COMPANY RESEARCH AND ANALYSIS REPORT

Nagaileben co., Ltd.

7447

Tokyo Stock Exchange First Section

14-Nov.-2018

FISCO Ltd. Analyst

Noboru Terashima

FISCO

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary 01

1. FY8/18 actual results 01
2. FY8/19 forecast 01
3. Mid-term Management Plan target 01

Company profile 02

Business overview 03

1. Sales breakdown 03
2. Sales channels and production status 04
3. Characteristics and strengths 04
4. Company policy (initiatives for CSR/ESG) 05

Results trends 06

- Summary of FY8/18 consolidated results 06

Business outlook 11

- FY8/19 full-year outlook 11

Medium- to long-term growth strategy 14

1. Mid-term Management Plan 14
2. Future business strategies: The supporting tailwind will continue for the time being 16

Shareholder return policy 17

Summary

Operating profit was a new record high in FY8/18, while in the Med-term Management Plan, the aim is for operating profit of ¥5,600mn in FY8/21

Nagaileben co., Ltd. <7447> (hereafter, also "the Company") is the leading manufacturer of medical gowns in Japan, with a domestic market share of over 60%. The Company boasts high profit margins and a solid financial condition.

1. FY8/18 actual results

The Company has announced its FY8/18 consolidated results, in which net sales increased 0.7% year-on-year (YoY) to ¥17,144mn, operating profit rose 0.4% to ¥5,264mn, recurring profit decreased 0.0% to ¥5,338mn, and net profit attributable to the owners of the parent company grew 0.1% to ¥3,675mn. Due to the simultaneous revisions to the medical treatment fees and nursing care fees in April 2018, the entire market became slightly confused in 3Q, and net sales were sluggish. In costs, factors including the depreciation of the yen and the increase in processing costs meant that the gross profit margin declined 0.5 of a percentage point YoY. But because of the reduction in SG&A expenses, the Company secured a YoY increase in operating profit, if only slightly, for a new record high.

2. FY8/19 forecast

The forecasts for the FY8/19 full year consolidated results are for net sales to increase 2.7% YoY to ¥17,600mn, operating profit to decrease 0.4% to ¥5,242mn, recurring profit to decline 0.6% to ¥5,304mn, and net profit attributable to the owners of the parent company to fall 0.7% to ¥3,650mn. The Company plans to secure an increase in sales by securely capturing projects and other work carried over from the previous year. But it expects the gross profit margin to decline slightly due to factors including an increase in depreciation expenses alongside the construction of the new plant and real estate acquisition tax. In addition, operating profit is forecast to decline because of the recording in SG&A expenses of a scheduled reward-for-services amount of ¥81mn following the abolition of the retirement benefits system for directors.

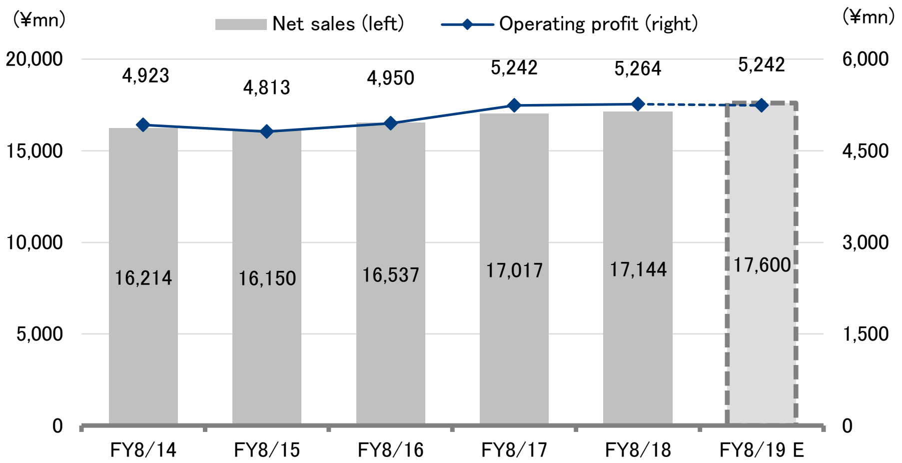
3. Mid-term Management Plan target

Based on the results in the previous fiscal year (FY8/18), the Company announced that it had rolled over its plan up to that time and set new medium-term management targets for FY8/21, of net sales of ¥18,600mn and operating profit of ¥5,600mn. It would seem to be aiming to achieve these targets through expanding overseas production and strengthening advanced-function products that have significant profit margins. The Company is also actively returning profits to shareholders. It has pledged a dividend payout ratio of above 50% (on a non-consolidated basis) and in FY8/19, it plans to pay an annual dividend of ¥60. We see a possibility of increased dividends depending on the earnings results. It has also declared that it will flexibly buy back its own shares, and its approach toward returning profits to shareholders would seem worthy of praise.

Key Points

- Operating profit increased in FY8/18, if only slightly, up 0.4% YoY for a new record high
- Mid-term Management Plan target aims for operating profit of ¥5,600mn in FY8/21
- Annual dividend of ¥60 planned with proactive shareholder returns including share buybacks

Trends in net sales and operating profit (consolidated)



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

Company profile

Leading manufacturer of medical gowns with a domestic market share of over 60%

Nagaileben is a specialist manufacturer of medical gowns for nurses, doctors, patients and others. Established in 1915 as Nagai Shoten, the Company has a rich history. Since then, it has expanded its operations nationally to become a leading domestic manufacturer with a share of over 60% of the market for medical gowns for nurses.

