equipment business	578	3.7%	591	3.7%	12	2.2%
Renewable energy business	-163	-94.2%	-10	-3.2%	153	-
Other businesses	177	13.1%	204	12.3%	27	15.6%
Adjustment	-805	-	-989	-	-184	-
Ordinary income	1,342	4.0%	1,500	4.2%	157	11.7%
Profit attributable to owners of parent	744	2.2%	1,000	2.8%	255	34.4%

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

(1) Forecast by business segment

The Company also has not altered full-year estimates for business segments.

a) Environmental equipment business

In the environmental equipment business, the Company expects a 7.0% YoY rise in net sales to ¥17,590mn, putting this segment at 49.4% of overall sales. It also forecasts a 25.3% rise in overseas sales to ¥1,712mn within this segment. It projects stable growth in maintenance sales to ¥4,344mn (+3.9%). Clean water ESCO business is aiming for 15 new contracts, compared to just 8 contracts added in FY12/17. Inquiries are picking up, and outlook attainment depends on implementation capacity. The FY12/18 outlook forecasts ¥1,554mn in operating income (+14.6% YoY) for an 8.8% operating margin.

b) Household equipment business

In the household equipment business, the Company anticipates ¥16,011mn in net sales (+2.7% YoY), including for construction customers roughly unchanged at ¥11,141mn, home center retail materials at ¥2,720mn (+6.5%), and housing facilities projects at ¥2,150mn (+13.2%). The FY12/18 outlook forecasts ¥591mn in operating income (+2.2% YoY) for a 3.7% operating margin.

c) Renewable energy business

The Company is separately reporting "renewable energy business" results from FY12/18. This business covers power sales from solar power operations, biodiesel fuel business, and compact wind power equipment business. It had ¥173mn in net sales and a ¥163mn operating loss in FY12/17. The FY12/18 outlook calls for ¥338mn in net sales (+94.5% YoY) and a ¥10mn operating loss. Management envisions a 3.4-fold YoY rise in solar power sales to ¥221mn thanks to steady utilization of rooftop facilities at DCM Group stores. Sales targets for biodiesel fuel and compact wind power equipment businesses are relatively modest at ¥96mn and ¥20mn respectively.

d) Other businesses

Targets in the other business segment, which consists of CreCla, civil works, and rent income, are ¥1,660mn in net sales (+22.4%) and ¥204mn in operating income (+15.6%). Specifically, the forecast factors in ¥620mn (+9.0%) for CreCla and ¥1,000mn (+28.5%) for civil works. DAD, which was added to consolidated results during FY12/17, contributed nine months last year and this year's forecast contains full-year values.

Medium- to long-term growth strategy

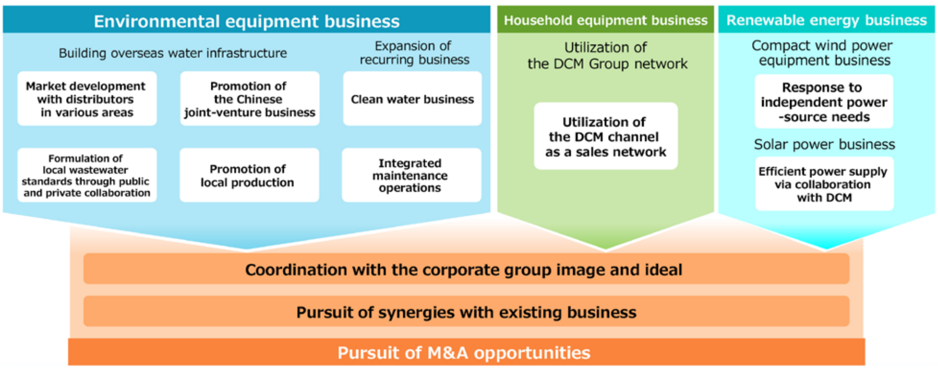
Aiming for its development via ESG-oriented management as an environmental creation development model company

1. V-PLAN 60 medium-term business plan

The Company formulated the V-PLAN 60 medium-term business plan covering the three years from FY12/16 to FY12/18. It updated the management philosophy following 10 years since the establishment by adopting a corporate slogan of "PROTECT By CHANGE." Specifically, "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." With plans to expand overseas business, the Company switched to an expression that is easier to understand in both Japan and abroad.

