

Funai Soken Holdings Incorporated

9757 Tokyo Stock Exchange
 First Section

26-Dec.-16

Important disclosures
 and disclaimers appear
 at the end of this document.

FISCO Ltd. Analyst
 Hideo Kakuta

■ Leads in Small/Medium-Sized Enterprise Business Consulting, Announced Great Value 2020 Medium-term Management Plan Targeting a Comprehensive Model

Funai Soken Holdings Incorporated <9757> (hereafter, also “the Company”) is one of the leading firms and a pioneer in the small and medium-sized enterprise business consulting industry. It is a corporate group with six subsidiaries, including logistics, IT, and contact center consulting operations, and 783 employees (as of the end of December 2015) and has strengthened consulting business and expanded into peripheral areas related to consulting under representative director, president, and group CEO Sakae Takashima, who assumed this position in 2010, and transitioned to a holding company structure in 2014. It provides services such as consulting, management workshops and seminars, and other services for small and medium-sized enterprises in more than 100 industries, including housing and real estate, medical, nursing care, and welfare, and certified professional services. It has cultivated a stock-type business with low churn through use of a unique consulting style that develops and applies successful models.

The Company has been posting all-time high net sales and profits in four straight years and sustained the trend of rising sales and profits in 3Q FY12/16. It achieved steep growth in mainstay housing and real estate and medical, nursing care, and welfare industries that led overall momentum in business consulting, the core segment. Company FY12/16 forecast in light of the 3Q results targets ¥16,300mn in net sales (+10.8% YoY; unchanged), ¥3,600mn in operating income (+2.9%; lowered), ¥3,600mn in ordinary income (-2.5%; lowered), and ¥2,500mn in net income (+3.0%; unchanged). We think the Company is offering solid disclosure considering recent results.

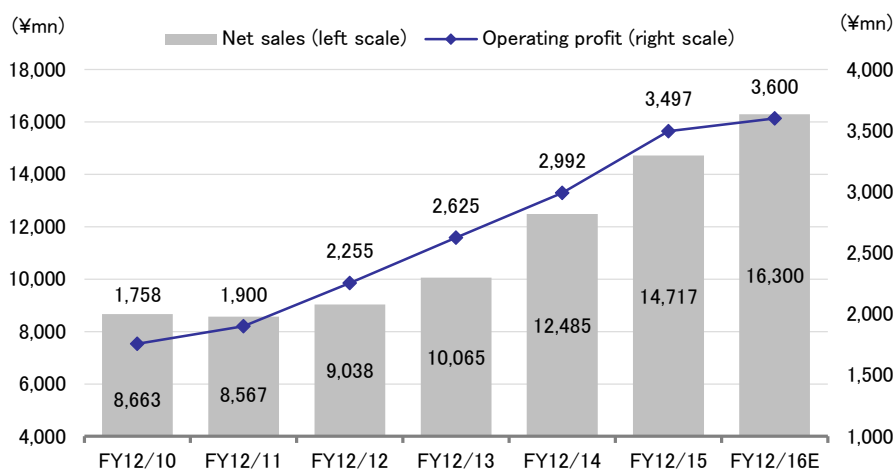
Funai Soken announced Great Value 2020 Medium-term Management Plan on November 4, 2016. This plan aims to realize a “Total Management Consulting Group” with a reliable brand in the final three years of the 10-year plan (2017-2019). The fundamental strategy aims to increase the member number in its industry-specific management workshops, a key strength of the Company, to 10,000 companies and solidify the stock-type consulting business. The Company also intends to acquire highly specialized consulting businesses and peripheral businesses related to consulting through M&As as part of its pursuit of comprehensive offerings. After three years, for FY12/19, the Company is targeting ¥22,000mn in net sales and ¥4,500mn in operating income. While these are slightly conservative values, the Company has attained the operating income target in the second year and significantly exceeded the net sales target in the current Medium-term Management Plan covering 2014-2016. We will again be looking for early achievement of targets under Great Value 2020.

Funai Soken has top-level ratings for all three indicators of business health for the 15 listed consulting firms – profitability (operating income margin), growth potential (past three-year average net sales growth rate), and stability (shareholders’ equity ratio). This outcome confirms the robust performance in the industry fueled by the Company’s unique stock-type consulting model. We expect attractive shareholder returns given support from strong performance. The Company conducted share buybacks worth about ¥500mn during August to November 2016 and is likely to come close to a total return ratio of 70% including this portion.

