Nagaileben

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Company Research and Analysis Report
FISCO Ltd.
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■Q1-3 FY8/13 results indicate the company could well exceed its full-year forecasts

Nagaileben is the largest manufacturer of clothing for medical use in Japan, with a market share of more than 60%. This market share is vastly higher than the second largest share, and Nagaileben is very profitable. The company's dominance in the production of medical clothing and its high profitability stem from several factors. First, its operations are integrated. The company performs all stages of work, from product planning to the procurement of raw materials, manufacturing, and sales. Second, Nagaileben is the only company in Japan that has specialized in the manufacturing of clothing for medical use for decades, so its products are distinct from those of competitors. Third, the company excels at inventory management.

On June 28, 2013, the company announced that it had achieved record-high sales and operating profit in the first three quarters of the fiscal year through August 2013, i.e., in Q1-3 FY8/13, for the fourth consecutive first three quarters of a fiscal year. On August 9, 2013, the company raised its forecasts for FY8/13, due to continued strong sales and expectations of an exchange rate gain on its US dollar bank deposits. Thus, the company foresees record-high sales and operating profit for the full fiscal year. The company intends to maintain a dividend payout ratio of 50% or more, on a parent-company basis so on August 9, it also raised its dividend per share planned for FY8/13 from ¥35 to ¥45. Given its strong growth to date, the company may raise its targets for FY8/15, the final year of its current three-year plan. The company's growth strategy is also developing on schedule. Nagaileben aims to increase its market share in clothing for medical use in western Japan, and it is expanding its market shares in nursing home wear and surgical wear.

Nagaileben is very financially sound, with an equity ratio of 89.9% and no debt. Company management is also positive on posting returns to shareholders. It has pledged to maintain a dividend payout ratio of 50% or more, on a parent-company basis, and it intends to buy back shares at opportune moments. Thus, many of its shareholders are likely to remain long-term holders. At the end of H1 FY8/13, 18.9% of the company's outstanding shares were held by non-Japanese investors, up by 1.6ppts y-o-y.

■Check Points

- Sales and operating profit in Q1-3 reached record highs for the first three quarters of a fiscal year, for the fourth consecutive year
- Company increased its forecasts for FY8/13 and its planned dividend from ¥35 to ¥45
- Demand for clothing for medical use and related products likely to increase in Japan and overseas

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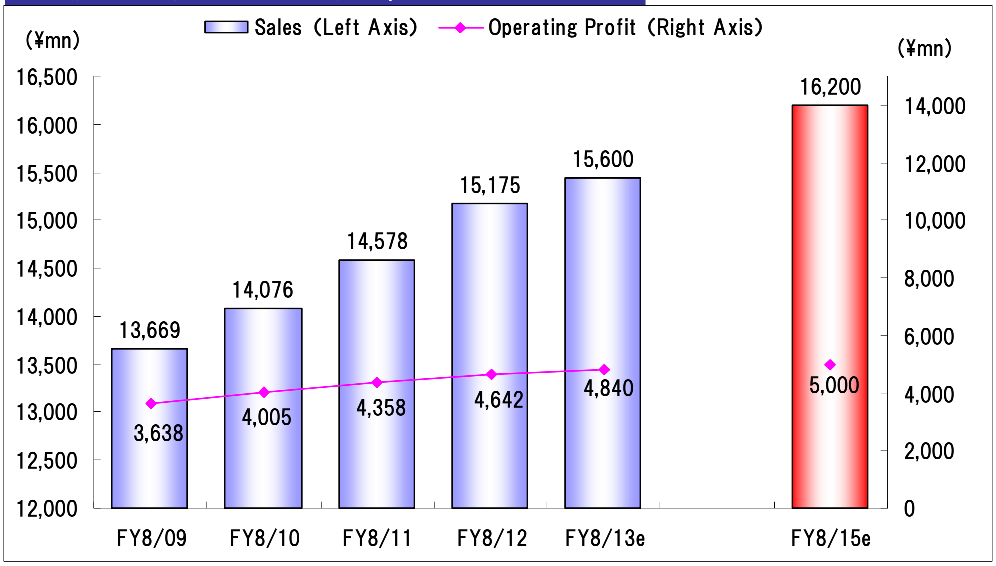
Consolidated Sales and Operating Profit (¥mn), FY8/09-FY8/13E and FY8/15 plan