Key points in the growth strategy are rapid expansion of overseas business with massive demand potential for water-related infrastructure and steady accumulation of recurring business, such as maintenance and clean water businesses, in Japan. Given the close relationship with the DCM Group, the Company also plans to leverage the DCM channel as a sales network in the household equipment business and expand solar power sales in the renewable energy business.

Growth strategy



Source: The Company's results briefing materials

Consolidated goals in FY12/18, the medium-term plan's final fiscal year, are ¥35,600mn in net sales (+10.0% vs. FY12/15), ¥1,350mn in operating income (+42.6%), and at least 13% ROE. In shareholder returns, it lifted dividend payout to at least 30%.

Goals in the V-PLAN60 new medium-term business plan

(¥mn)

	FY12/15	FY12/18 (plan)	Growth outlook	
			Change	%
Net sales	32,361	35,600	3,238	10.0%
Environmental equipment business	15,406	18,243	2,837	18.4%
(Overseas sales portion)	602	1,224	622	103.3%
Household equipment business	16,299	16,322	23	0.1%
Other businesses	655	1,033	378	57.7%
Operating income	946	1,350	403	42.7%
Ordinary income	1,082	1,500	417	38.6%
Profit	332	1,000	667	200.4%
ROE	5.9%	Over 13%	Over +7.1%	-
Equity ratio	29.6%	Over 35%	Over +5.4%	-
Dividend payout ratio	54.5%	Over 30%	-	-

Source: Prepared by FISCO from Company materials
Note: FY12/15 results excluding special factors, such as extraordinary income, extraordinary losses, and corporate taxes from past fiscal years, were 11.2% ROE, 29.6% equity ratio, and 28.8% dividend payout ratio.

Opening new manufacturing sites in China and India for overseas business

2. Development of overseas markets

The World Economic Forum listed “water crises” as the fifth item in a section on global risks in terms of impact in its 2018 report. The first four are “weapons of mass destruction,” “extreme weather events,” “natural disasters,” and “failure of climate-change mitigation and adaptation.” The Water Environment Partnership in Asia (WEPA), which consists of 13 Asian countries, is working to prevent water pollution. These countries are moving toward stricter environmental regulations aimed at stopping water pollution with efforts to treat residential wastewater too because past treatment of just human waste is not enough. We think an era has arrived in which Japan receives attention for its technologies and product capabilities and knowhow in facility operation and maintenance.

The Ministry of the Environment’s announcement of the “Fundamental Strategy for Overseas Deployment of Environmental Infrastructure” (July 2017) is likely to serve as a tailwind. It envisions provision of Japanese technologies to developing countries and assistance to resolve environmental issues and resulting creation of business opportunities for Japanese companies. The Ministry’s fundamental strategy reviews actions in six environmental infrastructure areas. For Johkasou, it outlines four actions of 1) proposing comprehensive polluted water treatment with sewage systems and Johkasou from the master-plan stage, 2) supporting project formulation with feasibility study assistance, business models for various developing countries, standard specifications, and Asian Development Bank (ADB) and other financial entity collaboration, 3) implementing assistance that includes promotion of system aspects of Johkasou and maintenance and management operations in Asia, and 4) localizing product specifications and assisting adoption of fair performance assessment schemes toward standardization of Johkasou in the ASEAN region through industrial, government, and academic cooperation. We expect contributions to awareness-raising activities by the Ministry as a national-level policy. Even if developing countries bolster legal regulations, capital investments to ensure compliance and monitoring and operational systems to maintain and continue standards are often inadequate.