■ Check Point

- Rising trend in sales and profits continued in 3Q and offset the 1Q lag versus forecast in 2Q and 3Q
- Announced the Great Value 2020 Medium-term Management Plan that targets becoming “the Reliable Total Management Consulting Group”
- Holds top-level ratings for profitability, growth potential, and stability in the consulting industry
- Forecasting total return ratio of around 70%

Full-Year Business Performance (Consolidated)



■ Corporate Outline

Steadily expanded since the founding; advancing to an even higher growth trajectory under the current president Sakae Takashima

(1) History

The Company was established by Mr. Yukio Funai in 1970, with its core business in comprehensive diagnosis of corporate management. With the founder's charismatic nature and hit publications, Funai Soken steadily expanded operations, having succeeded in forming a member organization of small- and medium-sized enterprises focusing on the distribution industry, and was the first company in the consulting industry to list its shares in 1988 (being a Specially Designated Stock on the 2nd Section of the Osaka Stock Exchange). From the 1990s, the baton was passed to the second president, with a shift in customers from predominantly the distribution industry to the services industry. Under president Takashima, the fourth president, who was appointed in 2010, the consulting business has been strengthened and the scope of operations has been expanded to areas peripheral to consulting. Funai Soken shifted to a holding company structure in 2014 and bolstered group management structure aimed at further growth. It is a corporate group with six subsidiaries, including logistics, IT, and contact center consulting operations as of the end of September 2016 and 783 employees as of the end of December 2015.

Business consulting forms the basis of net sales and operating income

(2) Business Overview

The business consulting segment forms the core, representing 85.7% of net sales and 96.2% of operating income (3Q FY12/16 values). Management support for small and medium-sized enterprises in over 100 industries, such as housing and real estate and medical, nursing care, and welfare, comprise the Company's main focus.

In FY12/14, Funai Soken Logistics Inc. became part of the Group, forming the logistics segment, as part of a strategy to enter businesses peripheral to consulting. It constitutes 10.8% of net sales and 3.5% of operating income of the Group (3Q FY12/16), and profit margin has greatly improved.

Business Description and Composition (Consolidated)

Business segment	Main client industries, description of business	Share of sales	Share of operating income
Business Consulting	Consulting for industries such as housing and real estate, medical, nursing care, and welfare, certified professional services, food service and food, and amusement	85.7%	96.2%
Logistics	Logistics operation, consulting businesses, etc.	10.8%	3.5%
Other	IT outsourcing, consulting businesses, etc.	3.4%	-0.2%

Source: prepared by FISCO based on Company materials

Strength in management workshops by industry type and solution; bringing together over 6,000 members

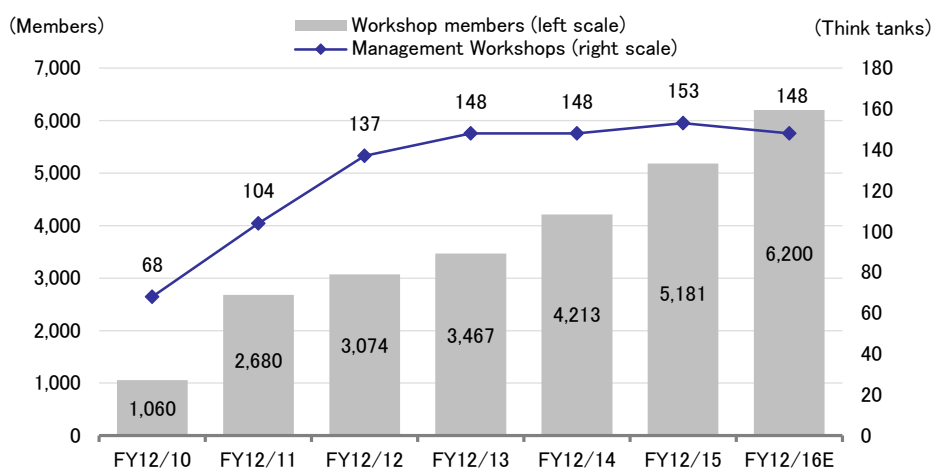
(3) Business model features

The approach supporting high growth has been holding management workshops by industry type and solution. The end of December 2016 outlook factors in 148 workshops engaging in activities such as study groups and model company inspections for 6,200 paying corporate members. The nature of pan-industry exchanges promotes the gathering of management, however, these workshops are focused on specific industry types and themes, where the purpose is more practical.