Description of Businesses

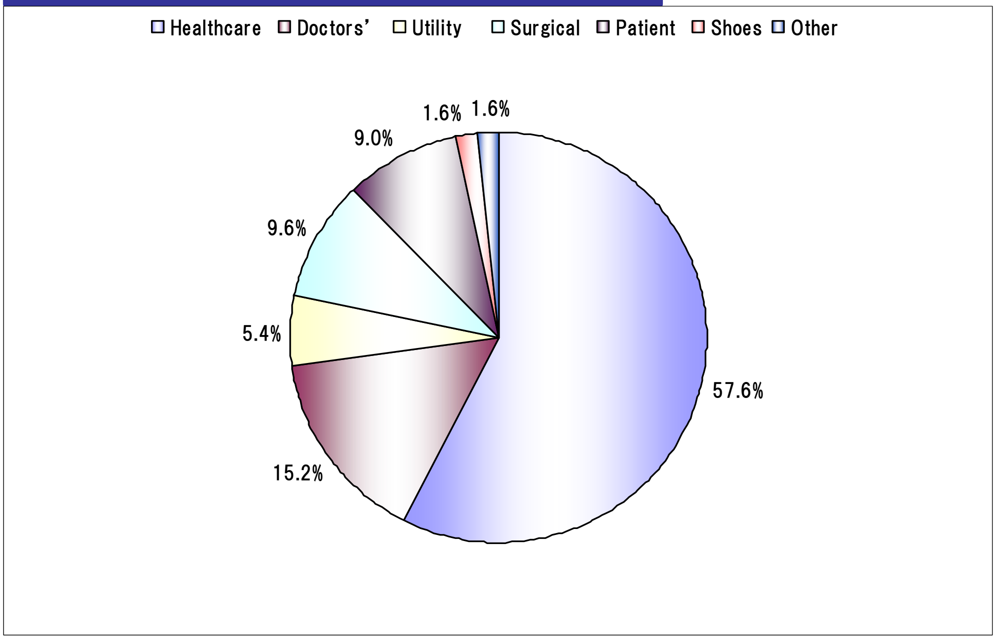
Healthcare wear provides more than half of sales

Consolidated Sales Breakdowns

All of Nagaileben's products are medical clothing or related items. The company's sales can be broken down by item, or type of clothing, by geographical market, and by clothing classification. Items include healthcare wear, primarily white uniforms for nurses; doctors' wear, mainly white coats for doctors and laboratory technicians; surgical wear; patient wear; utility wear, which is cardigan sweaters and aprons worn by nurses; shoes, and other products. By item, as detailed in the pie chart below, in H1 FY8/13, healthcare wear provided 57.6% of total sales, doctors' wear provided 15.2%, surgical wear supplied 9.6%, patient wear contributed 9.0, utility wear provided 5.4%, shoes, etc. provided 1.6%, and other products accounted for 1.6%. Shoes and other products, which are purchased, are less profitable than the other types of clothing, which are made in-house.

■Description of Businesses

Breakdown of H1 FY8/13 Consolidated Sales by Item



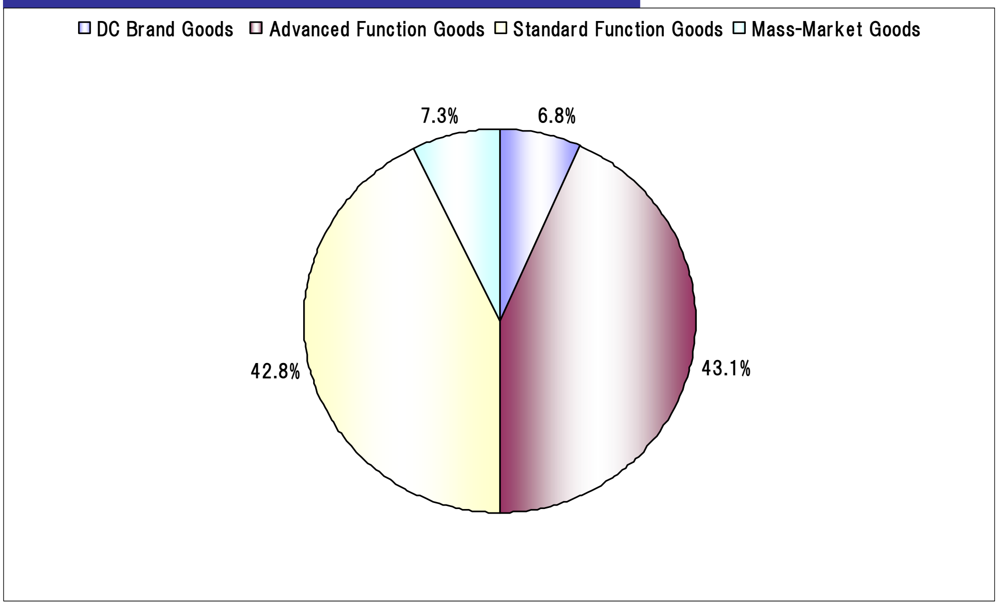
Examples of Different Items of Clothing Made by Nagaileben

