Walden Research Japan

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"Company Visit Memo"

Interviews with Company (26 July 2010)

A Series of Company Visits

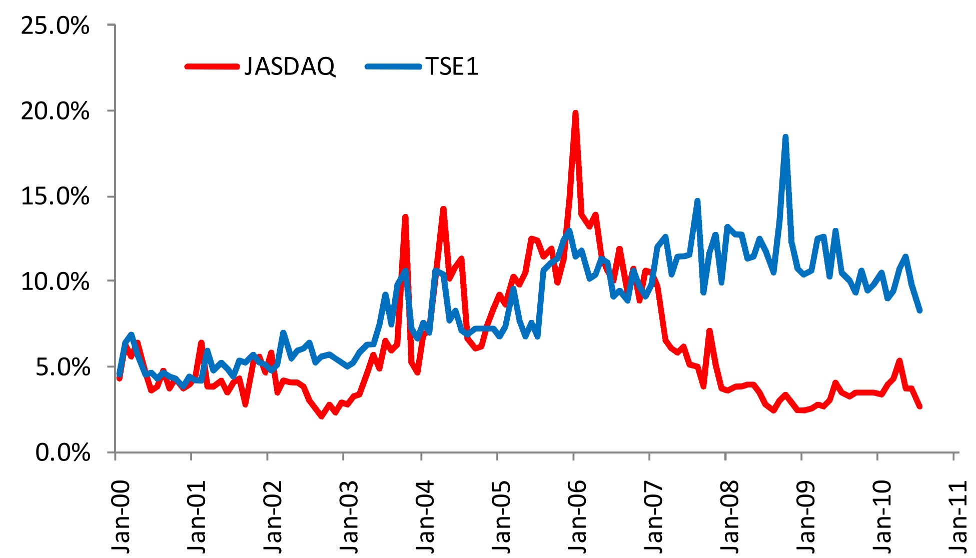
Walden Research Japan continuously goes and visits quoted companies in Japan, with a focus on those of relatively smaller-sized market cap, interviewing with IR officers, managing directors and top management, concerning the company's business model, recent trading and other IR information. Here have we briefly summarized main points on six companies out of our company visits over the past two weeks (12 July to 23 July):

CHINTAI (2420) Share Price (Japanese), IR Information (Japanese)
Yaizu Suisankagaku Industry (2812) Share Price (Japanese), IR Information (Japanese), Company Information (English)
Chiyoda Integre (6915) Share Price (Japanese), IR Information (Japanese)
Cosel (6905) Share Price (Japanese), IR Information (Japanese), Company Information (English)
Meiko Network Japan (4668) Share Price (Japanese), IR Information (Japanese)
BIC CAMERA (3048) Share Price (Japanese), IR Information (Japanese), IR Information (English)

A Change of Environment for Small Caps

Assuming TSE1 and JASDAQ as benchmarks for large-cap stocks and small-cap stocks, respectively, a trend that investors keep themselves away from small-cap stocks still lingers on in 2010. This is an idea based on historical trends of turnover ratio (trading value divided by market cap). Through 2000 to 2006, large caps and small caps had seen resembled trends of turnover ratio with their absolute levels on a monthly basis, although they experienced deviation between themselves to some extent. Since 2007, however, things have changed dramatically, small caps having been suffering far lower turnover ratio when compared with large caps. The historical average for large caps, on a monthly basis, is 8.6% while it is 8.3% at present, and thus it appears that they should be fairly valued by their fundamentals with their decent turnover now. Meanwhile, the historical average for small caps is 6.1% while it is 2.7% at present, which equates to almost the lowest levels over the past ten years, i.e., 2.0%. As far as such low levels continue in the future, it would not be easy for small caps to be fairly valued by their fundamentals. When it is required for small caps to maintain turnover ratio of 8.6%, the historical average of large caps, to get fairly valued by their fundamentals, all of the six stocks referred to here in this text have failed to do so for some time. More importantly, this is true of the bulk of over 3,000 stocks other than "Top 500 Market Cap Stocks (above ¥88bn)" in Japan. Meanwhile, the bulk of ex-Top-500 companies, including the six companies mentioned here in this text, maintains their resources upon their IR activities, for the sake of improvements of investors' recognitions over own companies, increased trading value of own shares and eventually for fair valuation on own shares. Still, it would be the case that the same old IR measures may not good enough to achieve the targets, given changes in the environment for small caps after 2007.