Actions in environmental infrastructure areas – Johkasou

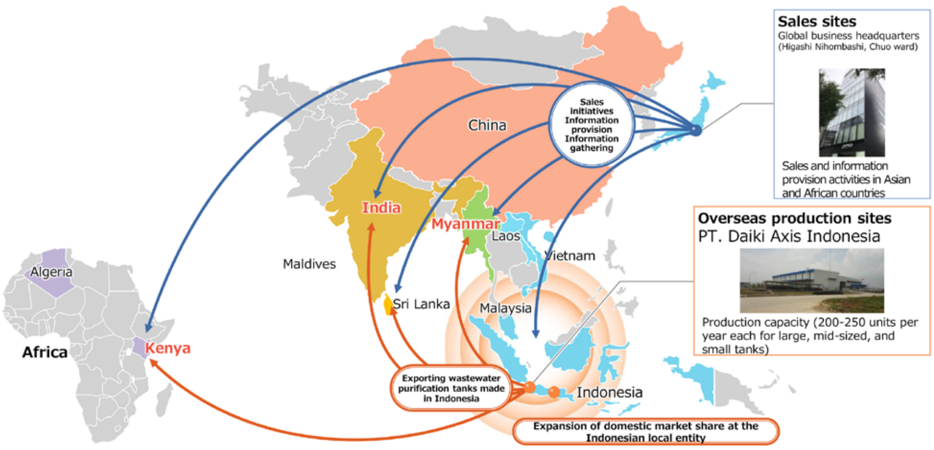
· Proposal of comprehensive polluted water treatment with sewage systems and Johkasou from the master-plan stage
· Support of project formulation with feasibility study assistance, business models for various developing countries, standard specifications, and ADB and other financial entity collaboration
· Implementation of assistance that includes promotion of system aspects of Johkasou and maintenance and management operations in Asia
· Localization of product specifications toward standardization of Johkasou in the ASEAN region through industrial, government, and academic cooperation

Source: Prepared by FISCO from the “Fundamental Strategy for Overseas Deployment of Environmental Infrastructure” (Ministry of the Environment; July 25, 2017)

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.

We expect the Company to acquire early-bird profits from expansion of markets in ASEAN countries, India, and Africa with its smaller-scale wastewater treatment. The Company created a Global Business Division with overseas subsidiaries in April 2015. The president directly leads the division in order to accelerate overseas initiatives. This include sales efforts to customer companies in Japan with local entities that are building plants and retail facilities as well as developing real estate, such as condominiums and standalone home communities. New regulations are setting fairly high levels, and disparities might occur by country in respect to whether local companies actually move quickly in compliance. However, authorities are generally strict in application of standards to foreign-capital companies.

Sales expansion strategies in Asian and African countries



Source: The Company’s results briefing materials

The Company is highly competitive in quality, cost, and delivery because it fulfills stricter water treatment standards, develops products that meet the climate in regions where equipment is installed, curtails manufacturing costs and transportation expenses and supplies products with shorter delivery times through local production. The plant in Indonesia, which started full-fledged operations in July 2015, has expanded production capacity to five times the previous level. Automation realized with installation of new production equipment established Japan quality and raised productivity. The Company lowered costs by narrowing product functionality because there is no need for measures to deal with low-temperature conditions in Southeast Asia that is warm throughout the year. It targets individual treatment systems for homes, buildings, plants, and retail sites that use Johkasou. The plant has annual output capacity of 200-250 units each for large, mid-sized, and small tanks and is already running at full capacity. The Company hopes to increase output through extension of plant operating hours. Inquiries are sharply increasing in the wake of concluding sales agent contracts in Myanmar, India, Vietnam, and Kenya in 2016-17. In FY12/18, it began local production of Johkasou in China and India, which have the world's No.1 and No.2 populations respectively and low wastewater treatment rates, through joint ventures with a local company and a new subsidiary.