Source: Results briefing of FY8/12

■Description of Businesses

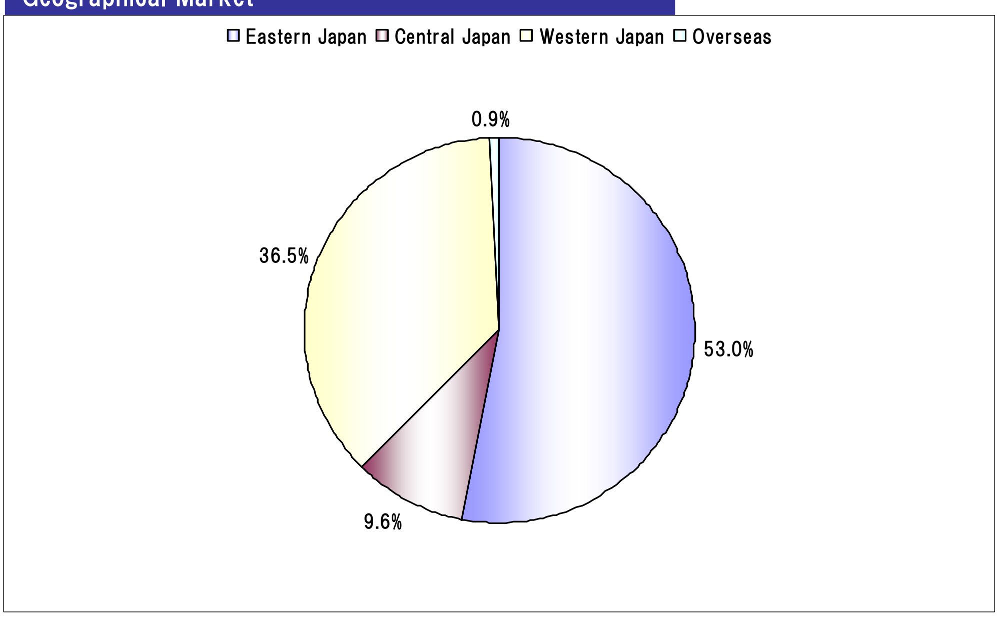
By product classification, mass-market goods are priced at ¥5,000 or less, standard function goods are priced at ¥5,000-7,500, advanced function goods are priced at ¥7,500-10,000, and designer-character (DC) brand goods are priced at ¥10,000 or more. Advanced function goods and DC brand goods together supply more than half of the company's total sales. The profitability of a product increases directly with its price.

Breakdown of FY8/12 Consolidated Sales by Product Classification



By geographical market, eastern Japan accounted for 53.0% of total sales in H1 FY8/13, western Japan, for 36.5%, central Japan, for 9.6%, and overseas for 0.9%.

Breakdown of H1 FY8/13 Consolidated Sales by Geographical Market



■Description of Businesses

Sales Routes

Nagaileben's main customers are hospitals, other medical facilities, and nursing homes. All of the company's sales are made through almost 1,000 agents, such as wholesalers of medical equipment and linen suppliers. Thus, the company has no direct selling cost. However, its sales representatives promote directly the product to large customer institutions to ascertain their needs.

Manufacturing

In FY8/12, products made in Japan accounted for 57.9% of sales, products made overseas accounted for 39.4%, and purchased products accounted for 2.7%. Nagaileben does not own overseas plants. Its products made overseas are manufactured at plants owned by partner companies in the host country, i.e., the country where the goods are manufactured. This arrangement minimizes Nagaileben's costs and investment risk.

