Walden Research Japan

URL: www.walden.co.jp
Written by Yoshiyuki Muroya
E-mail: yoshiyuki_muroya@walden.co.jp
Phone：+81 3 3553 3769

KAWANISHI HOLDINGS (2689)

Consolidated Fiscal Year (Million Yen)		Sales	Operating Profit	Recurring Profit	Profit Attributable to Owners of Parent	EPS (Yen)	DPS (Yen)	BPS (Yen)
FY06/2016		101,460	543	556	305	54.5	30.0	818.8
FY06/2017		105,778	1,044	1,112	690	123.1	30.0	942.8
FY06/2018CoE		106,377	1,100	1,109	714	127.3	30.0	-
FY06/2017	YoY	4.3%	92.2%	99.8%	125.9%	-	-	-
FY06/2018CoE	YoY	0.6%	5.3%	(0.3%)	3.4%	-	-	-
Consolidated Half Year (Million Yen)		**Sales**	**Operating Profit**	**Recurring Profit**	**Profit Attributable to Owners of Parent**	**EPS (Yen)**	**DPS (Yen)**	**BPS (Yen)**
Q1 to Q2 FY06/2017		53,184	571	590	377	-	-	-
Q3 to Q4 FY06/2017		52,593	473	522	313	-	-	-
Q1 to Q2 FY06/2018CoE		53,789	469	471	308	-	-	-
Q3 to Q4 FY06/2018CoE		52,588	631	638	406	-	-	-
Q1 to Q2 FY06/2018CoE	YoY	1.1%	(17.9%)	(20.1%)	(18.3%)	-	-	-
Q3 to Q4 FY06/2018CoE	YoY	(0.0%)	33.4%	22.2%	29.7%	-	-	-

Source: Company Data, WRJ Calculation

1.0 Executive Summary (25 September 2017)

Coping with Commoditization

KAWANISHI HOLDINGS, selling medical consumables and equipment to medical institutions represented by major base hospitals heavily involved with acute care, is planning to see long-term earnings growth by means of well coping with commoditization of merchandises to deal in. While the Company is to start up selling epoch-making new merchandises developed by venture company as the general sales agent, Imports and Sales to directly import merchandises to sell in Japan is expected to bring some add-on earnings starting in FY06/2020. The Company suggests that both of the operations are to see gross profit margin higher than existing trading of merchandises given involvement with distribution of merchandises deeper than the current levels. Meanwhile, the Company suffers from ongoing commoditization on existing merchandises to deal in, but the levels of gross profit margin have been maintaining together with successful implementation of rationalization measures. Over the past 5 years, the Company as a whole saw average gross profit margin of 10.30% (upper end of 10.47% to lower end of 9.99%), while the rationalization measures are to accelerate going forward. Midterm management plan (FY06/2018 to FY06/2020), having assumed all those factors, are calling for prospective sales of ¥114,000m, operating profit of ¥2,000m and operating profit margin of 1.75% in FY06/2020 or the last year of the plan, implying CAGR of 2.5% for sales and 24.2% for operating profit during the upcoming three-year period after FY06/2017, while operating profit margin to improve by 0.77% during the same period. As one of the rationalization measures, the Company is pulling out of unprofitable operations starting in FY06/2018, which is one of the reasons why prospective sales are not very inspiring. Still, this is one of the factors to drive prospective earnings growth going forward.

In FY06/2017, sales came in at ¥105,778m (up 4.3% YoY), operating profit ¥1,044m (up 92.2%) and operating profit margin 0.99% (up 0.45% points). By business segment, Medical Consumables and Equipment to sell medical consumables and equipment saw sales of ¥88,254m (up 4.1%), operating profit of ¥1,062m (up 85.4%) and operating profit margin of 1.20% (up 0.53% points), having accounted for 83.7% of sales as a whole for the Company and 83.4% of operating profit (before elimination). Thus, earnings as a whole for the Company hinge on this business segment. Roughly speaking, sales of consumables came in at ¥79,600m (up 2.9%) and sales of equipment ¥14,500m (up 9.9%), including internal sales or transfer of ¥5,500m among the business segments. On the consumables side, sales were rather adjusted due to one-off factor, while sales on the equipment side were buoyant with booking of sales for project exceptionally large-sized and carrying high gross profit margin. Given the latter as one of the factors, the Company saw gross profit margin of 10.30% (up 0.31% points). On top of this, increases of SG&A expenses were suppressed consequently, having resulted in surging operating profit.

FY06/2018 Company forecasts are going for prospective sales of ¥106,377m (up 0.6% YoY), operating profit of ¥1,100m (up 5.3%) and operating profit margin of 1.03% (up 0.05% points). Company forecasts assume sluggish sales for Medical Consumables and Equipment, being the reason why sluggish sales as a whole for the Company. Above-mentioned project on the equipment side in FY06/2017 is not to reappear, while another main issue comes from suspension of sales promotion activities by Ohta Medical Co. Ltd. or one of the business companies of the Company's group to have been running operations of selling consumables, etc. toward the end of FY06/2017. The latter cutbacks sales and gross profit as well as SG&A expenses with the Company. Given an implication that the impacts of cutting back SG&A expenses are most significant, it should be the case that the Company's rationalization measures are accelerating. However, while above-mentioned operations as the general sales agent will remain just having started in FY06/2018, while the Company suffers from expenses associated with frontloaded investment on the Imports & Sales side. As a result, short-term earnings with the Company are to only edge up.