History

1915	Mitsuji Nagai started a privately owned business "Nagai Shoten" specializing in medical gowns in Kanda-Jinbocho, Chiyoda-ku, Tokyo
1950	Liquidated Tokyo Eisei Hakui Co. Ltd. Mitsuji Nagai and Tatsuro Sawanobori jointly established Nagai Shoten Co. Ltd.
1969	Established a subsidiary, Nagai Hakui Kogyo Co. Ltd., in Akita Prefecture to expand the medical gowns manufacturing division. Tatsuro Sawanobori was appointed President. Shifted focus of manufacturing and sales business specialization from multi-purpose white gowns to medical gowns.
1977	Built second product center in Kameido, Tokyo. Established a partnership with a US company, G.D. Searle & Company, and established Japan Surgical Apparel Co. Ltd. in Hiroshima to expand sales of new surgical apparel products for hospitals.
1978	Established technology partnerships with Angelica Corp (US) and Toray Industries, Inc. <3402>. Developed and released medical gowns made with a new fabric for leasing.
1979	Changed name to Nagai Co., Ltd.
1980	Opened a sales office in Takamatsu, Kagawa Prefecture. Concluded a license agreement with designer Kansai Yamamoto.
1982	Concluded a license agreement with designer Yukiko Hanai.
1988	Established Emit Co. Ltd. as a spin-off from Nagai Co. Ltd. Thereafter, the two companies exchanged their names, with Emit Co. Ltd. becoming a group management company, and Nagai Co. Ltd. becoming a group headquarters for sales.
1989	Newly built Nagai Luminous, a manufacturing plant for high-grade products, in Akita Prefecture. Started overseas production toward the global division of labor.
1994	Changed name from Nagai Co. Ltd. to Nagaileben Co. Ltd. Built a new logistics center in Akita Prefecture.
1995	Started over-the-counter trading of the Company's stock. Started development and sales of a second pillar product to respond to the aging of society. Vice President Ichiro Sawanobori appointed President.
1996	Concluded a license agreement with French designer Andre Courreges.
1999	Opened a sales office in Nagoya, Aichi Prefecture. Concluded a license agreement with designer Atsuro Tayama.
2001	Listed on the Second Section of Tokyo Stock Exchange.
2002	Established a technology partnership with Standard Textile Company, Inc. (US) and Toray Industries, Inc. for surgical textiles. Raised the status of the Nagoya sales office to a branch.
2004	Acquired ISO 9001. Listed on the First Section of Tokyo Stock Exchange. Absorbed Hokkaido Nagai Co. Ltd. and established the Hokkaido branch.
2005	Acquired ISO 14001. Concluded a license agreement with designer Keita Maruyama.
2006	Concluded a brand agreement with designer Minako Yokomori.
2014	Relocated to a new head office building in Kajicho, Chiyoda Ward, Tokyo.
2015	Held ceremony to commemorate its 100th anniversary.
2016	Transitioned to a Company with Audit & Supervisory Committee
2017	Concluded a joint development agreement with Shiseido Company, Ltd. <4911>.

Source: Prepared by FISCO from the Company's securities report

Business overview

Focusing on expanding sales of high value-added, advanced-function products

1. Sales breakdown

All of the Company's products are medical gowns and related products. The contribution to sales by item (FY8/18) is 58.2% from healthcare wear, 15.6% from doctors' wear, 2.9% from utility wear, 11.4% from patient wear, 9.6% from surgical wear, 1.1% from shoes, and 1.2% from other products. Healthcare wear consists mainly of products for nurses, and utility wear consists of aprons, cardigans, and other items worn as outer garments. Profit margins for each item do not vary significantly, but the profit margins of purchased products, such as shoes and other products, are relatively lower.

In terms of each region's contribution to sales (FY8/18), eastern Japan accounts for 52.9%, western Japan 35.4%, central Japan 10.5%, and overseas 1.2%. While coverage is nationwide, sales in western Japan and overseas remain low, indicating the potential for future expansion.

The product (function) categories were changed from FY8/17. The Company's own brand of high-priced products, together with the products previously in the DC brand, became the "high-end products" category, and products that up to that time were called advanced-function products have been redefined and categorized as "high value-added products." The name of the standard-function products category was changed to "value-added products," while the mass-produced products category has been left unchanged.

In the new categories, the percentages of total net sales by product (FY8/18) are 7.4% from high-end products, 51.1% from high value-added products, 36.5% from value-added products, and 5.0% from mass-produced products. On looking at the approximate price-band classifications in nurse wear, mass-produced products are less than ¥5,000, value-added products are ¥5,000 to ¥7,500, high value-added products are ¥7,500 to ¥10,000, and high-end products are more than ¥10,000. The tendency is for higher prices to achieve greater profit margins, so the Company is focusing on expanding sales of high-end products and high value-added products.

2. Sales channels and production status

The Company's end users include nurses and doctors, with the purchasers of the products mainly being medical facilities such as hospitals, nursing care facilities, and other such facilities. However, the Company does not conduct direct sales, with 100% of sales being agency sales via medical equipment wholesalers that sell to these medical and other facilities. As a result, sales expenses are kept down, but the Company is still able to understand customers' needs as the sales staff is constantly in contact with large hospitals and other facilities.

In most cases up until recently, medical gowns were laundered within the hospitals by the hospitals themselves, but in recent years they have been switching to leasing alongside the spread in laundry outsourcing. The lease term is typically four years. Because this generates lease renewal demand every four years, it seems to stably support the Company's earnings. However, the lease renewal cycle does not necessarily occur in the same time period as the previous time and there are cases of it being slightly before or after, so sometimes a slight shifting occurs for the net sales (YoY) for each quarter.

Looking at the Company's production structure, based on FY8/18 performance, internal production and at partner plants constitute an aggregate of 98.6% (49.6% domestically and 49.0% overseas), with purchased products accounting for 1.4%. Overseas production predominantly takes place in Indonesia, Vietnam, and China, but the Company owns no plants and the goods are produced at the plants of its local partners, which mitigates investment risk and reduces costs.

3. Characteristics and strengths

The Company is a specialized manufacturer of medical gowns, and one of its strengths is that it has in place an integrated system to undertake every aspect of this business, from planning through to raw material procurement, manufacturing, and sales. In its product planning, it can accurately understand customer needs and reflect them in its products. Specifically, the Company sells products that are easy to work in while incorporating anti-static, antibacterial, and other functions, as well as featuring excellent designs, and they have earned excellent reputations among their users. At the same time, it deals directly with major synthetics manufacturers and textiles traders, including Toray Industries, Inc. <3402>, with which it is jointly developing materials, so it is able to secure optimal materials and products at low costs while selling them at appropriate margins.

