COMPANY RESEARCH AND ANALYSIS REPORT

Prospect Co., Ltd.

3528

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Index

Summary

A conglomerate that conducts a wide range of businesses with a focus on those related to real estate, including construction, investment advisory, and renewable energy

The origins of Prospect Co., Ltd. <3528> (hereafter, also "the Company") are found in Inami Kigyo Co., Ltd., which conducted a textile business. But in 1994, the Company withdrew from the textile business and changed its main business to a real estate business (primarily sales of condominiums). After that, the Company was temporarily a member of the DAIKYO <8840> Group, which is a major condominium developer. But it left the Group and started independent management in 2007. Mr. Curtis Freeze*1, the owner and president of the former Prospect Co., Ltd., which had invested in the Company as a fund, was appointed as the representative director and president in 2010. Since then, the Company has used M&A to expand its business to incorporate a public works construction business*2 and custom-made homes business, and currently it is engaged in a wide range of businesses, including a real estate development business (condominium sales, land and buildings), an asset management business, and a renewable energy business, including solar power generation.

*1 Mr. Curtis Freeze resigned from his post of representative director on December 13, 2018 to take responsibility for the confusion caused by the delay in submitting the Company's earnings report for the second quarter (the first half) of the fiscal year ending March 31, 2019. Furthermore, he resigned from his post of director on June 27, 2019, in conjunction with the Company's transition to a company with an audit and supervisory committee from FY3/20.

*2 The construction business has not been included in the segments since FY3/20, because all the shares of a subsidiary were sold in March 2019. Also, due to the resolution to liquidate a subsidiary in May 2019, the results of the asset management business up to May 2019 will be reflected in the FY3/20 consolidated results, but not in subsequent consolidated results. Both segments will be completely abolished by FY3/21.

1. FY3/20 1H consolidated results

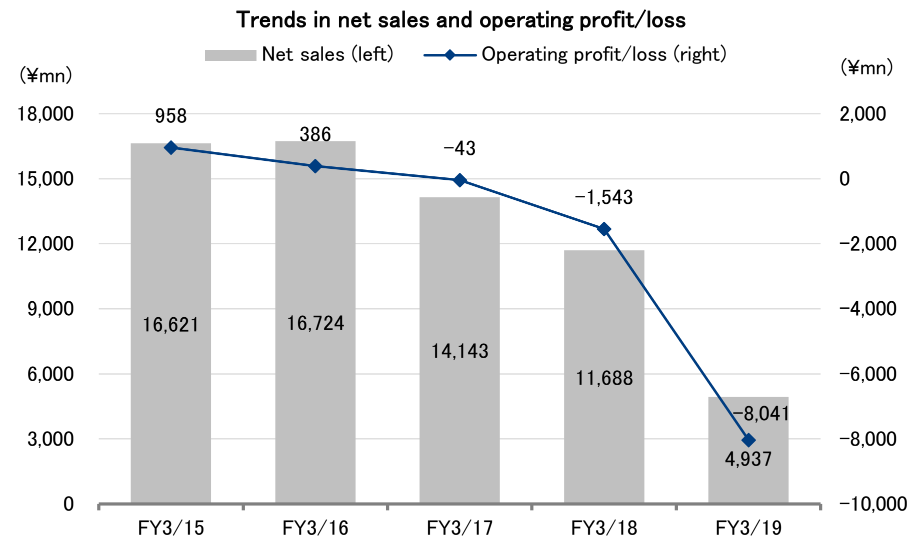
In the FY3/20 1H consolidated results, net sales were ¥1,833mn (down 45.8% year-on-year (YoY), the operating loss was ¥1,383mn (compared to a loss of ¥1,907mn in FY3/19 1H), the ordinary loss was ¥477mn (a loss of ¥1,483mn), and the net loss attributable to owners of the parent was ¥536mn (a loss of ¥1,569mn). The most significant reason for the operating loss was the recording of a large valuation loss by The Prospect Japan Fund Limited (hereafter "TPJF," which on May 15, 2019, the Company passed a resolution to dissolve and liquidate), which was made a subsidiary in July 2017, due to decreases in the market values of the Fund's holdings, which led to negative net sales and an operating loss in the consolidated results. But apart from this, results trended steadily and basically as forecast in each business segment. Also, from the progress made in collecting loans, a reversal of the allowance for doubtful accounts of ¥496mn was recorded in non-operating revenue, which meant that the ordinary loss was smaller than the operating loss. The majority of the losses were ultimately from the valuation loss, not from losses associated with an outflow of cash, so the impact on cash on hand was minimal.