IR representative: Managing Director, Nobuharu Murata (+81 86 236 1115 murata2@kawanishi-md.co.jp)

2.0 Company Profile

One of the largest of Integrated Medical Traders

Company Name	KAWANISHI HOLDINGS, INC. Website IR Information Share Price
Established	2 October 1967 (Inaugurated on 1 May 1921)
Listing	21 December 2000: Tokyo Stock Exchange 2nd section (Ticker: 2689)
Capital	¥ 607 m (As of the end of June 2017)
No. of Shares	6,250,000 shares, including 639,332 treasury shares (As of the end of June 2017)
Main Features	● Set up by mergers among three wholesale distributors of medical consumables and equipment based in Chugoku and Shikoku regions ● Expectations for new mergers preceded by Sansei Medical Materials Co., Ltd. ● In the pursuit of profitability in Imports and Sales, etc.
Business Segments	Ⅰ. Medical Consumables and Equipment Ⅱ. SPD Ⅲ. Care Supplies Ⅳ. Imports and Sales
Top Management	President COO: Yohei Maeshima
Shareholders	MASP Inc. 15.1%, Treasury shares 10.2%, ESOP 6.0 % (As of the end of June 2017)
Headquarters	Kita-ku, Okayama-city, Okayama-prefecture, JAPAN
No. of Employees	Consolidated: 1,179, Unconsolidated: 29 (As of the end of June 2017)

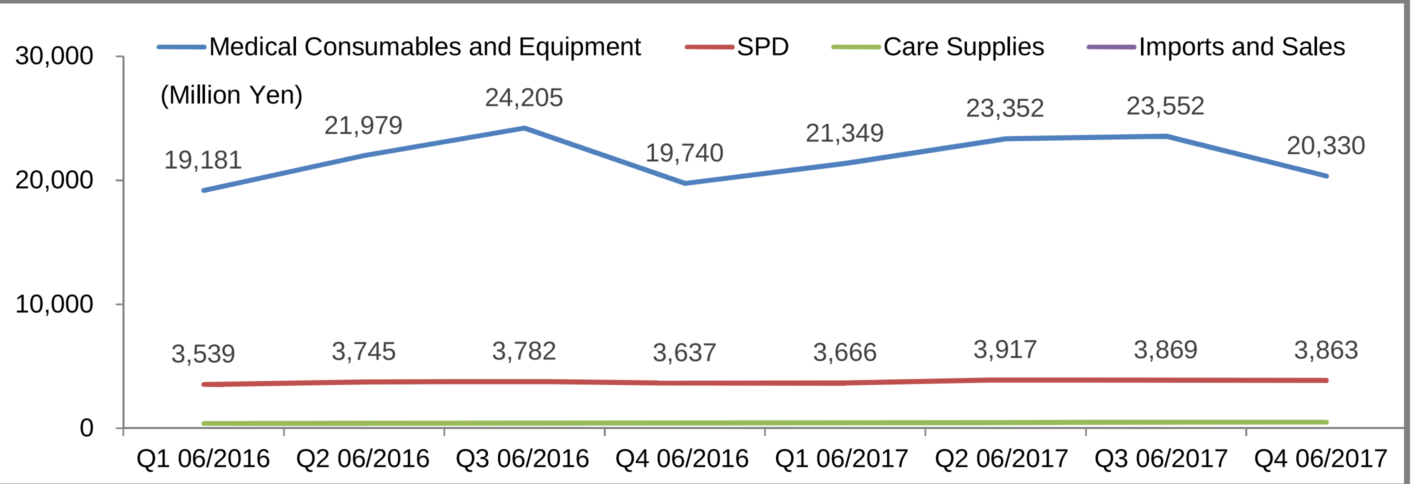
Source: Company Data

3.0 Recent Trading and Prospects

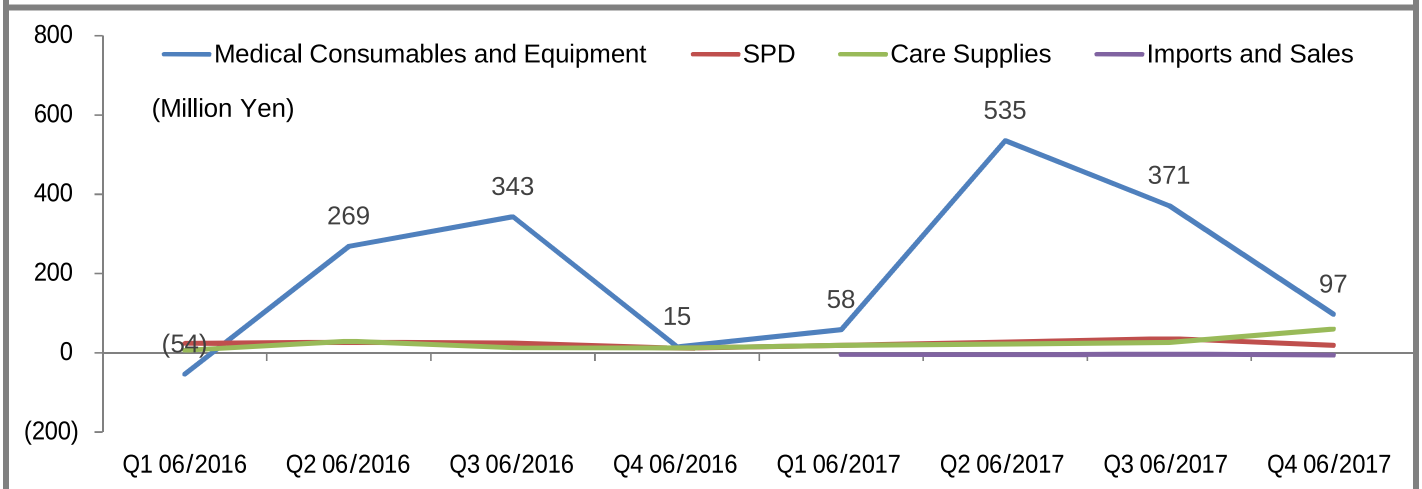
FY06/2017 Results

In FY06/2017, sales came in at ¥105,778m (up 4.3% YoY), operating profit ¥1,044m (up 92.2%), recurring profit ¥1,112m (up 99.8%) and profit attributable to owners of parent ¥690m (up 125.9%). While operating profit margin came in at 0.99% (up 0.45% points), changes of earnings across the board were basically in line with changes of operating profit.