Furthermore, in addition to its large number of affiliated plants, the Company has the necessary financial resources to be able to constantly maintain product item inventories that extend into the thousands of varieties, while also being able to swiftly respond to a broad range of user needs, including for made-to-order products, through a rapid production and sales system (the quick response system) that delivers the desired product on the specified day. This has also helped to earn it the strong trust of its customers. On the sales side, it has a network of close to 1,000 agents nationwide as mentioned above, and while its sales capabilities are robust, the Company itself keeps down its sales expenses as much as possible.

As a result, the Company's share of the domestic market for medical gowns for nurses exceeds 60%, and it maintains a firm position as the leading medical gown manufacturer in Japan. Additionally, it is maintaining profitability with a gross profit margin of 47.0% (actual results for FY8/18). The fact that it is both highly profitable and has a high market share demonstrates that most of its customers are satisfied with its products and services, which is the Company's greatest strength.

By concentrating its business resources in the niche market of medical gowns, the Company can efficiently manage every aspect of its business, from planning through to manufacturing and sales. Moreover, although it is a niche market, there remains room for further development, as the Company has relatively low shares of the peripheral markets for patient wear, surgical wear, and other items. The Company has explicitly stated that the medical gown business could grow for some time and that it will take active steps to develop the peripheral markets.

4. Company policy (initiatives for CSR/ESG)

The Company commemorated its centennial in 2015, by cultivating a corporate culture called Nagaism that is focused on realizing interpersonal harmony, generating profits, and contributing to society. It has undertaken the following specific initiatives for CSR/ESG.

(1) Expanding women's roles: Supporting industries led by women

Many of the Company's products are for women working on the frontlines at hospitals and nursing care facilities, and its production facilities have many women involved in sewing work. The Company's business operations create many opportunities to expand the roles of women from a variety of life stages, which connects to supporting working women.

(2) Contributing to communities

a) Lending of historical gowns

Together with the changes to gowns, the Company lends gowns free of charge, such as to the events of medical facilities, with the objective of understanding the history of nurses.

b) Contributing to communities through production sites

The Company is creating employment and contributing to regional economies through its production operations in Akita Prefecture in Japan, and in China, Indonesia, Vietnam, and elsewhere overseas.

c) Medical kids project

This project started from the idea of deepening interaction between hospitals and local communities and enabling children to attend hospitals or undergo hospitalization with ease of mind. Child-sized medical gowns resembling those worn by doctors and nurses are lent to hospitals and a Miffy character makes hospital visits.

(3) Contributing to customers

a) Opened the ITONA gallery, an oasis for nurses

The ITONA gallery, Japan's first communication space for nurses, was opened in 2015 to celebrate the centenary of foundation and as a gesture of gratitude to nurses, the Company's main customers.

b) Beauty courses for nurses

With the cooperation of Shiseido Japan Co., Ltd., the Company is providing practical courses, including learning about make-up and personal behavior that are suitable for nurses in medical settings.

(4) Social contribution

a) Promotion of the employment of disabled persons

Subsidiary Nagai hakui kougyou co., Ltd. was awarded by the Minister of Health, Labour and Welfare in September 2016 after being selected as a business in terms of contribution to the employment and promotion of people with disabilities.

b) Disaster support activities

Monetary donations, provision of medical gowns and presentation of wheelchairs and other items has been made through nursing associations or the Japanese Red Cross Society following the outbreak of SARS and natural disasters including the Indonesian earthquake, the Great Hanshin Earthquake, the Great East Japan Earthquake and the Kumamoto earthquakes.

(5) Environmental initiatives

The Company secured ISO 14001 certification in 2005. Cutting wastage from raw materials is reused for roofing processing and other purposes. The Company has also developed and sells COMPELPAK, a reusable product for use on surgical front lines. By converting to a reusable product instead of the disposable type that had been used until now, it enables medical waste to be reduced and contributes to solving environmental problems.

Results trends

Operating profit increased slightly in FY8/18, up 0.4% YoY for a new record high

● **Summary of FY8/18 consolidated results**

(1) Profit-and-loss conditions

The Company has announced its FY8/18 consolidated results, in which net sales increased 0.7% YoY to ¥17,144mn, operating profit rose 0.4% to ¥5,264mn, recurring profit decreased 0.0% to ¥5,338mn, and net profit attributable to the owners of the parent company grew 0.1% to ¥3,675mn. Due to the simultaneous revisions to the medical treatment fees and nursing care fees in April 2018, the entire market became slightly confused in 3Q, and net sales were sluggish. In costs, factors including the weakening of the yen and the increase in processing costs meant that the gross profit margin declined 0.5 of a percentage point YoY. But because of the reduction in SG&A expenses, the Company secured a YoY increase in operating profit, if only slightly, for a new record high.

Summary of FY8/18 consolidated results

(¥mn, %)

	FY8/17		FY8/18			
	Amount	% of total	Amount	% of total	Change	YoY
Net sales	17,017	100.0	17,144	100.0	127	0.7
Gross profit	8,086	47.5	8,050	47.0	-36	-0.4
SG&A expenses	2,843	16.7	2,786	16.3	-57	-2.0
Operating profit	5,242	30.8	5,264	30.7	22	0.4
Recurring profit	5,340	31.4	5,338	31.1	-2	-0.0
Net profit attributable to the owners of the parent company	3,673	21.6	3,675	21.4	2	0.1

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

In terms of the market and industry environments, in April 2018 there was a double revision, to both the medical treatment fees and the nursing care fees. Since the revisions were kept down to -0.90% of medical treatment fees (of which, +0.55% for the medical treatment fees themselves and -1.45% for drug prices, etc.) and +0.54% for nursing care fees, the direct effects on the Company were negligible. But slight confusion was seen in the markets due to the simultaneous revisions. In particular, for the Company, which has large net sales in 3Q, the revisions' effects appeared over the full fiscal year and the increase in net sales was kept down to 0.7%. But in monetary terms, it was still a new record high.