2. FY3/20 forecast

The Company noted that it is engaged in the biomass related business in Russia, and also that its Asset Management and Overseas Real Estate Development Businesses are important segments that tend to be significantly affected by changes in economic conditions and the market environment, both domestically and abroad, and that it is extremely difficult to properly forecast ordinary business results. Based on this, the Company has adopted a policy of not disclosing results forecasts. Accordingly, the Company has not disclosed consolidated results forecasts for FY3/20, but it plans to resume a dividend in FY3/20. Under this plan, the Company will establish mandatory targets for the payment of an annual dividend of ¥1 per share, and conducted measures to improve results as well as transferring from the capital surplus to retained earnings, along with other moves, in order to pay this dividend.

Key Points

- A conglomerate that conducts a wide range of businesses with a focus on those related to real estate, including construction, investment advisory, and renewable energy
- It is actively conducting M&A while developing the renewable energy-related business as the growth driver



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

Company profile

Although it was originally a textile company, today it has become a conglomerate conducting a wide range of businesses, mainly real estate-related

The Company has a long history and its predecessor, Inami Kigyo Co. Ltd., was founded in Toyama Prefecture in 1937. It subsequently changed its corporate name to Carolina Co., Ltd., in 1961, and was listed on the Tokyo Stock Exchange Second Section in 1962. Then on entering the 1990s, it withdrew from the textile business and shifted to its mainstay businesses of condominium sales, and at the same time it joined the DAIKYO Group, which is a major condominium developer.

After that, in 2007 it left the DAIKYO Group and started independent management. In 2010, Mr. Curtis Freeze, who was the owner and president of the former Prospect, which had invested in the Company as a fund, was appointed as the representative director, president and fund manager. In 2013, it made a wholly owned subsidiary of former Prospect through an exchange of shares. In 2014, it merged with this former company through an absorption merger, and at the same time, it changed its corporate name to the current name of Prospect Co., Ltd. During this period, it diversified its business through conducting M&As to make consolidated subsidiaries of Sasaki House Co., Ltd., and Kidoh Construction Co., Ltd., and it then launched a solar business in 2015. It also made a subsidiary of TPJF from an exchange of shares, in July 2017.

* TPJF was dissolved and liquidated on July 27, 2019, and all of the shares in Kidoh Construction were sold in March 2019.

History

Year	Major event
1937	Inami Kigyo Co. Ltd., was established in Toyama Prefecture
1961	Changed corporate name to Carolina Co., Ltd.
1962	Listed on the Second Section of Tokyo Stock Exchange
1990	Changed how the name was written in Japanese
1991	Entered an alliance with the DAIKYO <8840> Group
1993	Began sales of the Morris condominium series (Series No.1 Morris Kawasaki)
1994	Withdrew from the textiles business
1994	Moved head office from Toyama Prefecture to Shibuya Ward, Tokyo
2000	Moved head office to its current location (1-30-8 Sendagaya, Shibuya Ward, Tokyo)
2001	Changed corporate name to Gro-Bels Co., Ltd.
2007	Left the DAIKYO Group and began independent management
2010	Mr. Curtis Freeze was appointed representative director and president
2012	Acquired all the shares and made a consolidated subsidiary of Sasaki House Co., Ltd.
2013	Acquired all the shares and made a consolidated subsidiary of (former) Prospect Co., Ltd.
2013	Entered into the overseas real estate-related business
2014	Acquired all the shares and made a consolidated subsidiary of Kidoh Construction Co., Ltd.
2014	Conducted an absorption merger with a subsidiary, former Prospect, and changed its corporate name to Prospect Co., Ltd.
2015	Launched the solar power generation business (the first project: Asago Tachiwaki Solar Power Plant)
2017	Acquired all the shares and made a subsidiary of The Prospect Japan Fund Ltd. though an exchange of shares
2018	Mr. Masato Tabata was appointed representative director and president
2019	Sold all shares of Kidoh Construction Co., Ltd.

Source: Prepared by FISCO from the Company's website

Business overview

The Company is developing a wide range of businesses centered on real estate and including housing, construction, and renewable energy-related businesses

1. Main business activities

The Company discloses information on the following business segments; real estate development business, asset management business, public works construction business, renewable energy business, and others. The real estate development business is further broken down into condominium sales, land and buildings, and custom-made homes.