Sales



Operating Profit/Loss



Source: Company Data, WRJ Calculation

In Medical Consumables and Equipment to drive operating profit as a whole for the Company, sales are apt to change on a quarterly basis, being influenced by trends of capital expenditures among customers and/or seasonal factor and thus operating profit even more. As far as consumables, having accounted for 85% of sales here, including those of diverse domains such as surgery-related, orthopedic, circulatory organ and ophthalmology, are concerned, the Company sees stability in sales short-term and long-term in that they are all steadily consumed in line with daily medical activities, e.g., surgeries, etc. However, on the equipment side, having accounted for the remaining 15% of sales here, sales are volatile short-term and even long-term. On top of this, gross profit margin depends projects to project. For example, the Company saw operating profit of no less than ¥535m in Q2 FY06/2017 for Medical Consumables and Equipment, which had a lot to with booking of sales on exceptional project with high gross profit margin, according to the Company.

Both consumables and equipment are sold to medical institutions represented by major base hospitals heavily involved with acute care and thus they have customers in common. However, demand for equipment, comprising MRI, cineangiography, CT, ultrasonic diagnostic equipment and operating room equipment such as artificial respirator, hinges on the trends of capital expenditures, driven by new construction, rebuilding and expansion of hospitals, implying demand here is driven by something totally different from that of consumables. In a long-term view, customers are apt to implement capital expenditures in line with rebuilding cycle of hospitals, etc., while short-term sales are apt to concentrate in Q3 and to adjust in Q4 to directly follow because of seasonal factor that Q3 (January to March) includes March in which the customers execute their own budgets. In FY06/2016, it appears that sales trends were in line with this existing pattern, having resulted in sales and operating profit in the same way for Medical Consumables and Equipment.

However, in FY06/2017, the Company saw booking of sales for exceptional project in Q2, which was to correspond to earthquake recovery in Tohoku, having resulted in short-term earnings trends not in line with existing pattern. In regards to this project, the Company was not only involved with operations to simply supply customer with equipment but also with provision of solutions across the board, including those of placement and installation for equipment to be supplied. Thus, gross profit margin was higher to this extent, according to the Company.

Meanwhile, it was inevitable that sales of consumables or the mainstay merchandises of Medical Consumables and Equipment failed to increase favorably, given one-off negative factor. Sales increased by no more than 2.9% versus by 5.0% in FY06/2015 and by 5.8% in FY06/2016. Said one-off factor took place on consumables associated with circulatory organ. Although the Company saw sales increasing by more than 20% in regards to catheter ablation (to cauterize myocardial tissue causing tachycardia that makes the heart pulse faster with high frequency), sales of this domain as a whole stagnated due to one-off decreases of cases stemming from transfer of doctor.

Income Statement (Cumulative, Quarterly)

Income Statement (Million Yen)	Cons.Act Q1 06/2016	Cons.Act Q1 to Q2 06/2016	Cons.Act Q1 to Q3 06/2016	Cons.Act Q1 to Q4 06/2016	Cons.Act Q1 06/2017	Cons.Act Q1 to Q2 06/2017	Cons.Act Q1 to Q3 06/2017	Cons.Act Q1 to Q4 06/2017	YoY Net Chg.
Sales	**23,103**	**49,238**	**77,649**	**101,460**	**25,459**	**53,184**	**81,105**	**105,778**	**+4,317**
Cost of Sales	20,743	44,222	69,907	91,325	22,953	47,727	72,832	94,879	+3,554
Gross Profit	2,360	5,016	7,742	10,135	2,506	5,456	8,273	10,898	+763
SG&A	2,433	4,821	7,207	9,592	2,464	4,885	7,313	9,854	+262
Operating Profit	**(72)**	**194**	**534**	**543**	**41**	**571**	**960**	**1,044**	**+500**
Non Operating Balance	2	(1)	1	13	11	19	66	68	+55
Recurring Profit	**(70)**	**193**	**535**	**556**	**52**	**590**	**1,026**	**1,112**	**+555**
Extraordinary Balance	9	14	19	14	5	14	17	1	(12)
Profit before Income Taxes	(60)	208	554	571	57	604	1,044	1,114	+543
Income Taxes	11	117	256	265	38	231	388	432	+166
NP Belonging to Non-Controlling SHs	-	-	-	-	(1)	(4)	(5)	(8)	(8)
Profit Attributable to Owners of Parent	**(72)**	**91**	**298**	**305**	**20**	**377**	**661**	**690**	**+384**
Sales YoY	+2.8%	+7.9%	+9.4%	+7.3%	+10.2%	+8.0%	+4.5%	+4.3%	-
Operating Profit YoY	-	(16.9%)	+9.9%	(18.7%)	-	+193.3%	+79.6%	+92.2%	-
Recurring Profit YoY	-	(16.1%)	+10.2%	(16.0%)	-	+205.2%	+91.6%	+99.8%	-
Profit Attributable to Owners of Parent YoY	-	(20.7%)	+13.7%	(24.6%)	-	+312.9%	+121.7%	+125.9%	-
Gross Profit Margin	10.22%	10.19%	9.97%	9.99%	9.84%	10.26%	10.20%	10.30%	+0.31%
(SG&A / Sales)	10.53%	9.79%	9.28%	9.45%	9.68%	9.19%	9.02%	9.32%	(0.14%)
Operating Profit Margin	-0.32%	0.40%	0.69%	0.54%	0.16%	1.07%	1.18%	0.99%	+0.45%
Recurring Profit Margin	-0.31%	0.39%	0.69%	0.55%	0.21%	1.11%	1.27%	1.05%	+0.50%
Profit Attributable to Owners of Parent Margin	-0.31%	0.19%	0.38%	0.30%	0.08%	0.71%	0.82%	0.65%	+0.35%
Total Income Taxes / Profit before Income Taxes	-	56.1%	46.2%	46.5%	67.0%	38.3%	37.2%	38.8%	(7.7%)