For example, in the housing and real estate industry, the workshops are extremely specific and divided into groups such as the “FAST-Reform Workshop,” the “Rental Management Business Workshop,” the “Home and Land Utilization for Senior Citizens and Disabled Persons Workshop,” the “Northern European Modern Housing Workshop,” and the “Smart House Workshop.” Given that existing clients also participate, both the actual state and benefits of business consulting are easily transmitted by word of mouth. The Company’s consulting style involves preparation of “successful business models” ahead of time and attracting clients who agree with the models. The management workshops also play an important role in refinement of “successful business models.”

Additionally, these management workshops enable the acquisition of special characteristics and perspectives of managers through communication between young consultants and clients, and constitute an opportunity to collect, analyze, and study raw management data, thereby contributing to quick human resource development. The Company hires a large number of new-graduate consultants (it hired 114 new graduates in 2016) and excels in quick cultivation of human resources by promoting these incoming resources to full-fledged consultants (team leaders) in about five years and four months.

The Numbers of Management Workshops & Members of Workshops



Source: Company materials and interviews

■ Performance Trends

Continued rising trend in sales and profits and offset the 1Q lag versus forecast in 2Q and 3Q

○ Review of 3Q FY12/16 results trends

Funai Soken sustained sales and profit increases in 3Q FY12/16 at ¥11,908mn in net sales (+11.9% YoY) and ¥2,838mn in operating income (+8.2%). In net sales, mainstay business consulting remained strong. Operating income also received a large contribution from business consulting. While net sales lagged in 1Q with only 23.1% progress made toward the full-year plan, the Company saw a strong performance in 2Q (47.0%) and 3Q (73.1%). High operating income margin at 23.8% stands out.

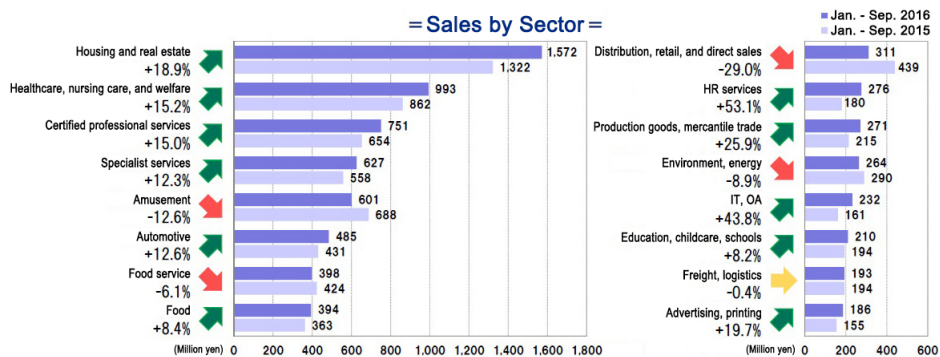
3Q FY12/16 Results

	Cumulative 3Q FY12/15		Cumulative 3Q FY12/16				
	3Q results (¥mn)	vs. net sales (%)	Initial plan (¥mn)	3Q results (¥mn)	vs. net sales (%)	YoY change (%)	Progress toward full-year plan (%)
Net sales	10,637	100.00	16,300	11,908	100.0	11.9	73.1
Cost of sales	6,855	64.4	-	7,725	64.9	12.7	-
Gross margin	3,781	35.6	-	4,183	35.1	10.6	-
SG&A expenses	1,159	10.9	-	1,344	11.3	16.0	-
Operating income	2,622	24.7	3,900	2,838	23.8	8.2	72.8
Ordinary income	2,758	25.9	3,900	2,840	23.9	3.0	72.9
Net income attributable to owners of parent	1,861	17.5	2,500	1,931	16.2	3.8	77.3

Source: Company's financial results summary

Looking at business consulting trends by industry, the three core areas of housing and real estate, healthcare, nursing care, and welfare, and certified professional services steadily increased sales, while amusement, food service, and distribution, retail, and direct sales decreased. Funai Soken concentrates consultants and other business resources in key industries and achieves company-wide growth through portfolio management. Sales increased 53.1% YoY in human resource services, 25.9% in production goods, mercantile trade, and 43.8% in IT and OA, as industries with relatively low sales but strong growth potential. Funai Soken holds No.1 market shares in many industries where it participates, including housing and real estate, healthcare, nursing care, and welfare, and certified professional services, and holds a strong lead.