The gross profit margin was 47.0% (47.5% in the previous fiscal year), down 0.5 of a percentage point YoY. This was due to the impact of the yen's depreciation (decline in cover from foreign currency forward exchange contracts), and also from the rise in the domestic production ratio in the 1H following the introduction of new products (replacement of product lines). The Company's practice is to manufacture products domestically when initially launching new products, moving production offshore in phases as the volume increases. Therefore, there is a tendency for domestic production to increase initially when replacing former lines with new products. This tendency was particularly strong up to 2Q, so the gross profit margin also declined YoY for the full fiscal year.

As a result, gross profit declined ¥36mn YoY. But it increased by ¥60mn due to the higher sales, so it decreased by ¥95mn due to production. Breaking down the production factors, it decreased by ¥20mn from the impact of the rise in processing fees and by ¥105mn from the effects of the exchange rates on costs (¥104.0 to U.S.$1 in FY8/17→¥109.6 to U.S.$1 in FY8/18), and it increased by ¥40mn from the rise in the overseas production ratio (48.1% in FY8/17 → 49.0% in FY8/18).

Conversely, SG&A expenses decreased 2.0% YoY to ¥2,786mn, mainly because depreciation expenses declined ¥15mn, and also from the efforts to reduce other expenses. As a result, although operating profit increased only slightly, up 0.4% YoY, it was still a new record high.

Recurring profit decreased 0.0% YoY, slower than operating profit. This was mainly due to the impact of exchange-rate profit and loss in non-operating profit and loss (FY8/17 profit of ¥44mn, FY8/18 loss of ¥3mn).

Capital expenditure was ¥904mn. Of this, ¥800mn was related to buildings associated with the integration of the Company's plants, ¥34mn was related to production facilities, ¥20mn was related to IT facilities, and ¥28mn was related to logistic facilities. Depreciation and amortization expenses were ¥289mn (decreased ¥22mn compared with ¥311mn in the same period of the previous fiscal year).

a) Net sales by item

In net sales by item, healthcare wear increased 0.3% YoY to ¥9,974mn, doctors' wear decreased 0.4% to ¥2,671mn, utility wear decreased 10.5% to ¥498mn, patient wear increased 10.0% to ¥1,964mn, surgical wear increased 0.6% to ¥1,643mn, shoes decreased 7.9% to ¥187mn, and other products decreased 4.7% to ¥204mn.

In the mainstay healthcare wear, doctors' wear, and surgical wear, there occurred shifts in demand for renewals due to the impact of the double revision in 3Q. A recovery could be seen on entering 4Q, but for the full fiscal year, net sales remained at basically the same level as in the previous fiscal year. Sales of utility wear declined, as the trend of shifting from suppling individuals to shared goods continued. But this result was within the expected range and not a particular cause for concern.

In the peripheral markets, which have come to be focused on in recent years, the Company expanded its share and continued to achieve double-digit sales growth in patient wear due to the market's favorable reception to the Company's value-added products. This is occurring against the backdrop of market expansion from the spreading use of hospitalization sets.

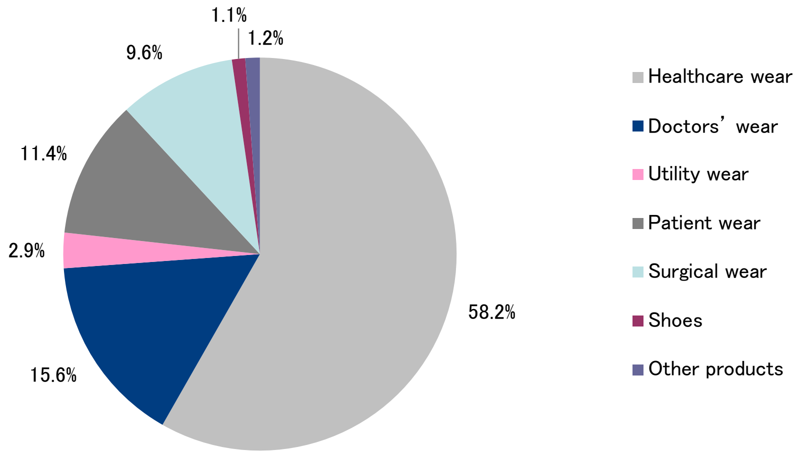
Net sales by item

(¥mn, %)

	FY8/17		FY8/18	
	Amount	YoY	Amount	YoY
Healthcare wear	9,940	2.8	9,974	0.3
Doctors' wear	2,681	1.0	2,671	-0.4
Utility wear	557	-7.4	498	-10.5
Patient wear	1,786	10.7	1,964	10.0
Surgical wear	1,634	3.8	1,643	0.6
Shoes	203	-0.8	187	-7.9
Other products	214	0.3	204	-4.7
Total	17,017	2.9	17,144	0.7

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

Net sales composition by item (FY8/18)



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

b) Net sales by region

By region, in eastern Japan, net sales increased 0.6% YoY to ¥9,065mn; in central Japan, they grew 2.2% to ¥1,795mn; in western Japan, they increased 0.0% to ¥6,069mn; and overseas, they grew 16.4% to ¥214mn.

In eastern Japan, the Company focused on increasing sales of the high value-added products and patient wear, and despite the impact of 3Q, it secured an increase in sales for a new record high. The scale of the central Japan market is small so the Company's results are greatly affected by the number of projects, but the sales increase was maintained, including from the acquisition of new projects. In western Japan, the postponements of renewal contracts in 3Q were recovered in 4Q, but not all were recovered, so net sales remained basically unchanged YoY. Overseas, although the growth rate was high from the acquisition of large contracts, the absolute amount remained small and its effect on results as a whole was minor.