(1) Condominium sales (% of total net sales in FY3/19: 77.5%)

The same as general condominium developers, in this business the Company purchases land and constructs and sells condominium units. They are sold under the GRO-BEL brand, which is derived from the former company name. Net sales and segment profit fluctuate depending on the status of site purchases and other factors. It sold (delivered) 96 units in FY3/19.

(2) Land and buildings

This business includes the sales of residential land, detached housing, and buildings, but it mainly involves the sales of land and buildings that accompany sales of condominiums. For the land and buildings (including unfinished buildings) that are intended to be sold for condominiums, it mainly sells those properties in which it expects to achieve profits (profitability) above the target, and it does not purchase and sell land and buildings for which a sale (profits) was expected from the beginning. Consequently, net sales for FY3/19 have not been recorded.

(3) Custom-made homes (% of total net sales in FY3/19: 42.5%)

The main business area is Yamagata Prefecture, primarily for the construction outsourcing work and renovation work of detached housing carried out by Sasaki House, which it made a subsidiary through an M&A. Sasaki House has a history of more than 50 years in the residential housing business, but because it did not have a successor to take over its business, it sold all its shares to the Company and became its subsidiary. In FY3/19, it delivered 58 buildings.

(4) Asset management business (% of total net sales in FY3/19: -147.3%)

This is an investment advisory business that conducts the fund management (mainly for Japanese equities) that was previously conducted by the former Prospect. However, in July 2017, the Company acquired 100% of the listed shares in TPJF, which was one of the management funds, in a share-for-share transaction, so currently the investor in TPJF is the Company itself. Net sales and profit fluctuate depending on the end-of-period valuations of stocks held, and in some cases negative values end up being posted. In FY3/19, net sales of negative ¥7,273mn were recorded. In May 2019, the Company passed a resolution to dissolve and liquidate TPJF, and the shares it held have all been recorded in investment securities. Therefore, this business' results up to May 2019 will be reflected in the FY3/20 consolidated results, but there will be absolutely no changes after that, and this segment will be abolished in FY3/21.

(5) Public works construction business (% of total net sales in FY3/19: 126.1%)

The business includes the microtunneling projects and the pre-stressed concrete (PC) construction works carried out by subsidiary Kidoh Construction. Because the Company sold all of its shares of Kidoh Construction in March 2019, the public works construction business will be abolished as a segment from FY3/20.

(6) Renewable energy business (% of total net sales in FY3/19: 11.5%)
The business model entails developing solar power generation projects, and selling the power generated to electric power companies. On the points of generating profits (cash flows) from acquiring rights and conducting investment, or from selling equipment, it can be said that the approach in this business is the same as for a rental building business. As of the end of September 2019, it had nine operational plants (the ratio of power generated according to the Company's share, 29.1MW), and currently three plants are under development.

(7) Others (% of total net sales in FY3/19: 0.9%)
This business mainly entails leasing the condominiums owned by the Company.

2. Business features

(1) The "investment" approach
As mentioned previously, at first glance the Company seems to be developing its businesses in different fields. But in fact, fundamentally they are all based on the same approach, of acquiring (purchasing) land, rights, projects, and so on, and then investing (capital) in them, and collecting the profits at a later date. This point can be said to be a feature of the Company's business development.

(2) Business diversification (the portfolio approach)
On the other hand, the Company conducts various businesses, such as for custom-made homes and construction, via the subsidiaries it has acquired through M&A. The reason why it conducted these M&A is that in the custom-made homes and public works construction businesses, it can recover its investment in a relatively short period of time compared to in its other businesses such as condominium sales, and they can be said to be suitable for diversifying business risk and the time spans for recouping its financial investment. In other words, currently the Company conducts its various businesses based on a portfolio approach, rather than simply diversifying on a line extending from its existing businesses or into related fields. This can also be said to be one of its features.

Results trends

Posted an operating loss in FY3/20 1H due to the recording of a valuation loss at a subsidiary, but the impact of this had ended by May and the outflow of cash was minimal

● **FY3/20 1H results**

(1) Profit and loss conditions
The main reason for the operating loss was the recording of a valuation loss (comparison of the end of December 2018, to July 27, 2019) due to the decreases in the market values of the shares held by TPJF, which was made a subsidiary in July 2017, and this led to the recording of negative net sales, and moreover an operating loss, in the consolidated results. Therefore, the majority of the losses were ultimately from the valuation loss (non-cash), not from losses associated with an outflow of cash, so the impact on cash on hand was minimal.