The profits from sales of these products manufactured overseas are greatly affected by changes in exchange rates between the yen and other currencies, mainly the US dollar. To minimize the impact of changes in yen exchange rates on profits, the company covers about 80% of its imports planned for the coming two-three years with forward currency exchange contracts. Thus, changes in these rates affect profits only gradually. As a hedge against profit declines stemming from yen depreciation against the US dollar, the company maintains US dollar bank deposits equivalent to about ¥2bn.

Seasonality of Sales

Because Nagaileben specializes in the production of clothing for medical use and related products, its customer industries are limited to medical institutions and nursing care facilities. Many hospitals and nursing care facilities earn their highest monthly sales in March, the final month of their fiscal years. Nagaileben's inventories peak in February and hit a yearly low in August, the final month of the company's fiscal year. Therefore, third quarter (March to May), which includes the peak month of March, is the key quarter for the company to analyze its business trends.

Market Share

Nagaileben has gained a more than 60% share of the Japanese market for medical clothing. According to the company, the second largest seller of this clothing has only a 7-8% market share, while companies ranking third or below have shares of only a few percentage points. Thus, it is difficult for competitors to reap the benefits of scale that Nagaileben enjoys.

■Description of Businesses

Profitability

In FY8/12, Nagaileben earned an operating profit margin of 30.6%, and for FY8/13, the company forecasts an operating profit margin of 31.3%. In Q1-3, FY8/13, the company earned a gross profit margin of 46.9%. Most listed manufacturers in Japan aim to attain an operating profit margin of 10%, but many fail to.

Reasons for high market share and profitability

The company's high market share and profitability reflect five factors described below.

○Integrated operations

Except for shoes and a few other items, the company performs all stages of work, from product planning to the procurement of raw materials, manufacturing, and sales. Thus, it does not lose profit to sub-contractors.

○Specialization

Nagaileben is the only company in Japan specializing in clothing for medical use. Competitors also produce clothing for other industries, such as restaurants, barbers, beauty parlors, etc. Clothing for these other industries differs from medical clothing in properties and design. It must therefore be planned, manufactured and sold differently, necessitating a dispersion of resources.

By specializing, Nagaileben concentrates its resources on a single product type, enabling it to ascertain client needs in detail and to develop products that meet these needs. Through long experience, the company has developed products distinct from those of competitors, built a unique sales method and service offerings, and managed costs effectively, as detailed below.

○Product differentiation

Because Nagaileben discovers the needs of medical clothing users more precisely than competitors, it can develop products that satisfy these needs better than competitors. For example, it has developed fabric that does not produce static electricity, which could cause medical equipment to malfunction, and antibacterially processed fabric. It develops such fabrics jointly with Toray Corp. (3402), Japan's largest textile company, which probably cooperates with Nagaileben because it can count on selling large quantities of any fabric produced. Thus, Nagaileben has formed a cycle through which it develops products responsive to customer needs, enabling it to work jointly with other leading companies, allowing it to expand its sales of high-margin, advanced products.

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■Description of Businesses

○Unique sales method and service offerings

Nagaileben also considers its client's needs in selling its products. For example, from 3 to 40 years ago, most hospitals washed their linen internally, but to improve operating efficiency, hospitals gradually outsourced this service. Nataileben offered a lower running cost for hospital linen supply service than its competitors, so its service was quickly adopted throughout Japan. Through such sales and service offerings, Nagaileben satisfies its customers while stabilizing its sales and profit growth.

○Efficient product management

Nagaileben sells about 5,000 items of clothing for medical use, which can be delivered the day after they are ordered. Ordinarily, it is considered dangerous to hold an inventory of 5,000 items for next-day delivery. However, Nagaileben has accumulated the knowhow to maintain such an inventory profitably, based on the turnover rate for each item. In FY8/12, the company's overall inventory turnover rate was 5.8 times, which is unusually high. Next-day delivery pleases customers and allows Nagaileben to increase its market share. As the company's sales spurt every March, the company delivers its products from distribution warehouses in Akita and Hiroshima prefectures, rather than consigning delivery to a third party, to insure prompt delivery and reduce costs.

■Business Trends

Sales and operating profit in Q1 –3 reached record highs for fourth straight first three quarters of a fiscal year in a row

(1) Q1-3 FY8/13 Results

On June 28, 2013, the company announced its results for Q1–3 FY8/13. As shown in the table below, consolidated sales grew by 3.4% y-o-y to ¥12,433mn, operating profit rose by 7.1% to ¥4,005mn, recurring profit advanced by 21.0% to ¥4,637mn, and net profit increased by 28.7% to ¥2,857mn. Sales and operating profit hit record highs for the fourth straight first three quarters of a fiscal year in a row, and the gross profit margin rose by 0.5ppt y-o-y to 47.1%.