Income Statement (Million Yen)	Cons.Act Q1 06/2016	Cons.Act Q2 06/2016	Cons.Act Q3 06/2016	Cons.Act Q4 06/2016	Cons.Act Q1 06/2017	Cons.Act Q2 06/2017	Cons.Act Q3 06/2017	Cons.Act Q4 06/2017	YoY Net Chg.
Sales	**23,103**	**26,134**	**28,411**	**23,811**	**25,459**	**27,725**	**27,920**	**24,673**	**+862**
Cost of Sales	20,743	23,478	25,685	21,417	22,953	24,774	25,104	22,047	+629
Gross Profit	2,360	2,655	2,726	2,393	2,506	2,950	2,816	2,625	+232
SG&A	2,433	2,388	2,386	2,384	2,464	2,420	2,427	2,541	+157
Operating Profit	**(72)**	**267**	**339**	**8**	**41**	**530**	**388**	**84**	**+75**
Non Operating Balance	2	(3)	2	12	11	7	46	2	(9)
Recurring Profit	**(70)**	**264**	**342**	**21**	**52**	**537**	**435**	**86**	**+65**
Extraordinary Balance	9	5	4	(4)	5	9	3	(16)	(11)
Profit before Income Taxes	(60)	269	346	16	57	547	439	70	+53
Income Taxes	11	105	139	9	38	192	156	44	+35
NP Belonging to Non-Controlling SHs	-	-	-	-	(1)	(2)	(1)	(2)	(2)
Profit Attributable to Owners of Parent	**(72)**	**164**	**206**	**7**	**20**	**356**	**283**	**29**	**+21**
Sales YoY	+2.8%	+12.8%	+12.1%	+1.2%	+10.2%	+6.1%	(1.7%)	+3.6%	-
Operating Profit YoY	-	+44.9%	+34.9%	(95.1%)	-	+98.1%	+14.5%	+843.1%	-
Recurring Profit YoY	-	+43.8%	+34.0%	(88.1%)	-	+103.7%	+27.3%	+309.7%	-
Profit Attributable to Owners of Parent YoY	-	+60.4%	+40.6%	(94.9%)	-	+117.4%	+37.2%	+299.9%	-
Gross Profit Margin	10.22%	10.16%	9.60%	10.05%	9.84%	10.64%	10.09%	10.64%	+0.59%
(SG&A / Sales)	10.53%	9.14%	8.40%	10.01%	9.68%	8.73%	8.69%	10.30%	+0.29%
Operating Profit Margin	(0.32%)	1.02%	1.20%	0.04%	0.16%	1.91%	1.39%	0.34%	+0.30%
Recurring Profit Margin	(0.31%)	1.01%	1.20%	0.09%	0.21%	1.94%	1.56%	0.35%	+0.26%
Profit Attributable to Owners of Parent Margin	(0.31%)	0.63%	0.73%	0.03%	0.08%	1.29%	1.02%	0.12%	+0.09%
Total Income Taxes / Profit before Income Taxes	-	39.1%	40.2%	55.5%	67.0%	35.2%	35.7%	62.7%	+7.2%

Source: Company Data, WRJ Calculation

Segmented Information (Cumulative, Quarterly)

Segmented Information (Million Yen)	Cons.Act Q1 06/2016	Cons.Act Q1 to Q2 06/2016	Cons.Act Q1 to Q3 06/2016	Cons.Act Q1 to Q4 06/2016	Cons.Act Q1 06/2017	Cons.Act Q1 to Q2 06/2017	Cons.Act Q1 to Q3 06/2017	Cons.Act Q1 to Q4 06/2017	YoY Net Chg.
Medical Consumables and Equipment	19,181	41,161	65,366	85,107	21,349	44,702	68,254	88,584	+3,477
SPD	3,539	7,285	11,067	14,704	3,666	7,583	11,452	15,316	+611
Care Supplies	382	792	1,214	1,648	442	899	1,397	1,877	+229
Imports and Sales	-	-	-	-	0	0	0	0	-
Sales	**23,103**	**49,238**	**77,649**	**101,460**	**25,459**	**53,184**	**81,105**	**105,778**	**+4,317**
Medical Consumables and Equipment	(54)	214	557	573	58	593	965	1,062	+489
SPD	23	50	76	87	19	47	84	103	+15
Care Supplies	6	36	50	63	19	41	67	128	+65
Imports and Sales	-	-	-	-	(4)	(9)	(13)	(20)	(20)
Segment Profit	**(24)**	**302**	**684**	**724**	**92**	**672**	**1,103**	**1,274**	**+550**
Elimination	(48)	(107)	(150)	(180)	(51)	(101)	(143)	(230)	(49)
Operating Profit	**(72)**	**194**	**534**	**543**	**41**	**571**	**960**	**1,044**	**+500**
Medical Consumables and Equipment	(0.29%)	0.52%	0.85%	0.67%	0.27%	1.33%	1.41%	1.20%	+0.53%
SPD	0.67%	0.70%	0.69%	0.60%	0.53%	0.62%	0.74%	0.67%	+0.08%
Care Supplies	1.81%	4.65%	4.16%	3.84%	4.30%	4.60%	4.84%	6.85%	+3.01%
Imports and Sales	-	-	-	-	-	-	-	-	-
Operating Profit Margin	**(0.32%)**	**0.40%**	**0.69%**	**0.54%**	**0.16%**	**1.07%**	**1.18%**	**0.99%**	**+0.45%**