Also, in every business segment other than the asset management business, while they did not necessarily record profits, their results trended basically as forecast in FY3/20 1H. Conversely, long-term loans receivable (¥554mn), which in previous years had been classified into loans with the possibility of default and recorded as an allowance for doubtful accounts, were completely collected, and alongside this, a reversal of the allowance for doubtful accounts of ¥496mn was recorded in non-operating revenue, which kept down the ordinary loss to ¥477mn.

FY3/20 1H results

(¥mn, %)

	FY3/19 1H		FY3/20 1H		
	Amount	Ratio to sales	Amount	Ratio to sales	YoY
Net sales	3,380	100.0	1,833	100.0	-45.8
Gross profit	-609	-	-314	-	-
SG&A expenses	1,297	38.4	1,069	58.3	-17.6
Operating loss	-1,907	-	-1,383	-	-
Ordinary loss	-1,483	-	-477	-	-
Net profit (loss) attributable to owners of the parent	-1,569	-	-536	-	-

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

(2) Conditions by segment

FY3/20 results by segment

(¥mn, %)

	FY3/19 1H		FY3/20 1H			
	Amount	Ratio to sales	Amount	Ratio to sales	Change	% change
Net sales	3,380	100.0	1,833	100.0	-1,547	-45.8
Condominium sales	1,472	43.6	1,643	87.3	171	11.6
Land and buildings	-	-	-	-	-	-
Custom-made homes	620	18.3	713	37.9	93	15.1
Asset management business	-1,233	-36.5	-1,003	-53.3	230	-
Public works construction business	2,302	68.1	-	-	-2,302	-
Renewable energy business	321	9.5	470	25.0	149	46.6
Others	19	0.6	7	0.4	-12	-59.1
Operating loss	-1,907	-	-1,383	-	524	-
Condominium sales	53	-	66	-	13	25.9
Land and buildings	-	-	-	-	-	-
Custom-made homes	-28	-	-39	-	-11	-
Asset management business	-1,410	-	-1,122	-	288	-
Public works construction business	-45	-	-	-	45	-
Renewable energy business	77	-	144	-	67	87.4
Others	3	-	2	-	-1	-9.6
(Company-wide expenses, etc.)	-557	-	-434	-	123	-

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

a) Condominium sales

In FY3/20 1H, the Company executed new contracts for 26 units (62 units in FY3/19 1H) with a value of ¥1,190mn (¥2,527mn in FY3/19 1H), and delivered 34 units (37 units in FY3/19 1H). As a result, net sales were ¥1,643mn (up 11.6% YoY) and segment profit was ¥66mn (up 25.9% YoY).

b) Land and buildings

No contract results were recorded in FY3/20 1H.

c) Custom-made homes

In this business, the Company performs construction of detached homes, as well as related renovation work and other activities, in its main business area of Yamagata Prefecture. In FY3/20 1H, new contracts were made for 34 buildings worth ¥852mn (compared to 36 buildings worth ¥976mn in FY3/19 1H), and 20 buildings were delivered (compared to 13 in FY3/19 1H). The Company recorded net sales of ¥713mn (up 15.1% YoY) and segment loss of ¥39mn (a loss of ¥28mn in FY3/19 1H).

d) Asset management business

TPJF held shares as a fund business, but due to the resolution to dissolve and liquidate it on May 15, 2019, all the shares it held were transferred to investment securities. Therefore, their valuations on this transfer date were recorded in the FY3/20 1H results. As a result, net sales were negative ¥1,003mn and the segment loss was ¥1,123mn (compared to net sales of negative ¥1,233mn and a segment loss of ¥1,386mn in FY3/19 1H). Due to the resolution to dissolve the Fund, results in the future will not fluctuate greatly and the current values will be recorded as the full fiscal year results.

e) Public works construction business

All of the shares of Kidoh Construction, which conducts this business, were sold in March 2019. Therefore, this business segment was abolished, and it recorded no net sales or segment loss in FY3/20 1H.

f) Renewable energy business

In this business, in which the Company sells the power generated by the solar power generation facilities it manages to electric power companies, it recorded net sales of ¥470mn and segment profit of ¥144mn.

At the end of September 2019, the Company had nine projects in operation (Asago Project, Katori Project, Ushiku Project, Kumamoto Yatsushiro Project, Rikuzentakata Project, Sendai Project, Utsunomiya Tokujiro Project, Higashi Hiroshima Project, and Narita Kanzaki Project). The Company's share of power generation at these projects is 29.1 MW. It is also scheduled to acquire power from another three projects (total power generation,13.9 MW) that are being constructed up to July 2021.

g) Others

This business mainly involves the rental to general tenants of condominium and other properties owned by the Company. The Company recorded net sales of ¥7mn (¥19mn in FY3/19 1H) and segment profit of ¥2mn (¥3mn in FY3/19 1H).