Sales of the company's two main items, healthcare wear and doctors' wear, increased, and sales of surgical wear grew by double digits y-o-y. From April 2012, insurance payments for medical and nursing home care were increased. These increases should have contributed to higher revenues for medical institutions and nursing homes, which have probably supported Nagaileben's operations since then. The company limited the growth of its SGA costs in Q1–3 FY8/13. This restraint, plus sales growth, were the main factors contributing to operating profit growth. Because of y-o-y yen depreciation against the US dollar in Q1–3 FY8/13, the company's US dollar deposits, equivalent to about ¥2bn, earned a non-operating valuation gain. Thus, non-operating income grew by about five times y-o-y to ¥664mn, contributing to recurring and net profit growth.

■Business Trends

By item, sales of healthcare wear increased by 3.0% y-o-y in Q1-3 FY8/12 to ¥7,252mn, sales of doctors' wear advanced by 4.4% to ¥2,086mn, sales of utility wear fell by 4.0% to ¥659mn, sales of patient wear grew by 2.3% to ¥931mn, sales of surgical wear rose by 10.7% to ¥1,090mn, sales of shoes declined by 6.2% to ¥206mn, and sales of other products turned up by 13.5% to ¥206mn.

Consolidated Results (¥mn) in Q1-3 FY8/12 and Q1-3 FY8/13

	Q1-3 FY8/12		Q1-3 FY8/13		
	Amount	Sales (%)	Amount	Sales (%)	YOY (%)
Sales	12,023	100.0	12,433	100.0	3.4
Gross profit	5,607	46.6	5,852	47.1	0.4
SGA cost	1,866	15.5	1,847	14.9	-1.0
Operating profit	3,741	31.1	4,005	32.2	7.1
Recurring profit	3,834	31.9	4,637	37.3	21.0
Net Profit	2,220	18.5	2,857	23.0	28.7

Very strong balance sheet, with equity ratio near 90%

(2) Financial Condition

Nagaileben's financial condition improved in Q1-3 FY8/13. Current assets grew by 2.0% y-o-y to ¥25,711mn, mainly due to a ¥2,004mn increase in sales and notes receivable. Fixed assets grew by 10.7% to ¥10,836mn, as tangible fixed assets rose by 4.5% to ¥7,648mn, intangible fixed assets advanced by 4.8% to ¥90mn, and investments and other fixed assets jumped by 29.6% to ¥3,097. As a result, total assets increased by 4.5% y-o-y to ¥36,547mn.

The company's taxes due declined y-o-y in Q1-3 FY8/13, supporting an 8.6% drop in current liabilities to ¥3,053mn. The company's reserves for the retirement allowances of directors and employees increased y-o-y, leading to a 9.8% y-o-y decrease in fixed liabilities to ¥623mn. As a result, total liabilities shrank by 5.9% to ¥3,676mn.

The company paid ¥1,205mn in dividends in H1 FY8/13, but it earned a net profit of ¥2,857mn in Q1-3 FY8/13, which enabled a ¥5.8% increase in equity in Q1-3 FY8/13, to ¥32,870mn. At the end of Q1-3 FY8/13, the company's equity ratio was 89.9%, which was 1.1ppts higher than the ratio a year earlier.