Net sales by region

(¥mn, %)

	FY8/17		FY8/18	
	Amount	YoY	Amount	YoY
Eastern Japan	9,007	5.5	9,065	0.6
Central Japan	1,756	2.3	1,795	2.2
Western Japan	6,068	-0.2	6,069	0.0
Overseas	184	-8.2	214	16.4
Total	17,017	2.9	17,144	0.7

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

c) Net sales by product

By product, for high-end products, net sales increased 6.5% YoY to ¥1,269mn; for high value-added products, they grew 1.7% to ¥8,759mn; for value-added products, they declined 1.4% to ¥6,255mn; and for mass-produced products, they decreased 1.0% to ¥860mn. In high-end products, despite the slump in sales for the DC brand, an increase in sales was secured for high-end products as a whole, driven by the performance of the Company's own brand of high-priced products. Sales also steadily increased in high value-added products, which is the market's volume zone and where the Company is focusing most on expanding sales. However, sales of general value-added products and mass-produced products declined.

Net sales by product

(¥mn, %)

	FY8/17		FY8/18	
	Amount	YoY	Amount	YoY
High-end products	1,191	7.9	1,269	6.5
High value-added products	8,612	3.3	8,759	1.7
Value-added products	6,343	2.3	6,255	-1.4
Mass-produced products	869	-3.1	860	-1.0
Total	17,017	2.9	17,144	0.7

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

The financial position is solid, with cash and deposit at the end of FY8/18 at ¥23.9bn and a shareholders' equity ratio of 89.9%

(2) Financial position

The Company's financial position continues to be stable. Total assets at the end of FY8/18 were ¥42,643mn, up ¥1,692mn compared to the end of the previous fiscal year. Current assets were ¥33,327mn, an increase of ¥1,002mn. The main factors were an increase in cash and deposits of ¥1,168mn, a decrease in notes and accounts receivable of ¥811mn and an increase in inventories of ¥75mn. Fixed assets were ¥9,315mn, up ¥689mn, mainly due to a ¥624mn increase in tangible fixed assets for capital expenditure.

Total liabilities were ¥4,297mn, down ¥108mn compared to the end of the previous fiscal year. The main factors included a decrease in notes and accounts payable of ¥4mn and a decrease in income taxes payable of ¥34mn. Net assets were ¥38,345mn, an increase of ¥1,800mn. This was mainly due to an increase in retained earnings of ¥1,681mn following the recording of net profit for the period. As a result of these factors, the shareholders' equity ratio at the end of FY8/18 was 89.9%, increasing 0.7 of a percentage points from the end of the previous fiscal year.

Summary of the consolidated balance sheet

(¥mn)

	FY8/17	FY8/18	Change
Cash and deposits	22,762	23,930	1,168
Notes and accounts receivable	3,944	3,133	-811
Inventories	4,311	4,386	75
Current assets	32,325	33,327	1,002
Tangible fixed assets	7,256	7,880	624
Intangible fixed assets	54	44	-10
Investments and other assets	1,315	1,390	75
Fixed assets	8,626	9,315	689
Total assets	40,951	42,643	1,692
Notes and accounts payable	1,428	1,424	-4
Income taxes payable	1,091	1,057	-34
Total liabilities	4,405	4,297	-108
Retained earnings	36,989	38,670	1,681
Treasury shares	-4,902	-4,902	-
Net assets	36,545	38,345	1,800
Total liabilities and net assets	40,951	42,643	1,692

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

(3) Cash flow conditions

In FY8/18, cash flow provided by operating activities was ¥4,009mn. The main income items were the recording of net income before income taxes of ¥5,338mn, depreciation and amortization of ¥289mn, and a decrease in notes and accounts receivable of ¥271mn, while the main expenditure items included an increase in inventory assets of ¥74mn and a decrease in accounts payable of ¥4mn. Cash flow used in investing activities was ¥1,244mn, which was primarily due to the acquisition of tangible fixed assets of ¥878mn and fixed deposits (net) of ¥400mn. Cash flow used in financing activities was ¥1,994mn, with the main item being ¥1,994mn for dividend payout. As a result, cash and cash equivalents during the period increased ¥768mn, and the balance of cash and cash equivalents at the end of FY8/18 was ¥5,430mn. The Company does not have any interest-bearing debt, and in addition, it holds ¥4,902mn of treasury stock (4,989,551 stocks). Therefore, as before it has an abundance of cash on hand.

Summary of the consolidated cash flow statement

(¥mn)

	FY8/17	FY8/18
Cash flow from operating activities	3,979	4,009
Net income before income taxes	5,341	5,338
Depreciation and amortization	311	289
Change in notes and accounts receivable-trade	116	271
Change in inventory assets	36	-74
Change to accounts payable	-132	-4
Cash flow from investing activities	-4,389	-1,244
Acquisition of tangible fixed assets	-102	-878
Change in fixed deposits (net)	-4,400	-400
Cash flow from financing activities	-1,662	-1,994
Dividend payout	-1,662	-1,994
Change to cash and cash equivalents	-2,042	768
Balance of cash and cash equivalents at period end	4,662	5,430

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

Business outlook

Despite higher sales, operating profit is forecast to decline in FY8/19 due to special factors

● **FY8/19 full-year outlook**

(1) Outlook of profit and loss

The forecasts for the FY8/19 full year consolidated results are for net sales to increase 2.7% YoY to ¥17,600mn, operating profit to decrease 0.4% to ¥5,242mn, recurring profit to decline 0.6% to ¥5,304mn, and net profit attributable to the owners of the parent company to fall 0.7% to ¥3,650mn. The gross profit margin is forecast to decline due to factors including the impact of exchange rates and the increase in depreciation expenses. In addition, the Company expects transportation expenses to rise and to record a reward-for-services amount (¥81mn) following the abolition of the retirement benefits system for directors. Therefore, operating profit is forecast to decrease, it only slightly.