Segmented Information (Million Yen)	Cons.Act Q1 06/2016	Cons.Act Q2 06/2016	Cons.Act Q3 06/2016	Cons.Act Q4 06/2016	Cons.Act Q1 06/2017	Cons.Act Q2 06/2017	Cons.Act Q3 06/2017	Cons.Act Q4 06/2017	YoY Net Chg.
Medical Consumables and Equipment	19,181	21,979	24,205	19,740	21,349	23,352	23,552	20,330	+589
SPD	3,539	3,745	3,782	3,637	3,666	3,917	3,869	3,863	+226
Care Supplies	382	409	422	433	442	456	498	479	+46
Imports and Sales	-	-	-	-	0	0	0	0	-
Sales	**23,103**	**26,134**	**28,411**	**23,811**	**25,459**	**27,725**	**27,920**	**24,673**	**+862**
Medical Consumables and Equipment	(54)	269	343	15	58	535	371	97	+82
SPD	23	27	25	11	19	27	36	19	+7
Care Supplies	6	29	13	12	19	22	26	60	+48
Imports and Sales	-	-	-	-	(4)	(5)	(3)	(6)	(6)
Segment Profit	**(24)**	**326**	**382**	**39**	**92**	**580**	**430**	**170**	**+131**
Elimination	(48)	(58)	(42)	(30)	(51)	(50)	(41)	(86)	(56)
Operating Profit	**(72)**	**267**	**339**	**8**	**41**	**530**	**388**	**84**	**+75**
Medical Consumables and Equipment	(0.29%)	1.23%	1.42%	0.08%	0.27%	2.29%	1.58%	0.48%	+0.40%
SPD	0.67%	0.72%	0.67%	0.32%	0.53%	0.71%	0.95%	0.49%	+0.18%
Care Supplies	1.81%	7.31%	3.23%	2.94%	4.30%	4.89%	5.28%	12.70%	+9.75%
Imports and Sales	-	-	-	-	-	-	-	-	-
Operating Profit Margin	**(0.32%)**	**1.02%**	**1.20%**	**0.04%**	**0.16%**	**1.91%**	**1.39%**	**0.34%**	**+0.30%**

Source: Company Data, WRJ Calculation

Balance Sheet (Quarterly)

Balance Sheet (Million Yen)	Cons.Act Q1 06/2016	Cons.Act Q2 06/2016	Cons.Act Q3 06/2016	Cons.Act Q4 06/2016	Cons.Act Q1 06/2017	Cons.Act Q2 06/2017	Cons.Act Q3 06/2017	Cons.Act Q4 06/2017	YoY Net Chg.
Cash and Deposit	2,586	2,011	2,555	2,142	2,435	3,063	2,775	2,220	+77
Accounts Receivables	17,264	20,315	22,228	18,116	19,328	21,412	21,688	18,726	+609
Inventory	4,427	4,756	4,416	4,147	4,576	4,792	4,581	4,331	+184
Other	1,023	767	972	1,048	900	745	738	937	(110)
Current Assets	**25,302**	**27,850**	**30,173**	**25,455**	**27,240**	**30,013**	**29,784**	**26,215**	**+760**
Tangible Assets	3,416	3,409	3,779	3,745	3,741	3,714	3,671	3,668	(77)
Intangible Assets	329	295	255	246	215	184	178	212	(33)
Investments and Other Assets	1,760	1,828	1,967	1,601	1,443	1,479	1,430	1,678	+76
Fixed Assets	**5,506**	**5,533**	**6,002**	**5,594**	**5,401**	**5,377**	**5,280**	**5,558**	**(35)**
Total Assets	**30,809**	**33,384**	**36,176**	**31,049**	**32,641**	**35,391**	**35,064**	**31,774**	**+725**
Accounts Payables	19,560	22,350	24,622	20,989	21,174	23,627	23,807	21,089	+99
Short Term Debt	4,001	3,695	2,995	1,794	3,554	3,414	2,574	1,535	(259)
Other	1,183	1,082	1,411	1,560	1,318	1,372	1,510	1,815	+255
Current Liabilities	**24,745**	**27,127**	**29,029**	**24,344**	**26,048**	**28,415**	**27,892**	**24,440**	**+95**
Long Term Debt	402	328	1,005	881	797	729	630	546	(335)
Other	1,208	1,279	1,296	1,229	1,242	1,278	1,284	1,362	+132
Fixed Liabilities	**1,611**	**1,608**	**2,301**	**2,110**	**2,040**	**2,008**	**1,915**	**1,908**	**(202)**
Total Liabilities	**26,356**	**28,735**	**31,330**	**26,455**	**28,089**	**30,423**	**29,807**	**26,349**	**(106)**
Shareholders' Equity	**4,239**	**4,403**	**4,610**	**4,617**	**4,467**	**4,827**	**5,111**	**5,140**	**+522**
Other	212	245	234	(24)	84	140	145	285	+309
Net Assets	**4,452**	**4,648**	**4,845**	**4,593**	**4,552**	**4,968**	**5,256**	**5,425**	**+831**
Total Liabilities and Net Assets	**30,809**	**33,384**	**36,176**	**31,049**	**32,641**	**35,391**	**35,064**	**31,774**	**+725**
Equity Capital	4,452	4,648	4,845	4,593	4,435	4,827	5,117	5,289	+696
Interest Bearing Debt	4,404	4,024	4,000	2,676	4,352	4,143	3,205	2,081	(594)
Net Debt	1,817	2,012	1,444	533	1,917	1,080	429	(138)	(672)
Equity Capital Ratio	14.5%	13.9%	13.4%	14.8%	13.6%	13.6%	14.6%	16.6%	+1.9%
Net Debt Equity Ratio	40.8%	43.3%	29.8%	11.6%	43.2%	22.4%	8.4%	(2.6%)	(14.2%)
ROE (12 months)	7.4%	8.5%	9.5%	6.6%	9.0%	12.5%	13.4%	14.0%	+7.4%
ROA (12 months)	1.8%	1.9%	2.1%	1.8%	2.1%	2.8%	2.9%	3.5%	+1.7%
Days for Inventory Turnover	19	18	16	18	18	18	17	18	-
Quick Ratio	80%	82%	85%	83%	84%	86%	88%	86%	-
Current Ratio	102%	103%	104%	105%	105%	106%	107%	107%	-

Source: Company Data, WRJ Calculation

Cash Flow Statement (Cumulative)