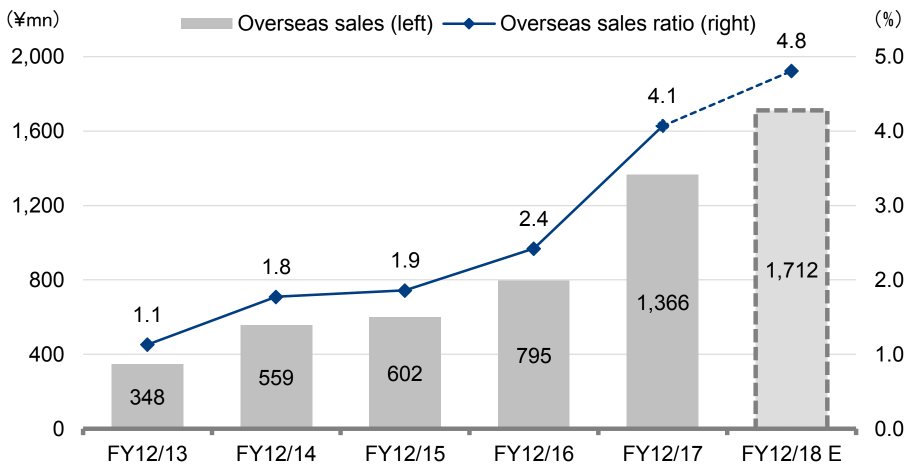
Overseas business history and plans

	Overview
October 2005	Received Dalian Daqi Environmental Protection Equipment Co., Ltd. (now, Daqi Environmental Protection Engineering (Dalian) Co., Ltd.) as a spin-off transfer from Daiki
October 2013	Acquired PT. BESTINDO AQUATEK SEJAHTERA (now consolidated subsidiary) <Indonesia> as a subsidiary
April 2014	ncreased the ownership stake in PT. BESTINDO AQUATEK SEJAHTERA
August 2014	Ministry of the Environment designated the "household wastewater treatment business using Johkasou in Malaysia" proposed by three companies (including Daiki) as a "model business for water environmental improvement in Asia"
April 2015	Formed the East Japan Project Business Division at the Tokyo Headquarters to promote overseas initiatives
June 2015	Opened a branch in Surabaya, Indonesia's second largest city
August 2015	Renamed PT. BESTINDO AQUATEK SEJAHTERA as PT. DAIKI AXIS INDONESIA Completed a new plant in Indonesia
January 2016	Announced the new corporate slogan "Protect By Change" Concluded a sales agent contract with a company in Myanmar
April 2016	Concluded a sales agent contract with a company in India
July 2016	Donated Johkasou to the Indian government with installations at a park and village public toilet and conduct test marketing for industrial wastewater
August 2016	Established DAIKI AXIS SINGAPORE PTE. LTD. (now consolidated subsidiary) with the aiming of supervising overseas subsidiaries
June 2017	Formed a Global Business Division in Tokyo with the president directly leading activities as the general manager of this business division Concluded region-based sales agent contracts with four companies in India
August 2017	First shipment, delivery, and installation in Kenya Concluded a sales agent contract with a local business in Sri Lanka
July 2018	Established joint-venture DAIKI AXIS INDIA Private Limited to manufacture, sell, install, and maintain and manage Johkasou in India Established joint-venture Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd. to manufacture and sell Johkasou in China

Source: Prepared by FISCO from Company materials

The Company had expected overseas business sales to double over three years from ¥602mn in FY12/15 to ¥1,224mn, but raised the FY12/18 goal to ¥1,712mn because of early attainment. The overseas sales ratio is likely to expand from 1.9% in FY12/15 to 4.8%.

Overseas sales and overseas sales ratio trends



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

Below we review progress in individual countries.

(1) Indonesia

The Company opened a branch in Surabaya, the second largest Indonesian city, in June 2015. It can obtain orders by setting up sales locations. It renamed the subsidiary to clarify that it is a group company in August 2015. Local production offers an advantage in competition with Japanese manufacturers because of the 15-20% tariff on products imported from Japan.

Tokyu Land Corporation is developing a large-scale condominium site (two buildings with 381 units), including a commercial wing, in Jakarta, the Indonesian capital, scheduled to complete in December 2018. The Company is participating in this project and will deliver 10 FRP cylindrical Johkasou. Besides Aeon Mall <8905>, the Company successfully acquired orders from a major Japanese automaker plant and an LNG plant.