FY8/19 consolidated earnings outlook

(¥mn, %)

	FY8/18		FY8/19 forecast			
	Amount	% of total	Amount	% of total	Change	YoY
Net sales	17,144	100.0	17,600	100.0	456	2.7
Gross profit	8,050	47.0	8,210	46.7	160	2.0
SG&A expenses	2,786	16.3	2,968	16.9	182	6.5
Operating profit	5,264	30.7	5,242	29.8	-22	-0.4
Recurring profit	5,338	31.1	5,304	30.1	-34	-0.6
Net profit attributable to the owners of the parent company	3,675	21.4	3,650	20.7	-25	-0.7

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

The forecast is for net sales to continue to achieve a new record high. In the mainstay healthcare wear market, sales will increase as the Company will further strengthen its value-added strategy for the high-end products and the high value-added products. It is also aiming to further increase sales for peripheral markets, including patient wear and surgical wear.

The gross profit margin is forecast to decline slightly YoY, to 46.7% (47.0% in the previous fiscal year). Gross profit is expected to increase ¥160mn, with the anticipated factors being an increase of ¥212mn from the higher sales and a decrease of ¥52mn due to production. Breaking down the decreases due to production, they include a decrease of ¥40mn from the impact of the rise in processing costs and other costs, a decrease of ¥45mn from the effects of the exchange rates on costs (¥109.6 to U.S.$1 in FY8/18→¥112.0 to U.S.$1 in FY8/19), an increase of ¥55mn from the rise in the overseas production ratio (49.0% in FY8/18 →50.0% in FY8/19), a decrease of ¥30mn from the increase in depreciation expenses alongside the construction of the new plant, and a decrease of ¥15mn on the occurrence of real estate acquisition tax on the construction of the same new plant. However, for the exchange rates, the Company already has in place forward contracts for the portion from September to December 2018, and the actual average rates may be lower than expected.

SG&A expenses are forecast to be ¥2,968mn (up 6.5% YoY), as in addition to the increase from normal business expansion, the Company will record expenses of ¥81mn as the reward-for-services amount following the abolition of the retirement benefits system for executives. As a result, operating profit is expected to decrease, if only slightly, to ¥5,242mn (down 0.4%). Due to this, both recurring profit and net profit attributable to the owners of the parent company are also forecast to decrease.

a) Net sales forecasts by item

In net sales by item, healthcare wear is forecast to be ¥10,180mn (up 2.1% YoY), doctors' wear ¥2,730mn (up 2.2%), utility wear ¥450mn (down 9.8%), patient wear ¥2,170mn (up 10.4%), surgical wear ¥1,700mn (up 3.5%), shoes ¥175mn (down 6.4%), and other products ¥195mn (down 4.5%).

In healthcare wear, the Company will continue to revitalize the market through introducing high value-added and high-end new products, and sales are expected to steadily increase. In doctors' wear, despite the severe conditions for mass-produced products, it is aiming for higher sales by focusing on increasing sales of the high-end products. In patient wear, against the backdrop of a firm increase in demand in the market, the Company plans to increase its share of the market to continue achieving greater sales. Higher sales are also expected in surgical wear from increasing capacity at the COMPELPAK laundry sterilization plant and through developing new customers.

Net sales forecasts by item

(¥mn, %)

	FY8/18		FY8/19 forecast	
	Amount	YoY	Amount	YoY
Healthcare wear	9,974	0.3	10,180	2.1
Doctors' wear	2,671	-0.4	2,730	2.2
Utility wear	498	-10.5	450	-9.8
Patient wear	1,964	10.0	2,170	10.4
Surgical wear	1,643	0.6	1,700	3.5
Shoes	187	-7.9	175	-6.4
Other products	204	-4.7	195	-4.5
Total	17,144	0.7	17,600	2.7

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

b) Forecasts for net sales by region

The forecasts for net sales by region are ¥9,250mn in eastern Japan (up 2.0% YoY), ¥1,850mn in central Japan (up 3.0%), ¥6,270mn in western Japan (up 3.3%), and ¥230mn overseas (up 7.1%).

In eastern Japan, the Company expects sales to continue to increase from securing demand for renewal projects by proposing new high value-added products. In central Japan and western Japan, the Company is aiming to achieve sales growth YoY by focusing on increasing market share through strengthening sales promotions. Overseas results will be affected by exchange rates, but the Company plans to utilize its name recognition and focus on expanding sales. The plan is to increase sales in every region and to achieve record highs for net sales.

Forecasts for net sales by region

(¥mn, %)

	FY8/18		FY8/19 forecast	
	Amount	YoY	Amount	YoY
Eastern Japan	9,065	0.6	9,250	2.0
Central Japan	1,795	2.2	1,850	3.0
Western Japan	6,069	0.0	6,270	3.3
Overseas	214	16.4	230	7.1
Total	17,144	0.7	17,600	2.7

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

c) Net sales forecasts by product

The net sales forecasts by product are ¥1,350mn for high-end products (up 6.3% YoY), ¥9,150mn for high value-added products (up 4.5%), ¥6,260mn for value-added products (up 0.1%), and ¥840mn for mass-produced products (down 2.4%).

In high-end products, conditions are severe for the DC brand, but the Company's luxury brands, including Bright Days', 4D+ and Beads Berry, are performing strongly among small-lot users in particular, thus the forecast for high-end products as a whole is for sales to increase. The high value-added products, such as PRO-FUNCTION advanced-performance products have been well- received by the market and their sales are trending favorably, and the Company plans to achieve even higher sales by continuing to promote its strategy of higher quality and value-added products. The forecast is for sales of mass-produced products to decline, but the plan is to transfer their customers to value-added products, including to the products of other companies.

Net sales forecasts by product

(¥mn, %)

	FY8/18		FY8/19 forecast	
	Amount	YoY	Amount	YoY
High-end products	1,269	6.5	1,350	6.3
High value-added products	8,759	1.7	9,150	4.5
Value-added products	6,255	-1.4	6,260	0.1
Mass-produced products	860	-1.0	840	-2.4
Total	17,144	0.7	17,600	2.7

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

(2) Reorganization and streamlining of domestic plants

To strengthen the production structure going forward, the Company merged two aging plants as a new plant adjacent to its logistics center. This move is designed to improve operation efficiency and facilitate quick response. The project has completed at the end of July 2018 and the depreciation cost expected to be recognized from FY8/19.