Turnover Ratio (Trading Value Divided by Market Cap) of TSE1 and JASDAQ on A Monthly Basis



Source: TSE Homepage, OSE Homepage and NIKKEI

CHINTAI (2420)

Real Estate Rents Information Services on Various Medias

The Company released its Q2 FY10/2010 results on 14 June. "Media Business" or real estate rents information services, accounted for almost 90% of operating profit (¥2.3bn). "Media" relates to its portal site, its paper medium and its mobile site, and the Company is in charge of providing end users with real estate rents information (advertising for objects available) through the own medias, having seen high margins of 43.6% in terms of operating profit before elimination. With its portal site, the number of objects posted is 600,000 to 800,000 (fluctuating due to seasonal factors through the year), while the Company issues paper medium "CHINTAI" for end users, different ones with selected objects in the 26 different regions across Japan. One third of the objects dealt in by the Company are those of ABLE (8872) or one of the largest brokers of objects for rents, while the rest comprises those of the other nation-wide majors as well as of smaller-sized players dedicated to operations in specific regions. As long as the paper medium "CHINTAI" in metropolitan regions are concerned, the bulk of objects posted are of ABLE, given that ABLE has many directly-operated shops in there. On the contrary, the paper medium has a little exposure to ABLE objects in non-metropolitan regions where it has a limited exposure to its directly-operated shops. With its company forecasts, sales in FY10/2010 are expected to be ¥15.8bn (up 5.5% YoY), operating profit ¥3.5bn (up 9.5%) and operating profit margins 21.8%.

ABLE-CHINTAI Holdings

The Company is going to set up a holding company together with ABLE, merging operations between themselves, making the merged new operations quoted on to the New JASADAQ market in Osaka Stock Exchange on 1 November. The long-term target for the new operations is to achieve sales of ¥60.0bn, operating profit of ¥8.0bn and operating profit margins of 13.3% in FY10/2013. As a result of incorporating operations based on a different business model, the prospective operating profit margins are inevitably lower than the current levels of the Company. Still, there should be benefits, stemming from the merger. ABLE, running directly-operated shops as many as 471 across Japan (plus FCs as many as 339) together with own employees over 3,000, has a large exposure to objects under own management, and thus it has set up a direct relationship with owners of objects to a large extent. The establishment of the new operations would, therefore, make information as symmetric as possible between owners and end users (as only an entity would intervene between them). The other thing is that ABLE, having hesitated to deal in objects of major house makers in a respect that itself with an emphasis upon objects under own management is exposed to head-on competition with them, would start dealing in their objects for the sake of the pursuit of earnings as the new operations as a whole after the merger. It is now estimated that the empowerments of appeals to end users and market share increases, as a result of increased objects on own line-up, will end up with net increases in earnings for overall new operations. In other words, it should become easier for ABLE to pursue top-line growth after the merger. On top of the objects of major house makers, the new operations are supposed to incorporate objects as many as possible, and thus the new operations are anticipated to gradually enhance its presence in the market for objects for rents.

Yaizu Suisankagaku Industry (2812)

Creating From Nature

Based on natural resources such as fish and shellfish, the Company, manufacturing natural seasonings as well as function food ingredients, has shown steady earnings growth. In FY03/2010, sales came in at ¥21.9bn (up 8.6% YoY) and operating profit ¥1.7bn (up 66.9%). Meanwhile, “Challenge & Growth”, or the Company’s long-term plan, calls for sales of ¥30.0bn and operating profit of ¥2.5bn in FY03/2013. Skipjack tunas, tunas, crab shells, scallops and other materials are processed into the Company’s products though the Company’s processing stages including extraction, refinement, dryness etc, shipped to the Company’s customers comprising domestic processed food makers (top 100 accounting for some 80% of sales here) and health food makers. The former relates to “Seasoning Business”, and it accounted for 67% of operating profit in FY03/2010 while the latter “Function Food Business” 31%.

”Challenge & Growth”

“Function Food Business” is expected to be the key driver for the Company to achieve its long-term plan. As for the markets for glucosamine and collagen, there is a prospect that the markets have a long-term growth potential. The Company intends to benefit from the market growth, together with its natural type N-Acetyl glucosamine (NAG) in which the Company’s strengths are adopted. NAG has the characteristic that changes into the hyaluronic acid in the inside of the human body, and is currently used as the main material of the beauty supplements. Moreover, the Company is also in charge of manufacturing oceanic collagen, and thus the Company should benefit from market expansion here too in the same way. There is big development room in the overseas markets in "Function Food Business" though in "Seasoning Business", there is no growth strategy except that the deep ploughing of the domestic market is advanced because it develops and manufactures by specializing in the products corresponding to a Japanese taste. Overseas sales as a whole were limited to ¥0.4bn in FY03/2010, while they are expected to expand to ¥3.0bn in FY03/2013. As for the overseas operations, the Company has manufacturing & marketing base in Dalian China, and the expansion of production and sales in there is expected in the foreseeable future.