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■Business Trends

Summary Consolidated Balance Sheet (¥mn), Q1-3 FY8/12-Q1-3 FY8/13

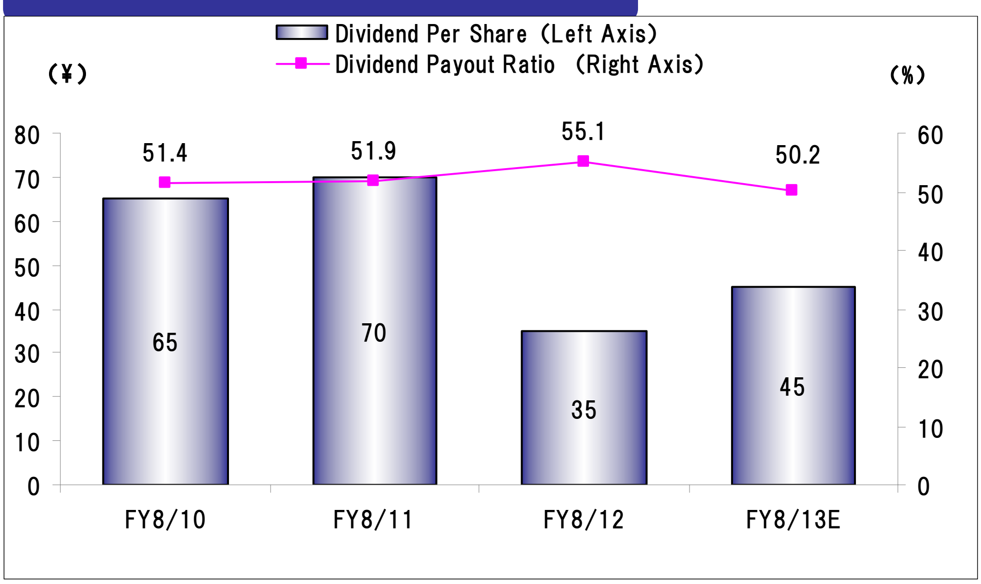
	FY8/12	FY8/13 3Q	Change Amount
Cash and deposits	16,627	15,671	▲ 955
Notes and accounts receivable	4,219	6,223	2,004
Inventories	3,396	3,202	▲ 193
Current assets	25,195	25,711	515
Tangible fixed assets	7,316	7,648	331
Intangible fixed assets	86	90	4
Investments, other	2,390	3,097	707
Fixed assets	9,793	10,836	1,043
Total assets	34,988	36,547	1,558
Current liabilities	3,340	3,053	▲ 286
Fixed liabilities	567	623	55
Total liabilities	3,908	3,676	▲ 231
Retained earnings	29,972	31,624	1,651
Treasury stock	▲ 3,172	▲ 3,401	▲ 229
Total equity	31,080	32,870	1,790
Total liabilities and equity	34,988	36,547	1,558

FY8/13 DPS raised to ¥45, from ¥35

(3) Shareholder Return Policy

On August 9, 2013, the company raised its forecasts for FY8/13, and reflecting these upgrades and the company’s aim to maintain a dividend payout ratio of 50% or more, on a parent-company basis it also raised the dividend per share it plans to pay for FY8/13 from ¥35 to ¥45.

Dividend Per Share (¥) and Dividend Payout Ratio (%), FY8/10-FY8/13E



Note: The company made a two-for-one stock split on September 1, 2011

■Business Trends

Company raises forecasts

(4) Company Forecasts for FY8/13

As noted above, on August 9, 2013, the company raised its forecasts for FY8/13. It lifted its projection of consolidated sales by ¥150mn to ¥15,600mn (up 2.8% y-o-y), its forecast of consolidated operating profit by ¥6mn to ¥4,840mn (up 4.3% y-o-y), its forecast of consolidated recurring profit by ¥483mn to ¥5,369mn (up 12.2% y-o-y), and its forecast of net profit by ¥91mn to ¥3,082mn (up 30.0% y-o-y).

The company raised its forecast of consolidated operating profit modestly because it now plans to record about ¥72mn of previously unbudgeted SGA costs stemming from preparations to move its head office in January 2014. The company's large upgrade of its recurring profit forecast primarily reflects its expectation of a currency exchange gain on its US dollar bank deposits. The company raised its net profit forecast little, compared with the upgrade of its recurring profit forecast, because it plans to record an extraordinary fixed-asset impairment loss of ¥330mn on the sale of its current head office.

Nagaileben's sales and profits peak in the third quarter of each fiscal year, but through Q3 FY8/13, the company had achieved 79.7% of its new full-term sales forecast, 82.7% of its full-term operating profit forecast, 86.4% of its full-term recurring profit forecast, and 92.7% of its full-term net profit forecast. These are high rates of progress. The yen has weakened sharply against the US dollar this year, but as explained previously, this yen depreciation will affect profits only gradually, due to the company's policy of covering imports with forward exchange rate contracts. For FY8/13, we foresee no great negative impact on earnings due to yen depreciation.