Medium- to long-term growth strategy

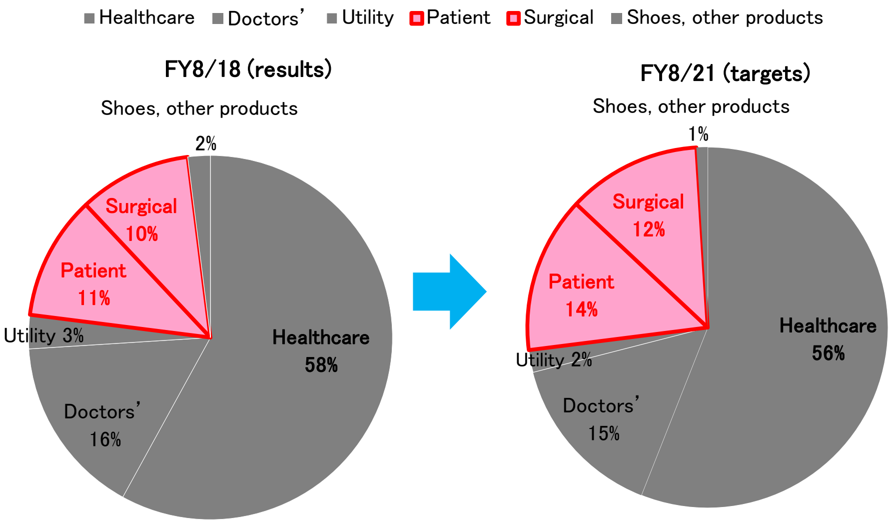
Mid-term Management Plan target aims for operating profit of ¥5,600mn in FY8/21

1. Mid-term Management Plan

The Company announced targets for FY8/21 of net sales of ¥18,600mn and operating profit of ¥5,600mn in its Mid-term Management Plan based on FY8/18 results.

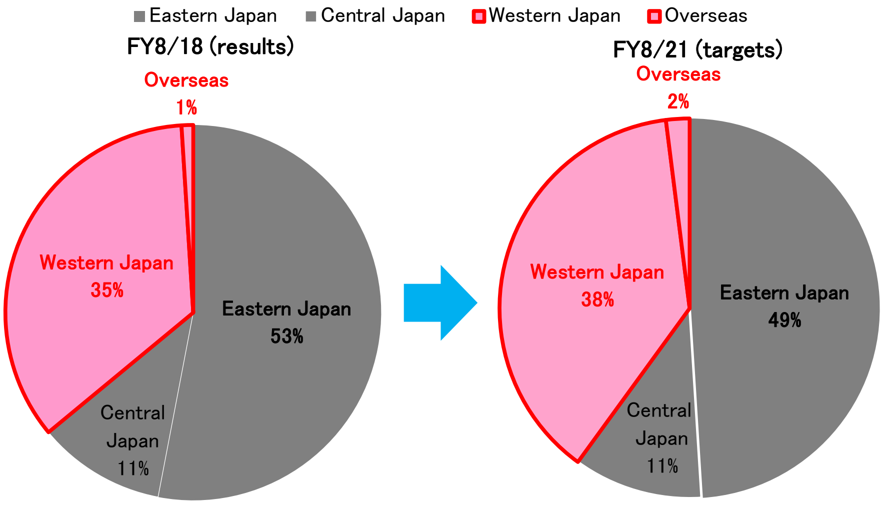
For percentages of total net sales by item, the forecasts are 56% from healthcare (58% in FY8/18), 15% from doctors' wear (16%), 2% from utility wear (3%), 14% from patient wear (11%), 12% from surgical wear (10%), and 1% from shoes and other products (2%). The forecast percentages of total net sales by region are 49% from eastern Japan (53%), 11% from central Japan (11%), 38% from western Japan (35%), and 2% from overseas (1%). The forecast percentages of total net sales by product are 9% from high-end products (7%), 54% from high value-added products (51%), 34% from value-added products (37%), and 3% from mass-produced products (5%).

Targeted net sales percentage by item



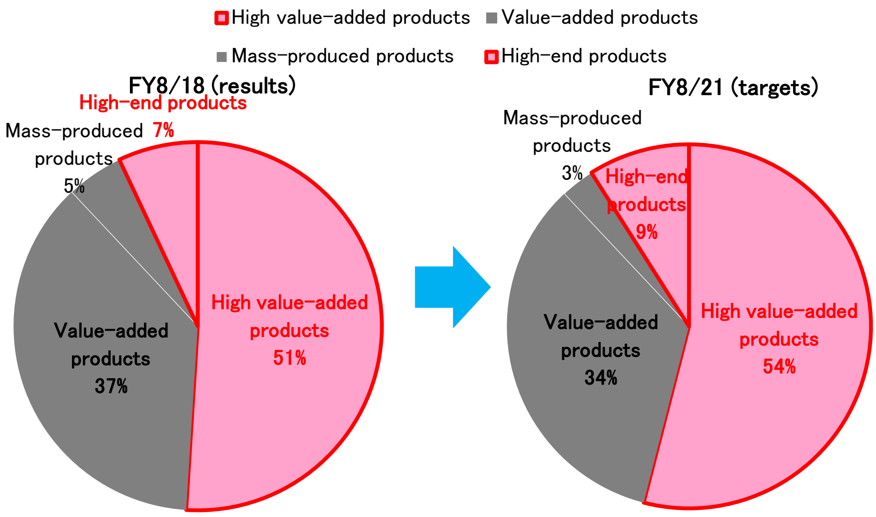
Source: Prepared by FISCO from the Company's results briefing materials