(2) Myanmar

Authorities are applying regulations more aggressively amid increase in pollution volume accompanying economic development. Biochemical oxygen demand (BOD), which indicates the state of water pollution, is standardized at BOD20. While Myanmar's quality standard lists local manufacturers with suitable levels, Kubota Corporation <6326> and Daiki Axis are approved firms.

The Company arranged a contract with one sales agent in Myanmar in January 2016 and already has a track record of deliveries. The Yangon City Development Committee (YCDC), which regulates the country's largest city, required Johkasou and other treatment facilities for buildings with 7.5 floors or more in applications for new projects. New town developments are steadily advancing in surrounding areas, and estimates suggest that Yangon's population could expand from 5.5mn people to more than 10mn people in 2040. Mandalay, the country's second largest city, is a tourist city that was the last royal capital. Officials are promoting improved environmental conditions in order to preserve tourism resources. While the Company imports products from Indonesia now, it is considering a switch to local production to accommodate robust demand.

(3) India

Swachh Bharat (Clean India) is a top-priority issue for the Modi government in India. Sewage systems are only available for about 15% of India. The Clean India project announced in October 2014 sets a goal of installing toilets in 120mn homes with an investment of about ¥3.5trn through 2019, the 150th anniversary of the birth of national founder Mahatma Gandhi. It will also install toilets in elementary and middle schools and public toilets. Roughly 48% of India's population, including 67% in farming villages, normally excretes human wastes outdoors because they do not have toilets. These conditions pose a public hygiene threat. Some female students decline to attend school due to lack of toilets separated by gender at schools. Furthermore, outdoor excretion at night leads to sexual assaults against women.

The Company donated Johkasou to the Indian government in July 2016 as a promotion of product quality. These tanks (with daily treatment capacity of 10 cubic meters) were installed in three locations – a park toilet in Nagpur (midwestern India), a village public toilet, and a plastics plant (industrial wastewater treatment) as test marketing.

The Company concluded regional sales agent contracts with one company in 2016 and four companies in 2017. Additionally, it concluded sales contracts for Johkasou with BI Marketing & Services Pvt., Ltd., the distributor for a Denmark-based global pump manufacturer, and parent HECS, which handles large-scale water treatment business.

India strengthened the regulatory level for water pollution from BOD30 previously to BOD10 for properties with wastewater of 2,000 cubic meters or more nationwide in April 2017. While regulations must be applied to new construction projects because of the massive demand, regulations also apply to existing facilities. Existing septic tanks cannot satisfy strengthened regulations because they only handle polluted water and do not treat household wastewater. Trial marketing results confirmed the presence of large demand.

The Company established DAIKI AXIS INDIA Private Limited as a wholly owned subsidiary via the Singapore-based regional supervisory subsidiary in July 2018. The subsidiary will manufacture, sell, install, and handle maintenance and management of Johkasou in India.

The first phase of the business initiative in India is local production of capsule-type midsized and compact Johkasou through consignments. The Company has formed a partnership with Jyoti Plastics Works Pvt Ltd., a local manufacturer of plastic products, and will provide molds and other production equipment and technology guidance. It intends to use low-cost product specifications developed for the Indonesian market except in some parts of northern India. Production of compact Johkasou in Mumbai begins in fall 2018. Plans call for annual output capacity of 100 capsule Johkasou, mainly in the midsized and compact range. Inquiries are vibrant and have already reached 30 cases a month. The commencement of local production will replace imports from Indonesia. It is best to locate Johkasou manufacturing sites near consumption areas because of transportation costs and other expenses. Given India's massive size and the strong authority of state governments, the Company is looking at a model of setting up production sites in various areas and developing markets from areas that it has entered. It expects to increase sales distributors.

In the second phase, the Company aims to have its Indian subsidiary and local cooperating companies establish a new joint venture for the purpose of manufacturing cylindrical-type wastewater treatment systems and entering the large wastewater treatment system. New market development typically begins with compact products and then broadens to midsized and large product opportunities. The initiative in India seeks to penetrate the market using the same pattern.

(4) China

In China, the Company has a wholly owned subsidiary in Dalian that operates as an engineering firm. It acquires major projects through designations from Japanese companies.