Performance by Segment: Consulting



- Sales of consulting services for clients in core segments such as housing, real estate, healthcare, nursing care, welfare, and certified professional services, continued to rise steadily.
- In addition to the sales shown above, consulting sales were also robust in segments such as specialist services, automotive, production goods manufacturers, mercantile traders, HR services, IT, and OA.

Source: Company materials

■ Full-year Outlook

Expecting higher sales and profits for a fifth straight year and all-time high net sales and profits

○ Outlook for FY12/16

The FY12/16 forecast calls for ¥16,300mn in net sales (+10.8% YoY; unchanged), ¥3,600mn in operating income (+2.9%; lowered), ¥3,600mn in ordinary income (-2.5%; lowered), and ¥2,500mn in net income (+3.0%; unchanged). We do not expect much deviation in actual results and think Funai Soken is on track to posting higher sales and profits for a fifth straight year, even with some 4Q uncertainty including bonuses, owing to the stock-type model of a high repeat rate in business consulting and logistics segments and catch-up progress through 3Q.

■ Growth Strategies

Announced the Great Value 2020 three-year Medium-term Management Plan as the final phase of the 10-year plan

○ 10-year plan

Funai Soken is entering the final three years of the 10-year plan (master plan for 10-year management plans) from FY12/17. The 10-year plan was formulated in 2010, when the Company transitioned to the structure under the current president Sakae Takashima with three phases – the first phase (Hop: 2011-2013), the middle phase (Step: 2014-2016), and the final phase (Jump: 2017-2019). It serves as a compass indicating the Company's direction. Funai Soken consistently posted results exceeding the plan's numerical targets in the first and middle phases.

○ Fundamental policy in the final phase (Jump: 2017-2019)

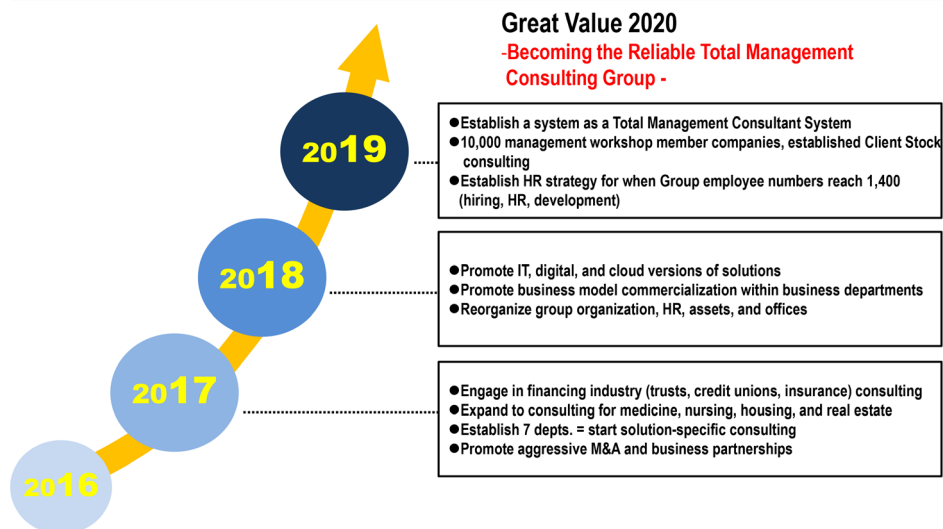
Funai Soken announced Great Value 2020 Medium-term Management Plan on November 4, 2016. This plan aims to realize a "Total Management Consultanting Group" with a reliable brand in the final three years of the 10-year plan (2017-2019). The fundamental strategy aims to increase the member numbers in its industry-specific management workshops, a key strength of the Company, to 10,000 companies and solidify the stock-type consulting business. Funai Soken also aims to have 1,400 group employees in three years and intends to hire 200 consultants per year during this period.

The Company will continue to focus on the top two industries of housing and real estate and medical, nursing care, and welfare in its industry-specific consulting during FY12/17. It is entering the financial industry (trusts, credit unions, and insurers) as a new development. This initiative sees the presence of common industry issues and a role for utilization of its consulting knowhow.