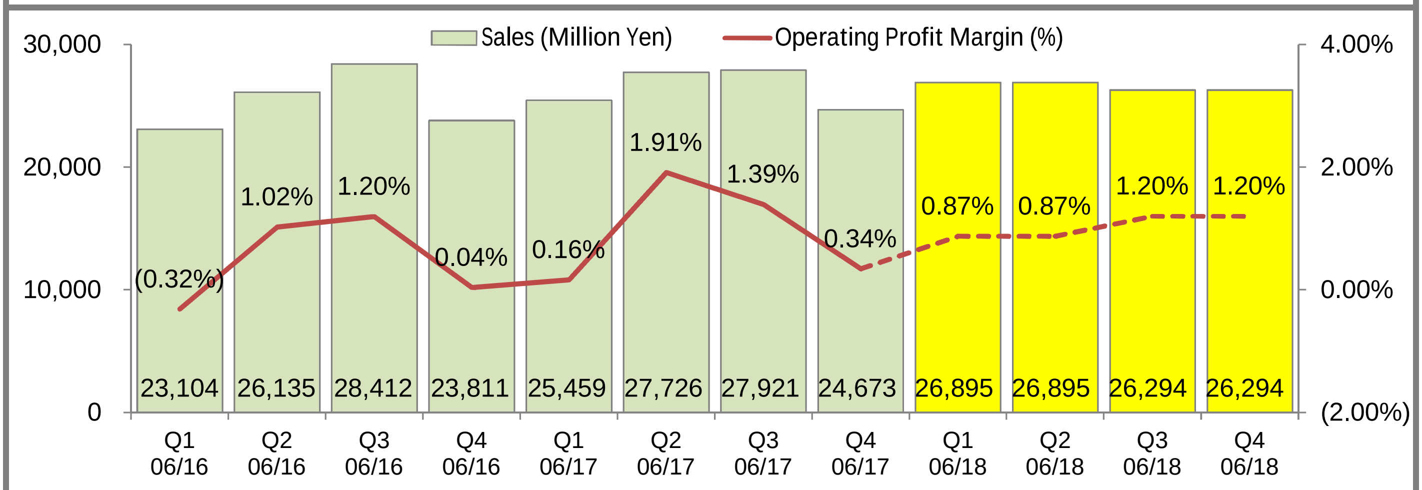
Cash Flow Statement (Million Yen)	Cons.Act Q1 06/2016	Cons.Act Q1 to Q2 06/2016	Cons.Act Q1 to Q3 06/2016	Cons.Act Q1 to Q4 06/2016	Cons.Act Q1 06/2017	Cons.Act Q1 to Q2 06/2017	Cons.Act Q1 to Q3 06/2017	Cons.Act Q1 to Q4 06/2017	YoY Net Chg.
Operating Cash Flow	-	(1,420)	-	710	-	(423)	-	871	+161
Investing Cash Flow	-	(66)	-	(705)	-	(39)	-	(99)	+605
Operating CF & Investing CF	**-**	**(1,487)**	**-**	**4**	**-**	**(463)**	**-**	**771**	**+766**
Financing Cash Flow	-	1,152	-	(208)	-	1,337	-	(741)	(532)

Source: Company Data, WRJ Calculation

FY06/2018 Company Forecasts

FY06/2018 Company forecasts are going for prospective sales of ¥106,377m (up 0.6% YoY), operating profit of ¥1,100m (up 5.3%), recurring profit of ¥1,109m (down 0.3%) and profit attributable to owners of parent of ¥714m (up 3.4%), while operating profit margin of 1.03% (up 0.05% points). Basically, there is no change in that operating profit drives recurring profit and profit attributable to owners of parent. However, we dare refer to insurance refund of ¥48m at the non-operating level in FY06/2017 not reappearing as the reason for marginal decreases of recurring profit. Meanwhile, Company forecasts assume gross profit margin of 10.24% (down 0.07% points) and SG&A expenses of ¥9,970m (down 0.7%).

Sales and Operating Profit Margin



Source: Company Data, WRJ Calculation (quarters of FY06/2018: half-year Company forecasts pro rata)

Sluggish sales are expected basically due to prospective sluggishness of sales for Medical Consumables and Equipment. As far as we could gather, sales on the mainstay consumables side are to increase, but sales on the equipment side are to come down. In regards to consumables, one of the issues is that sales activities have been suspended for Ohta Medical Co., Ltd. or one of the business companies for the Company's group, having seen sales of ¥1,046m (before consolidated adjustments) in FY06/2017, generating factor to reduce sales with the Company to the same extent. However, it looks this will be more than compensated for by positive impacts stemming from one-off factor to have reduced sales associated with circulatory organ in FY06/2017 not reappearing. In regards to equipment, the Company sees negative impacts from exceptional project with high gross profit margin (sales to have booked in Q2 FY06/2017) not reappearing. At the end of the day, Company forecasts assume gross profit margin as a whole for the Company coming down albeit not much. The Company's measures to have pulled out of consumables carrying low profit margin should beef up sales mix, but this is likely be more than offset by factor that gross profit margin of equipment inevitably coming down.

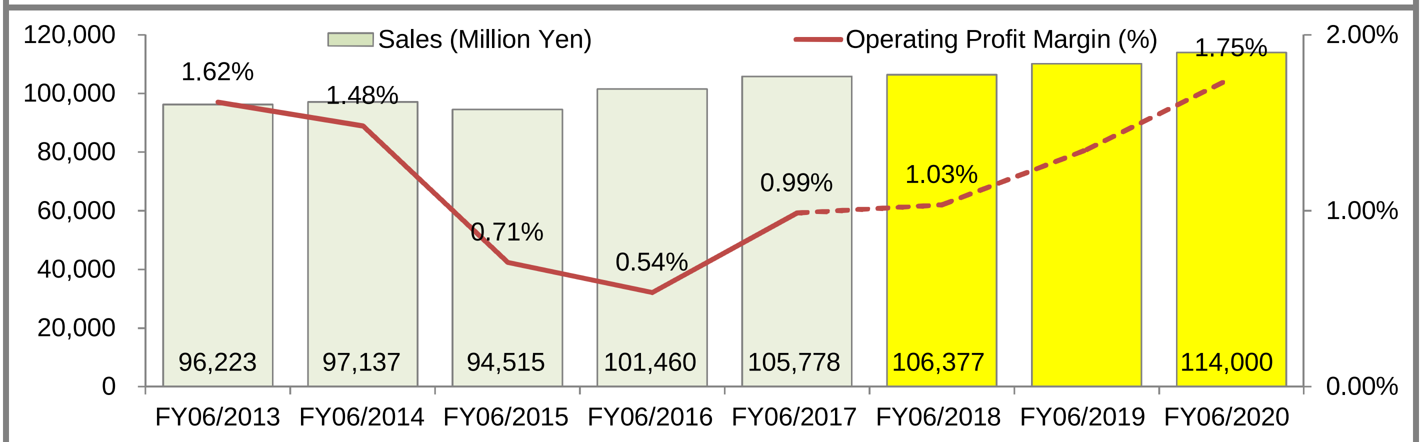
On the other hand, SG&A expenses, having consistently increased over the past 5 years, are expected to come down somewhat. Expenses stemming from frontloaded investment associated with Imports and Sales are to persist, but positive impacts form the Company's rationalization measures across the board are to accelerate. It should be mentioned as the key issue that SG&A expenses will be nothing in regards to above-mentioned Ohta Medical Co., Ltd. due to suspension of sales promotions, including extra expenses generated in FY06/2017, e.g. lease cancellation fees.