In November 2017, Chinese President Xi Jinping issued a directive to promote a "toilet revolution" of installing clean toilets. This "toilet revolution," which was communicated as an important directive, 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 in villages too. 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 Japan-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 participated in the establishment of Lingzhi Daqi Johkaso (Jiangsu) Co., Ltd., a joint venture to manufacture household community Johkasou. This entity is likely to be handled as an equity-method affiliate because Lingzhi Environmental Protection Co., Ltd. (Yixing, Jiangsu) owns 51% and Daiki Axis has a 49% stake. Yixing, the joint venture's location, has been selected as a National Environment Protection Model City and is part of the Taihu area, including Shanghai and Suzhou. Joint-venture partner Lingzhi has a 20-year track record in sewage treatment facilities (septic tanks). The joint-venture plant intends to supply products to the investor companies. Septic tanks installed in Chinese farming villages handle polluted water treatment, but do not address residential wastewater and are not enough to meeting water-quality standards. Installations thus will involve septic tanks that cover 3-4 ordinary households per tank and subsequent treatment using wastewater tanks.

The joint venture will build a new plant outfitted with Daiki Axis' production technology on the partner's grounds. Plans call for output capacity of up to 5,000 units a year. The Company has annual output of 120,000-130,000 units in Japan, including 6,000 to 7,000 units for compact products. Its Japanese production sites are distributed in multiple locations, versus having just one manufacturing location in China.

(5) Other regions

Vietnam, a farming country, is promoting stricter wastewater regulations for BOD, nitrogen, ammonia, and other substances. These conditions are likely to raise demand for products with Japanese specifications that deliver robust treatment performance. The Company selected a local partner and has started sales activities.

In Sri Lanka, the Company concluded a sales distributor contract with a local company. It aims to spread the Daiki Axis brand through aggressive use of exhibitions and newspaper advertisements. It exports compact products from Japan and has already sold three containers of product. Inquiries are robust and demand is likely to expand.

It shipped its first product to Kenya (Africa) and completed delivery and installation in August 2017. While inquiries from the new distributor in Nairobi have risen sharply, activity is stalled due to disruption related to the presidential election. There is a system delivery scheduled in 3Q FY12/18 in Algeria. The Company is continuing marketing efforts in light of possibilities to increase sales throughout Africa.

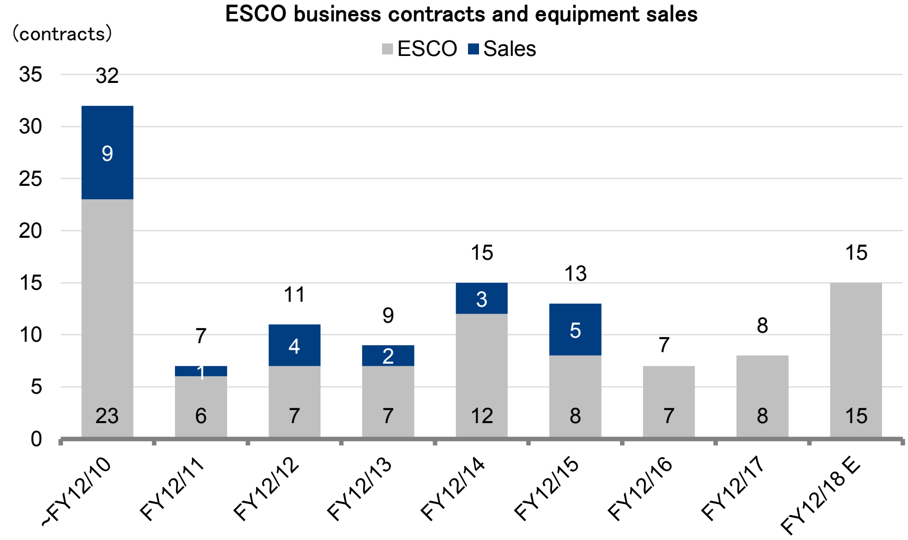
Strengthening clean water business with recurring income in Japan

3. Clean water business: Recurring-income business with healthy earnings

ESCO service uses a lengthy contract period of 10 years. Contracts with existing customers generate stable income over a prolonged 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 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.