(3) Financial position

Although a significant loss has been booked and the financial position is slightly worse off, it is not at a level of concern. At the end of FY3/20 1H, total assets were ¥32,784 million, up ¥1,029mn from the end of the previous fiscal year. Current assets were ¥9,089mn, down ¥8,590mn. This was mainly due to declines of both ¥1,999mn in cash and deposits and ¥7,740mn in securities. Meanwhile, non-current assets were ¥23,694mn, an increase of ¥9,620mn. The main components of this change were increases in property, plant and equipment of ¥2,303mn and in investments and other assets of ¥7,324mn (mainly from the transfer of the securities held for TPJF).

Total liabilities were ¥17,231mn, up ¥2,215mn from the end of the previous fiscal year. The main factors included increases in accounts payable for construction contracts of ¥25mn, short-term loans payable, etc. of ¥1,603mn and long-term loans payable of ¥262mn. Net assets were ¥15,552mn, down ¥1,185mn. This decrease was mainly due to the transfer of capital surplus and retained earnings and the recording of a net loss attributable to owners of the parent.

Balance sheets

(¥mn)

	End of FY3/19	End of FY3/20 1H	Change
Cash and deposits	5,049	3,050	-1,999
Notes and accounts receivable - trade	130	165	35
Securities	7,800	59	-7,740
Real estate for sale	1,263	1,775	511
Real estate for sale in process	2,409	2,769	360
Real estate for development	442	40	-401
Current assets	17,680	9,089	-8,590
Property, plant and equipment	9,876	12,179	2,303
Intangible assets	186	178	-7
Investments and other assets	4,011	11,335	7,324
Securities	230	6,411	6,180
Investments in capital	1,368	1,765	397
Long-term loans receivable	2,365	2,554	189
Non-current assets	14,074	23,694	9,620
Assets	31,754	32,784	1,029
Accounts payable for construction contracts	295	321	25
Short-term loans payable, etc.	2,169	3,773	1,603
Current liabilities	3,997	5,187	1,189
Long-term loans payable, etc.	10,414	10,676	262
Non-current liabilities	11,019	12,044	1,025
Liabilities	15,016	17,231	2,215
Net assets	16,738	15,552	-1,185

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

(4) Cash flow conditions

In FY3/20 1H, cash flow used in operating activities was ¥1,033mn. The main expenditures included the recording of ¥418mn as a loss before income taxes, a decrease in the allowance for doubtful accounts of ¥496mn, investment in silent partnerships of ¥110mn, investments in capital of ¥100mn, and an increase in inventories of ¥6.87mn. Conversely, the main income items included depreciation of ¥194mn and a decrease in investment securities for sale of ¥1,011mn.

Cash flow used in investing activities was ¥2,823mn. The main expenditures included ¥2,314mn to purchase property, plant and equipment and loan advances of ¥750mn, while the main income items included collection of loans receivable of ¥555mn.

Cash flow from financing activities was ¥1,913mn, with the main income items including an increase in long-term borrowing of ¥1,898mn.

As a result, cash and cash equivalents during the period decreased ¥1,999mn, and cash and cash equivalents at the end of FY3/20 1H were ¥3,050mn.

Cash flow statements

(¥mn)

	FY3/19 1H	FY3/20 1H
Cash flows from operating activities	-3,249	-1,033
Profit (loss) before income taxes	-1,483	-418
Depreciation	166	194
Increase (decrease) in allowance for doubtful accounts	34	-496
Increase (decrease) in provision for bonuses for directors	-725	-10
Loss (profit) on investment in silent partnership	14	-110
Loss (gain) on investments in capital	-85	-100
Decrease (increase) in trade receivables	137	-68
Decrease (increase) in inventories	-212	-687
Increase (decrease) in trade payables	-329	13
Decrease (increase) in investment securities for sale	-1,119	1,011
Cash flows from investing activities	-2,877	-2,823
Expenditure for the purchase of property, plant and equipment	-2,059	-2,314
Loan advances	-895	-750
Collection of loans receivable	7	555
Cash flows from financing activities	1,105	1,913
Net increase (decrease) in short-term borrowings	2,304	1,898
Proceeds from issuance of shares resulting from exercise of share acquisition rights	546	-
Dividends paid	-1,719	-1
Net increase (decrease) in cash and cash equivalents	-5,072	-1,999
Cash and cash equivalents at end of period	5,579	3,050