Targeted net sales percentages by region



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

Targeted net sales percentages by product



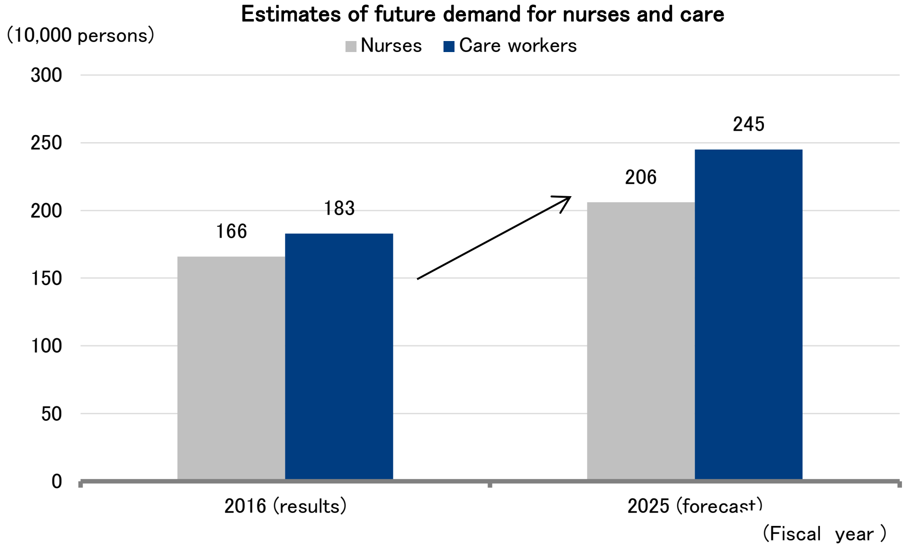
Source: Prepared by FISCO from the Company's results briefing materials

Actively developing advanced-function products and high value-added products

2. Future business strategies: The supporting tailwind will continue for the time being

The operating environment surrounding the Company should be favorable for some time. According to data released by the Ministry of Health, Labour and Welfare, the number of nurses in Japan is projected to increase from 1.66 million in 2016 to as many as 2.06 million in 2025. Moreover, the number of care workers is forecast to increase from 1.83 million in 2016 to 2.45 million in 2025. In this operating environment, the Company plans to achieve its medium-term growth by implementing the following strategies.

Estimates of future demand for nurses and care



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

(1) Marketing strategy to boost sales

a) Aim to increase share by further uncovering demand in the core markets, including the current mainstay markets for nurses and care workers.

b) In addition to the existing mainstay healthcare wear products, further expand the peripheral markets, including patient wear and surgical wear.

c) Actively open up overseas markets (particularly Taiwan).

(2) Production strategy to ensure a steady supply

a) In the context of the tightening of the domestic labor market, further strengthen the production system through the relocation and new establishment of domestic sewing plants, and also further improve the Quick Response capability and the ability to respond to small-lot, multiple-product production runs.

b) Strengthen collaborations with materials manufacturers and trading companies, and improve new product development capabilities.

(3) Strategy to stabilize profitability

a) Further promote the shift from domestic production to overseas production.

b) Develop new oversea materials applying special tax measures for EPA and FTA.

c) Secure business profitability by focusing on increasing sales of the high value-added products

Shareholder return policy

Pledges a dividend payout ratio of above 50% (non-consolidated basis) and while the forecast is for an annual dividend of ¥60, this may increase depending on the level of profits

The Company's shareholders' equity ratio reached 89.9% at the end of FY8/18, and it is financially stable. Additionally, considering the Company's business conditions, it seems highly unlikely that its profits will rapidly deteriorate, so continued stable earnings are expected. As a result, if its distribution of earnings outside the Company (particularly dividend payments) is low, profits will accumulate in shareholders' equity each year, and return on equity (ROE) will decline; which is to say, capital efficiency will decline. But in addition to paying dividends commensurate with the growth in profits, the Company actively and comprehensively returns profits to shareholders, including through share buybacks, and as a result has maintained a high ROE (9.8% in FY8/18).

The Company will thus maintain a stable financial position while pursuing solid shareholder returns. In FY8/15, it supplemented the regular dividend of ¥50 per share with an additional ¥50 per share to commemorate its centennial. This raised the total annual dividend to ¥100 per share, for a non-consolidated payout ratio of 107.5%. It also spent ¥1,500mn in repurchasing 1 million shares during the fiscal year, raising the total return ratio (non-consolidated basis) to 153.8%. In FY8/16, it paid an annual dividend of ¥50 for a dividend payout ratio of 52.5% on a non-consolidated basis.

The Company has pledged a dividend payout ratio of above 50% on a non-consolidated basis. InFY8/17, it increased the annual dividend from ¥50 to ¥60, and is planning for an annual dividend of ¥60 for FY8/18. The Company is also forecasting an annual dividend of ¥60 for FY8/19, which is currently underway. It may further increase the dividend if profits exceed their forecasts.

Trends in the dividend payout ratio and the total return ratio

	Total dividend amount (¥mn)	Share buybacks (¥mn)	Dividend payout ratio* (%)	Total return ratio* (%)
FY8/01	475	0	27.4	27.4
FY8/02	475	0	29.3	29.3
FY8/03	530	1,697	29.7	124.6
FY8/04	744	0	36.5	36.5
FY8/05	1,117	0	56.9	56.9
FY8/06	1,117	0	53.4	53.4
FY8/07	1,117	0	53.1	53.1
FY8/08	1,083	1,077	56.6	111.2
FY8/09	1,040	1,220	57.3	122.2
FY8/10	1,127	0	51.4	51.4
FY8/11	1,205	226	52.0	61.7
FY8/12	1,205	0	55.1	55.1
FY8/13	1,541	229	51.3	58.7
FY8/14	1,712	0	54.4	54.4
FY8/15	3,324	1,500	107.5	153.8
FY8/16	1,662	0	52.5	52.5
FY8/17	1,994	0	55.2	55.2
FY8/18	1,994	0	55.2	55.2

* On a non-consolidated basis
Source: prepared by FISCO from the Company's results briefing materials. Forecasts are as of FY8/18.

FISCO

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.

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

FISCO Ltd.