ESCO business contracts and equipment sales



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

Deployment of biofiltration technology is a recent advance. It removes iron, manganese, ammonia, and other substances found extensively in pretreated water without having to add chemicals and thereby enables low-cost, advanced treatment of underground water previously avoided for conversion to drinking water. Medical entities running dialysis require large amounts of water with high purity. Demand is likely to expand for emergency use other than daily usage.

Water supply operations by local government entities are facing a threat to sustainability. While aging equipment requires upgrades, Japan's aging society is likely to reduce the number of users and usage per capita. According to the "What is the Outlook for Water Supply Fees in an Era of a Shrinking Population? National Forecasts and Report" issued in February 2015 by Ernst & Young ShinNihon LLC and the Secretariat of the Water Security Council of Japan, 1,221 service operators, or 98% of those covered in the survey, will have to increase water supply fees in order to avoid losses by 2040. The report estimates that rate hikes of 30% or more will be necessary at 604 operators. Fee hikes are growing at public entities with a smaller number of people drinking water (less than 200,000), particularly in Hokkaido and the Tohoku area.

Water supply rate revisions by local public entities expand demand in the Company's water supply business. Increases in water supply fees also result in higher sewage fees so demand is expected to grow for water recycling business that reuses utilized clean water and curtails outflow. Administrative private-sector consignments with PFI and other formats should address not only clean water business, but also wastewater treatment community plants. We expect a business environment that takes advantage of strength from having a full lineup of clean water, recycled water, and sewage water systems.

4. Product development – High added value

The environmental equipment business focuses on increase of added value by releasing new products. Development policy seeks to open up high value-added markets and enhance price and quality competitiveness. In FY12/18, the Company will release the GA model, a new lineup of medium-scale Johkasou, and the DAC-S, a disposer system that is the Company's strength. The GA model accommodates smaller condominium buildings. It features compact capsule-type products with enhanced biological treatment (that cleans wastewater) performance as an alternative to former cylinders in order-based production. It should help shorten delivery periods and lower costs because inventory production is possible. The Company reduced sizes in comparison with existing products by 28%, thereby improving pricing and installability.

The DAC-S disposer system for multi-dwelling homes lowered sizes by more than 25% (compared to the existing products) through revisions to treatment flow. Applications include large kitchens, such as those at food plants and meal supply centers, as an industrial wastewater treatment system with zero emissions through use of a disposal system for raw garbage currently disposed of externally.

"GA model" medium-scale Johkasou

Multi-dwelling home disposer system DAC-S

Source: The Company's results briefing materials

DA Invent, which was acquired as a subsidiary in January 2018, holds multiple patents for high-temperature, high-pressure hydrothermal treatment and subcritical equipment. This subsidiary's Super Steam hydrothermal processing system dissolves organic wastes. The technology can be applied to lowering sludge volume. We expect synergy benefits due to the ability to expand business coverage to a new area.

Launching solar power business that utilizes rooftops of 100 DCM Group stores

5. Renewable energy business

(1) Selling power from solar-power facilities

The Company launched power sales business using solar power from facilities that lease the rooftops of DCM Group stores. While the long-term feed-in tariff (FIT) is ¥18/kWh in some cases, nearly all already applied at the Japanese fiscal year (JFY) 2017 rate of ¥21/kWh. Installations started in April 2018 and 35 sites had linked to the power grid as of the end of July 2018. The schedule calls for finishing installations at all stores by 2Q FY12/19. Total capital investment in this project is budgeted at ¥5bn. Power sales should only amount to around ¥200mn in FY12/18 with just some locations operating. However, this business is likely to generate ¥800mn in revenue and ¥400mn in operating income annually when operations fully ramp up.

(2) Compact wind power equipment

Electricity FIT for renewable energy was ¥55/kWh in JFY2017 for compact wind power equipment at less than 20kW. The price from JFY2018, however, will be 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. To meet current needs, the Company is releasing the Sylphid HS-10, which combines a horizontal-axis 10kW windmill from a Chinese company with a track record in Asian sites and a power conditioner from a major domestic electric equipment manufacturer. The Company is aware that this business is only sustainable for the next three years.