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

Outlook

Is aiming to be profitable for FY3/20 full year, even while results are unclear

1. FY3/20 forecast

(1) Results outlook

The Company has not announced forecasts for the FY3/20 full fiscal year results, because it conducts a finance-related business (asset management) that tends to be greatly affected by factors such as economic conditions and market conditions in Japan and overseas. The main reason it recorded a major operating loss in FY3/19 and FY3/20 1H was the recording of a valuation loss on the shares held (all Japanese shares) by a subsidiary, TPJF. But it has already passed a resolution to dissolve and liquidate TPJF, so in the future, results will not change due to this valuation loss. However, the impact of the negative net sales and the loss recorded in the FY3/20 1H will remain for the full fiscal year results. Therefore, the question for the FY3/20 full fiscal year results is how far can the profits in the businesses other than the asset management business cover for the loss incurred in the 1H. The Company has stated that it intends to “somehow become profitable and pay an annual dividend (scheduled as ¥1).”

When assessing the Company's business results, as stated earlier, the Company's businesses are widely dispersed and there are some aspects where earnings can be recorded in a short time and other businesses where retrieval takes time. Moreover, retrievals are not always booked as net sales, sometimes being recorded as non-operating profit, or as an extraordinary gain, so the financial statements should probably be evaluated looking at comprehensive profits, including extraordinary profit or loss, or cash flows and not just on operating profit and loss or ordinary profit and loss.

(2) Dividend forecast

As discussed above, the Company put off paying a fiscal year-end dividend because of the large loss posted in FY3/19, thereby resulting in no dividend. However, the Company has stated that it wants to pay a dividend of at least ¥1 in FY3/20, and the Company plans to pay this dividend by conducting transfer of capital (from capital surplus to retained earnings).

2. New business development:

Continuing on from its solar business within Japan, the Company has announced that it is entering into the biomass fuel (wood pellets) manufacturing business in Russia as its renewable energy business. It has launched a joint-venture company with Russia's RFP Group (Russia forest products group). Using as the raw material the sawdust and other such materials created within the wood processing plants owned by the RFP Group, it will construct a pellet manufacturing plant at a site adjacent to these wood processing plants, and it intends to export the wood pellets to biomass power generation plants in Japan. Customers are expected to mainly be biomass power generation plants that use feed-in-tariffs (FIT).

For the progress made up to the present time, in May 2018 the Company started site preparation work for a pellet manufacturing plant in Amursk in the Khabarovsk region of Russia. The plant was scheduled to begin operations in the autumn of 2019, but due to the impact of bad weather and other factors, its scheduled completion has been pushed back to February 2020.

The medium- to long-term growth strategy

Actively conducting M&A while developing the solar business as the growth driver

1. Growth driver among the existing businesses

As previously explained, the Company develops various businesses, and while businesses such as condominium and custom-made home sales stably generate cash flow, these businesses are not expected to achieve dramatic growth within Japan, and rather, they are cyclical businesses that are affected by economic fluctuations.

Conversely, the solar business using FIT and the biomass power generation business can be expected to generate cash flow over the long term. It is anticipated that the biomass power generation business will grow to replace the solar business and become a major growth field in Japan in the future. Therefore, it would seem that by supplying the pellets that are the fuel used in this field, the Company can be expected to achieve growth for this business the same as or greater than that of its existing businesses.

2. M&A strategy

The Company's M&A strategy is one more aspect that is supporting its growth. Previously, it has conducted M&A in the custom-made homes and construction fields. Going forward also, it plans to actively conduct them when it finds a candidate that satisfies its investment standards. It intends to raise the funds for M&A using methods that it deems to be optimal in each case, including from its own funds, borrowing, share exchanges, and issuing new shares. On the other hand, if the Company judges that there is no prospect for a business to contribute to profit growth, its policy is to sell it without hesitation and to respond quickly as the situation demands, just as it did recently with the construction business.

Shareholder return policy

Dividend expected to resume in FY3/20

The Company pays dividends in order to return profits to shareholders, but it has not formulated a specific basic policy for it. In FY3/18, the Company paid an annual dividend of ¥4 per share, but it did not pay a dividend in FY3/19. However, the Company plans to resume dividend payments in FY3/20, albeit a small annual dividend of ¥1 per share.

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