Consolidated Sales and Profit (¥mn) Breakdown for FY8/12 and FY8/13E

	FY8/12		FY8/13E			
	Amount	Sales (%)	Amount	Sales (%)	Change Amount	Change (%)
Sales	15,450	100.0	15,600	100	150	1.0
Operating profit	4,834	31.2	4,840	31.0	6	0.1
Recurring profit	4,886	31.6	5,369	34.4	483	9.9
Net profit	2,991	19.3	3,082	19.8	91	3.0

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■Medium-term Plan and Business Development Prospects

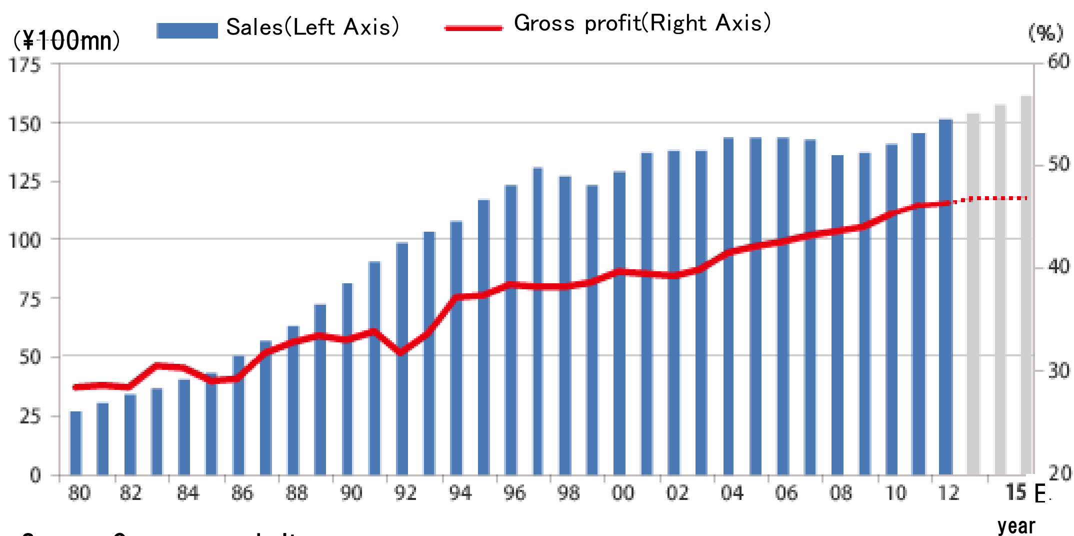
Targets likely to be raised

(1) Medium-term Plan

For FY8/15, the final year of its current medium-term plan, Nagaileben targets consolidated sales of ¥16.2bn and operating profit of ¥5bn. As the company has raised its forecasts of sales to ¥15,600mn and operating profit to ¥4,840mn for FY8/13, it will probably raise its targets for FY8/15 soon.

Although Nagaileben has not specified a recurring profit target for FY8/15, this profit will be affected by changes in the exchange rate between the yen and the US dollar. In Q1–3 FY8/13, the company earned a foreign exchange gain of ¥571mn on its US dollar deposits.

Sales (¥bn) and Gross Profit Margin (%), FY8/80-FY8/15 plan



Source: Company website

Consolidated Results (¥mn), FY8/09-FY8/15 plan

	Sales	YOY	Operating Profit	YOY	Recurring Profit	YOY	Net Profit	YOY	EPS	DPS
FY8/09	13,669	0.3%	3,638	4.0%	3,653	-0.2%	1,516	-27.6%	85.83	60.00
FY8/10	14,076	3.0%	4,005	10.1%	3,983	9.0%	2,344	54.6%	135.18	65.00
FY8/11	14,578	3.6%	4,358	8.8%	4,277	7.4%	2,493	6.4%	144.59	70.00
FY8/12	15,175	4.1%	4,642	6.5%	4,787	11.9%	2,371	-4.9%	68.86	35.00
FY8/13E	15,600	2.8%	4,840	4.3%	5,369	12.2%	3,082	30.0%	89.67	45.00
FY8/15 Plan	16,200	-	5,000	-	-	-	-	-	-	-

Note: The company made a two-for-one stock split on September 1, 2011

■Medium-term Plan and Business Development Prospects

To reach the sales target, the company plans to implement the following strategies.

○Sales item strategy

Over the next two fiscal years, the company intends to promote sales of two newer items, patient wear and surgical wear. In FY8/12, these items accounted for 8.1% and 9.0% of total sales, respectively, but by FY8/15, the company hopes to raise these ratios to 9.0% and 11.0%, respectively. The company also plans to expand its sales of nursing home wear.