The Medium-term Management Plan outlines a strategy of bolstering solution-specific consulting that runs across industries in addition to industry-specific consulting. The themes includes human resource development consulting, Web marketing, M&A and business succession consulting, promotion of logistics IT, research business, and IPO assistance. The Company aims to broaden the industry-specific consulting menu by pursuing these themes in depth and to build operations that comprehensively respond to a wide range of customer needs. It also will be promoting the service provision of IT, digital, and cloud versions in order to develop a wider customer base. It is emphasizing "active pursuit of M&A and business partnerships" in FY12/17 and hopes to acquire highly specialized consulting businesses and peripheral businesses related to consulting through M&As as part of its pursuit of comprehensive offerings.

Medium-term Management Plan – Fundamental Policies

■ The Funai Soken Group's 2017 - 2019 3-year plan is as follows

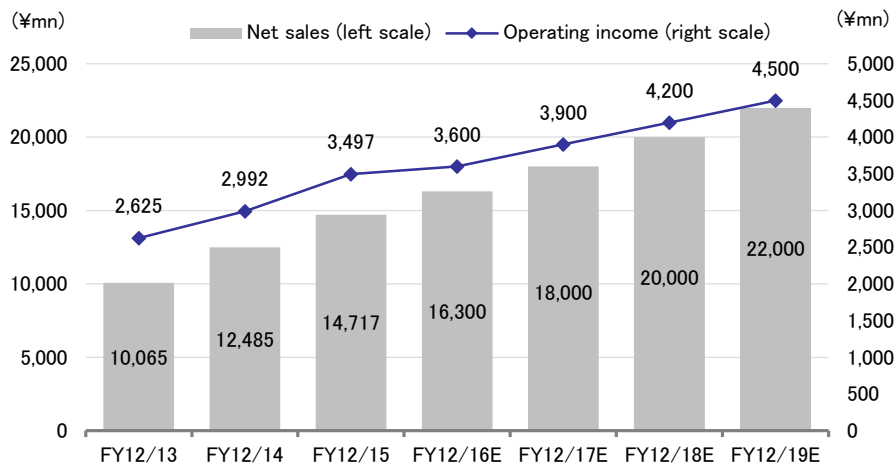


Source: Company materials

○ Numerical goals in the final phase (Jump: 2017-2019)

Goals for FY12/19 after the three years are ¥22,000mn in net sales (10.5% average annual growth during the three years) and ¥4,500mn in operating income (7.7% average annual growth). The plan envisions a modest drop in operating income margin from the 22.1% targeted in FY12/16 to 20.5% in FY12/19. We think this reflects the impact of business model differences related to diversification of business consulting services and other non-consulting business added through M&A, rather than a decline in the profitability of existing consulting business. The Company attained the operating income target in the second year (2015) and significantly exceeded the net sales target in the current Medium-term Management Plan covering 2014-2016. While it again adopts slightly conservative numerical goals, the Company's aim may be to build momentum by early achievement of targets.

Medium-term Management Plan



Source: Company materials

■ Benchmarks

Possesses top-level industry ratings in profitability, growth potential, and stability

○ Profitability, growth potential, and stability

We compared indicators of business health for the 15 listed consulting firms – profitability (operating income margin), growth potential (past three-year average net sales growth rate), and stability (shareholders' equity ratio). Funai Soken has top-level ratings for all three indicators at No.2 in profitability, No.4 in growth potential, and No.4 in stability. This outcome confirms robust performance in the industry fueled by the Company's unique stock-type consulting model that focuses on expanding the successful models by continuing relationships with customers through industry-specific management workshops.

However, we think this comparison has limitations because of the very wide range of consulting companies, including firms with large corporate clients and firms specializing in M&A, IT, and other areas, and the absence of a listed company that provides consulting services to small and medium-sized enterprises along the lines of Funai Soken.

Benchmarks for listed consulting firms

	Profitability		Growth potential		Stability	
	Operating income margin (%)	Ranking	Average annual growth rate (%)	Ranking	Shareholders' equity ratio (%)	Ranking
Company A (M&A)	47.4	1	27.0	1	83.1	2
Funai Soken Group	23.8	2	17.6	4	81.3	4
Company B (M&A)	23.4	3	10.5	6	84.2	1
Company C (IT)	13.8	7	14.8	5	70.6	7
Company D (IT)	16.6	5	6.5	9	75.3	6
Company E	10.3	8	4.2	11	81.4	3
Company F (M&A)	20.8	4	6.8	8	61.7	11
Company G (think tank)	13.8	6	5.0	10	66.2	9
Company H	4.2	13	18.2	3	63.2	10
Company I	6.0	10	-2.5	14	78.1	5
Company J	2.7	14	19.5	2	34.5	15
Company K (IT)	5.4	11	1.9	13	66.5	8
Company L	4.5	12	8.7	7	52.3	14
Company M (think tank)	6.3	9	2.3	12	56.9	13
Company N (IT)	0.0	15	-23.3	15	58.7	12