A group subsidiary has commercialized a vertical-axis product as a compact wind power system suited to Japan's wind conditions with substantial turbulence. This product is not being applied to power sales via grid linkage. Instead it is sold to public entities and corporations as an auxiliary power source or autonomous power source at public and retail facilities for on-site power generation. The current product has a power output capacity of 3kW. Development activities are addressing the more practical 10kW VAS 10.0 and downscaled 1kW VAS 1.0.

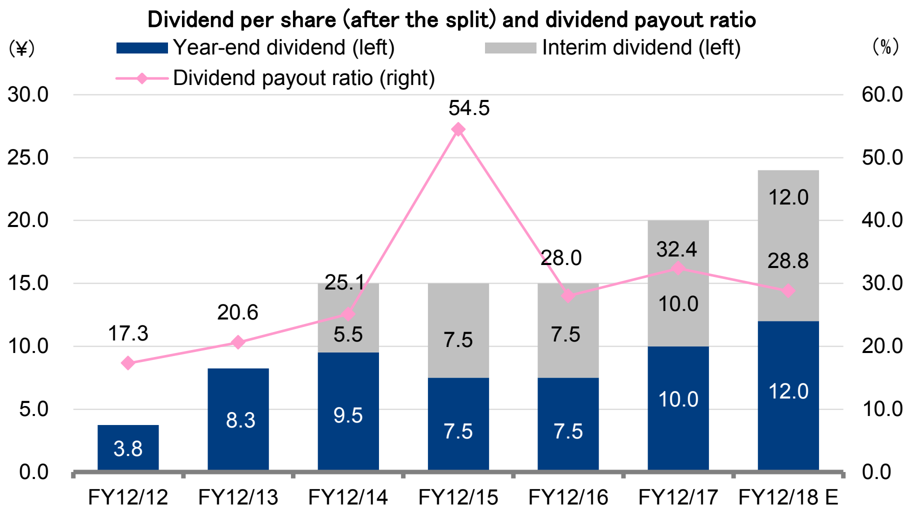
The earthquake with an epicenter in southwestern Hokkaido that occurred in early September 2018 had an estimated magnitude of 6.7. Power outages affected 2.95mn households throughout Hokkaido, exceeding the impact from the Great Hanshin Earthquake in 1995. Local government facilities, which serve as disaster headquarters, should have autonomous power sources to deal with prolonged outages in disasters. While Japan's land area is just 0.28% of global land area, 7.0% of volcanoes are located in Japan. Estimates suggest 70-80% probability of a Nankai Trough earthquake, which could have a magnitude of 8-9, striking within the next 30 years.

Shareholder return policy

Planning a consecutive dividend hike in FY12/18

1. Stock split, dividend per share, and payout ratio

The Company aims to pay a consolidated dividend at a ratio of at least 25% for the time being and raise it to 30% over the medium term, as shareholder return measures. In FY12/17, it split the stock at a 1-to-2 ratio for ordinary shares based on holdings as of June 30, 2017 for a purpose of improving stock liquidity. Dividend after the split is set at ¥10 per share at the end of 1H and the end of the fiscal year, for a total of ¥20 for the year. This is a ¥5 increase (¥10 on a pre-split basis) because the annual dividend after adjustment in FY12/17 was ¥15. The 32.4% dividend payout ratio exceeded the 25% anticipated level. In FY12/18, the Company plans to add a ¥2 commemorative dividend each time to the ¥10 ordinary dividend at the end of 1H and the end of the fiscal year. The resulting ¥24 for the year represents a consecutive dividend hike. Anticipated dividend payout ratio is 28.8%.



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

2. Shareholder benefit program

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. Management plans to implement a shareholder benefit program with the same content again in FY12/18.

Information security measures

Security education through e-learning

As information security measures, the Company deploys computer virus detection and removal anti-virus software in individual PCs. It 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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