Meanwhile, the Company, advocating stability for its dividend paid dividend of ¥30.0 per share, implying payout ratio of 55.1%, in FY06/2016, which is to be followed by ¥30.0 per share, implying payout ratio of 24.4%, in FY06/2017, while also going for ¥30.0 per share, implying payout ratio of 23.6%, in FY06/2018. However, the Company also advocates target payout ratio of 30% at the same time, implying that it should increase dividend when payout ratio less than 30% persists. Thus, it could be the case that dividend could be eventually raised over the previous year in FY06/2018.

Long-Term Prospects

At the release of FY06/2017 results on 9 August 2017, the Company also released new midterm management plan (FY06/2018 to FY06/2020), reflecting prospects for the business segment of Imports and Sales to have been newly set up since the beginning of FY06/2017, while the details were disclosed in results meeting to have been held on 25 August 2017. As prospective business performance target, midterm management plan is calling for sales of ¥114,000m, operating profit of ¥2,000m and operating profit margin of 1.75% in FY06/2020 or the last year of the plan, implying CAGR of 2.5% for sales and 24.2% for operating profit during three-year period just after FY06/2017 results, while operating profit margin improving by 0.77%.

Long-Term Prospects



Source: Company Data, WRJ Calculation

In regards to the midterm management plan, the Company is going for “acquisition of new earnings pillars”, “rationalization and efficiency” and “work style reform”. As far as we could see, the Company is looking to “acquisition of new earnings pillars” in particular as the driver to achieve above-mentioned target of prospective business performance.

Specifically, the Company is on the verge of selling epoch-making new merchandises developed by venture company as the general sales agent, while Imports and Sales to directly import merchandises to sell in Japan is expected to generate earnings on a full-fledged basis, starting in FY06/2020. Meanwhile, EXSOLA MEDICAL Inc., or the newly-established business company for the Company's group, is in charge of both of the operations. Sales and operating profit/loss are reflected in those of Imports and Sales to have been newly set up at the beginning of FY06/2017.

In order to efficiently utilize own sales network, the Company has been making corporate efforts to propel medical-device-sales-participation-type Medicine and Engineering Cooperation or cooperation between medical personnel and engineering personnel belonging to educational institutions, e.g., universities, R&D institutions and private-sector corporates with purpose of developing new technology and/or creating new business in the field of medical care, holding meetings for sales channel support consultation. As a result, the Company is now on the verge of benefiting from selling of promising new merchandises.

For example, it was disclosed in the release on 18 August 2017 that MICOTO Technology Inc., based in Yonago-city of Tottori-prefecture, and EXSOLA MEDICAL Inc. reached basic agreement to conclude the general sales agent agreement in regards to medical simulation robot or 'mikoto'. Based on this basic agreement, the Company is currently planning to sell said merchandise across Japan as well as providing users with solutions for introductions, maintenance and services after the introductions, etc.

Medical Simulator Robot 'mikoto': You can feel "life" with the Robot 'mikoto'

Source: Company Data

Over the past few years, it has been increasingly important for doctors' training to practically take part in medical treatment rather just watching in order to further facilitate acquisition of clinical skills and to understand medical safety. Thus, there has been changeover of the contents so that practical knowledge should be enhanced more than before. Meanwhile, one of the tools for this is practice-oriented simulation education to take advantage of simulators, favorably driving the market for medical simulation products. In order to cope with increasing needs here, MICOTO Technology Inc. has developed 'mikoto' or medical simulation robot being equipped with features of quasi-real appearance, structure and response having never been materialized before, making an impression as if it were real human being, while planning to propel sales promotions through concluding general sales agent contract with the Company.

Meanwhile, in FY06/2020, sales of systems and kits to detect breast cancer at early stage by means of analyzing exhalation are to take off on a full-fledged basis. On 16 February 2016, the Company concluded exclusive sales agreement in Japan on all those merchandises with Spectrosense Ltd. or medical equipment venture company based in Israel, while having been making progresses in demonstrations at medical institutions and generating expenses stemming from here as a part of SG&A expenses. At the end of the day, the Company is planning to launch them in Japan by the end of FY06/2019 after clinical trial and approval.