Because patient wear and surgical wear are relatively new items, their absolute sales are small, yet they are sold to the same organizations that buy other kinds of medical wear. Thus, the company should be able to increase their sales. The prospects for sales growth of reusable surgical wear are especially bright. Currently, only about 30% of the surgical wear used in Japan is reusable, while about 70% is disposable because hospitals want to avoid the tasks of cleaning and sterilizing this wear. However, Nagaileben offers an outsourced washing and sterilization service which it contends can lower the life cycle cost of reusable surgical wear about 20% below the life cycle cost of disposable surgical wear by washing and sterilizing reusable wear in conjunction with professional linen suppliers. The company has already succeeded in expanding the use of disposable surgical wear in central Honshu and the island of Shikoku. Hereafter, it aims for similar success in the Tokyo and Osaka regions.

The Japanese market for nursing home wear is projected to grow, so Nagaileben should be able to increase its sales of this wear relatively easily. In this market, sales tend to grow in proportion to the sales power allocated. If the company assigns more personnel to promote the sales of nursing home wear, such sales are likely to grow.

The company also plans to expand the sales of its other products through the following strategies.

○Geographical sales strategy

The company' s strategy for promoting sales by geographical market is the same as its strategy for promoting sales by item, i.e., it will promote sales in the areas where sales are the weakest. Thus, the company will try to raise its sales weighting from western Japan from 35.5% in FY8/12 to 37.0% in FY8/15, but not at the expense of growth in eastern Japan. Given the strength of its products and sales, this target appears achievable.

○Profit growth strategy

To increase its profit, the company plans to raise the sales weighting of its high-margin advanced function clothing from 43.1% in FY8/12 to 46% in FY8/15. As noted earlier, Nagaileben excels at developing products that satisfy client needs. Furthermore, if the company leases its products, it promotes new products for the new lease term when the leases are renewed. Reflecting these factors, the company has already raised the sales weighting of its advanced function clothing from 38% in FY8/09, and it should be able to lift this weighting further.

■Medium-term Plan and Business Development Prospects

Demand for clothing for medical use and related products likely to expand in Japan and overseas

(2) Overseas strategy

As Japanese society continues to age, Japanese demand for clothing for medical use is likely to expand. In 2010, Japan’s Ministry of Health, Education and Welfare compiled a report in which it forecast that the supply of nurses would grow at an average annual rate of 2.57% from 2011 to 2015. The same report projected an increase of at least 8.1% in the number of nursing home employees from 2012 to 2015 and an increase of 43% by 2025, relative to the number in 2012.

The demand for this clothing is likely to grow even faster overseas, especially in newly developing countries. Therefore, Nagaileben is planning to expand overseas. It now sells in Korea and Taiwan, but overseas sales account for less than 1% of its total sales. The company is now conducting surveys on the markets in China and Southeast Asia.

The market for medical wear is growing in China and Southeast Asia, but demand is mainly for mass-market goods, not advanced function goods, and price competition in mass-market goods made locally is strong, limiting profitability. Thus, the company does not plan to enter these markets soon. However, the company has prepared to launch overseas sales at an opportune moment.

In manufacturing overseas, Nagaileben has been a leader. By shifting part of its manufacturing to partner companies in China and Southeast Asia, Nagaileben has lowered its cost of goods sold. To offset labor cost rises, the company has recently shifted its production base in Vietnam, and it is now seeking a new approach to business in Indonesia.

■Shareholder Return Policy

Company maintains a dividend payout ratio of at least 50% on a parent-company basis and buys back shares at opportune times

As noted earlier, Nagaileben is financially strong, with an equity ratio of 89.9% and no debt. It also has an overwhelming share of the market it serves. Given its sound business, the company is unlikely falter, barring a large internal problem.

The company has vowed to maintain a dividend payout ratio of 50% or more, on a parent-company basis against its parent-company net profit. Management has also stated that it would buy back shares if there were a promising occasion to do so. Thus, it is quite conscious of the importance of maintaining attractive shareholder returns. Accompanying the upward revision of its forecasts for FY8/13, the company raised its planned dividend per share for the year.

The company is likely to continue to increase its profits. Based on the company’s strengths and its bright prospects, many of its current shareholders probably plan to remain long-term holders. At the end of H1 FY8/13, 18.9% of the company’s shareholders were non-Japanese, up by 1.6ppts y-o-y.