Source: Company's most-recent full-year financial results summary

Note: Past three-year average for the annual growth rate

Shareholder Returns Policy

Completed share buybacks worth about ¥500mn, headed for a total return ratio of around 70%

The Company recognizes appropriate distribution of profit to shareholders as its highest management priority, and intends to continue carrying this out through both “returns through dividends” and “returns through share buybacks” while considering business performance. Under a policy of raising the total amount of dividends sustainably, the Company is targeting a total return ratio of around 50%. Funai Soken expects to pay a ¥36 dividend per share in FY12/16 (unchanged YoY) consisting of an interim dividend of ¥15 and year-end dividend of ¥21. The Company also completed share buybacks worth about ¥500mn during August to November, and is likely to come close to a total return ratio of 70% including this portion.

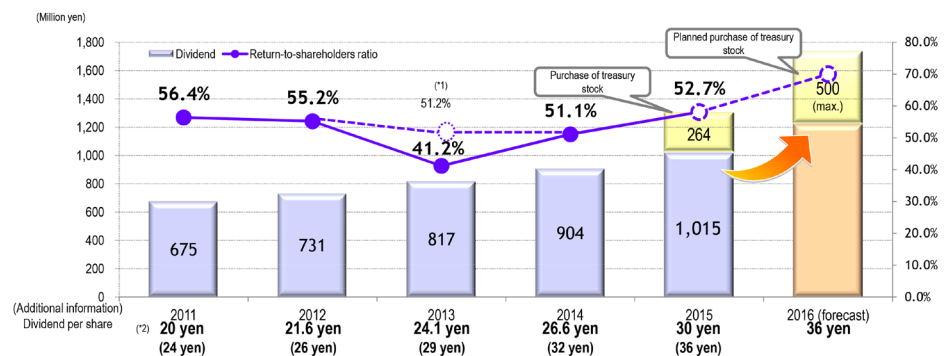
With regard to shareholder rewards, the Company changed the reward to a QUO card (it distributed book tokens or nationwide gift vouchers through FY12/14) to improve convenience. It distributes QUO cards (with a value up to ¥10,000) to shareholders as of December 31, according to the number of shares held.

Shareholder returns

■ We always strive to return adequate earnings to shareholders while strengthening our financial condition and management fundamentals. As such, we are determined to give back to shareholders through distribution of earnings and by buying treasury stock to an appropriate level in light of business performance.

Return-to-shareholders ratio

Our basic policy is to strive for a sustainable level of dividend increases and aim for a return-to-shareholders ratio of **around 50%**.



Source: Company materials

Disclaimer

FISCO Ltd. (the terms “FISCO”, “we”, mean FISCO Ltd.) has legal agreements with the Tokyo Stock Exchange, the Osaka Exchange, and Nikkei Inc. as to the usage of stock price and index information. The trademark and value of the “JASDAQ INDEX” are the intellectual properties of the Tokyo Stock Exchange, and therefore all rights to them belong to the Tokyo Stock Exchange.

This report is based on information that we believe to be reliable, but we do not confirm or guarantee its accuracy, timeliness, or completeness, or the value of the securities issued by companies cited in this report. Regardless of purpose, investors should decide how to use this report and take full responsibility for such use. We shall not be liable for any result of its use. We provide this report solely for the purpose of information, not to induce investment or any other action.

This report was prepared at the request of its subject company using information provided by the company in interviews, but the entire content of the report, including suppositions and conclusions, is the result of our analysis. The content of this report is based on information that was current at the time the report was produced, but this information and the content of this report are subject to change without prior notice.

All intellectual property rights to this report, including copyrights to its text and data, are held exclusively by FISCO. Any alteration or processing of the report or duplications of the report, without the express written consent of FISCO, is strictly prohibited. Any transmission, reproduction, distribution or transfer of the report or its duplications is also strictly prohibited.

The final selection of investments and determination of appropriate prices for investment transactions are decisions for the recipients of this report.

FISCO Ltd.