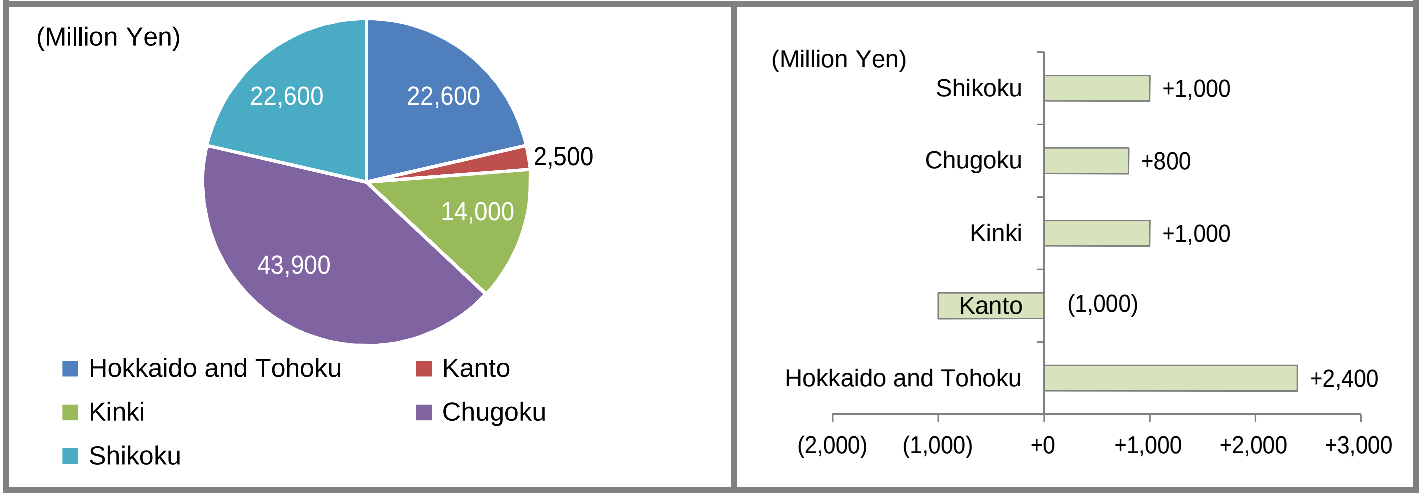
The market of doctor’s fee for mammography, detecting breast cancer while specifying the part at the same time although accompanying some invasion, etc., currently equates to some ¥28,000m in Japan, while the Company is going for the number of medical examinees more than one million collectively in three to four years after the launch in regards to said merchandises. This suggests that prospective earnings with the Company are likely to enjoy some meaningful add-ons stemming from said merchandises in FY06/2020 and the add-ons consistently increasing going forward. As far as we could gather, medical examination to take advantage of said merchandises not accompany invasion, etc. at all are to be implemented for extensive examinees to detect breast cancer whether existing or not existing, prior to examination by mammography.

4.0 Business Model

Medical Consumables and Equipment

In the mainstay Medical Consumables and Equipment, the Company sells medical consumables and equipment to medical institutions represented by major base hospitals heavily involved with acute care. Just roughly speaking, this business domain in Japan has market size of ¥2.8 trillion pa and CAGR of 4.7% going forward. Meanwhile, the number of players in the market stands at more than 1,000, implying a large room remaining for consolidation in the foreseeable future. For example, on 1 April 2016, it was announced that SHIP HEALTHCARE HOLDINGS, INC. merged with Konishi Kyowa Holding Co., Ltd. Meanwhile, the Company is one the largest players dedicating to this business domain, currently being ranked as the fourth largest in terms of market share.

Sales by Region and Net Change over the Previous Year (FY06/2017 Results)



Source: Company Data, WRJ Calculation

In terms of sales by region, the Company, based in Okayama-city, has the largest exposure to Chugoku region where Okayama-city is included as a part. Meanwhile, the Company merged with Sansei Medical Materials Co., Ltd., having made this business company for the Company's group since Q3 FY06/2012. Driven by this, exposure of the Company to Hokkaido and Tohoku region shot up, while that of Kanto region newly started up. Thus, the Company made remarkable progresses in sales enhancement in geographical territory having had remained uncultivated, while beefing up own market share at the same time together with the merger with peer. Meanwhile, recent circumstances of sales by region suggest that there are good opportunities for the Company to implement mergers in Kanto region in particular.

On top of Medical Consumables and Equipment, the Company is also involved with aforementioned Imports and Sales, SPD and Care Supplies by business segment. In regards to Imports and Sales to have been newly set up at the beginning of FY06/2017, sales were nothing in the first year of FY06/2017, while operating loss was generated as much as SG&A expenses comprising personnel expenses and those of frontloaded investment, as far as we could see. In regards to SPD and Nursing Care, the Company sees sales and operating profit to a certain extent, but impacts to operating profit/loss as a whole for the Company remains insignificant, including impacts from operating loss of Imports and Sales.

SPD (Supply Processing and Distribution) is run by business model that could be almost the same as that of Medical Consumables and Equipment but for the key difference that the Company also collects commissions from medical institutions by being in charge of management of inventory and information as well as of purchasing on behalf of them. In terms of gross profit, it appears that some 80% comes from said commissions.

Merchandises of Medical Consumables and Equipment (Image Pictures)

Source: Company Data

On the other hand, Care Supplies represents operations of sales and rental services for nursing-care beds and supplies. The mainstay operations here are those of rental services for nursing-care beds, accounting for some 80% of sales here and carrying gross profit margin of some 50%. In all the business segments but for Care Supplies, the Company is exclusively exposed to medical institutions as own customers, while Care Supplies to local elderly people and their families, which is the distinguished feature for this business segment.

When compared with the fact that Company as a whole saw average gross profit margin of 10.30% (upper end of 10.47% to lower end of 9.99%) over past 5 years, the mainstay operations of rental services for nursing-care beds carry gross profit margin far higher. This is because the business model here is totally different from that of Medical Consumables and Equipment, etc. While the bulk of gross profit of the Company as a whole comes from added value generated by operations of purchasing and selling merchandises, the Company is involved with rental services here literally generating added value by rental services. Recent trading is buoyant in terms of both sales and earnings, driven by strengths of new customer cultivations in Fukushima area and Miyagi area.

Disclaimer

Company name: Walden Research Japan Incorporated
Head office: 4F Hulic Ginza 1-chome Building, 1-13-1 Ginza, Chuo-city, Tokyo 104-0061 JAPAN
URL: www.walden.co.jp
E-mail: info@walden.co.jp
Phone：+81 3 3553 3769