Chiyoda Integre (6915)

A Major Mechanical Parts Specialist

In Q3 FY08/2010, released on 12 July, the Company performed well, with sales ¥28.6bn (up 8.7% YoY) and operating profit ¥1.0bn versus losses in the last Q3. Still, it appears that the levels of operating profit suffered from a little shortage when compared with the Company's expectations calling for a full-year operating profit ¥1.4bn in FY08/2010, having achieved 68.9% so far in Q3. The Company supplies mechanical parts with major office automation makers, home appliance makers etc., and one-off adjustments with a customer's production appear to have negatively affected its performance in Q3 results. Mechanical parts, developed and manufactured by the Company, are made of soft materials such as films etc. and processed by means of specialty high precision technology called "SOFT PRESS". Sales associated with office automation equipment in terms of final products equate to 48% of sales, where the Company's products are used as toner cartridge sealing for copiers (leak prevention), for instance. It differs for the Company with who to compete depending upon in which customers, which regions to refer to (regularly competing with a few competitors), while it is noteworthy that the Company almost always has relatively large supply share as the specialist of mechanical parts. With the Company, the largest eight customers account for collective 60% of sales or more, and all of them are Japanese makers.

Pursuit of Market Share and Developments with New Fields

In a long-term prospect, the Company is aiming at further supply share increases with existing customers and at enhancement of exposure to non-Japanese customers. Collectively, overseas sales account for over 60% of sales, and this relates to sales of products made by the Company's local production bases overseas to the Japanese customers' local production bases overseas, and thus there is a decent room for future developments for local makers overseas (as the Company's exposure is currently small). The Company operates its overseas production with own production facilities, mainly in China, corresponding to local demand by local production while importing key raw materials from Japan. In the mainstay China regions, the Company is trying to cope with problems like hiking wages by means of setting up labour-saving and personnel-saving facilities. Meanwhile, the Company has increased its resources to develop new applications, aiming at increasing exposure to automobiles etc. over the past years. To date, the Company has increased its exposure to automobiles up to c.11% of sales. Still, there is a more potential for further developments in this application. As a whole, the Company has some growth scenarios for the future, and the Company has been considering the releases of the long-term plan for some time.

Cosel (6905)

Improvements of Market Circumstances

Developing and producing switching power supply mainly for "Industrial Equipment", the Company is anticipated to see surging earnings. In FY05/2011, sales ¥24.0bn (up 42.8% YoY) and operating profit ¥6.0bn (up 98.1%) are anticipated by the Company. Specializing in standard products with its developments and production and listing these products on a catalogue (4,000 to 5,000 items, currently traded), the Company has some 90% exposure to sales through dealers in both domestic market (76.2% of sales) and overseas market (23.8%). In addition to own marketing, the direct sales force with the Company is also in charge of sales promotion guidance for all these dealers. "Industrial Equipment", mentioned earlier, relates to such final products like control equipment (40.5% of the domestic sales) whose demand hinges on the levels of capital expenditure among manufacturers, telecom & broadcasting equipment (16.1%) including telecom-infrastructure-related equipment such as mobile phone base-stations, semiconductor production equipment (10.3%) etc. On the overseas market front, the Company has a similar exposure to final products in terms of ratio to overall sales. In the market on a global basis, the Company is one of the second-tiers with a stable 8% share. The key strategy of the Company is to pursue profit margins, and it could be said that the market share is nothing but something produced as a result of the Company's pursuit. Lowering market defective rates as well as rates of total losses from spoilage are the two key issues always mentioned by the Company, and they are the details of the strategy. Consequently, recent improvements of the market circumstances should directly enhance earnings with the Company which sees stable market share.

Forecasts for FY05/2011 and Long-Term Target

Fixed costs of ¥6.0bn, marginal profit rate of 50% and then break-even-point sales of ¥12.0bn are probably assumed in the Company's forecasts in FY05/2011. Production by the Company relates to assembly of procured components, and thus collective costs associated with the procurement and assembly equate to about half of sales. The assembly processes have a high exposure to manual labour of individual workers and low to machinery, while such operations are effectively all carried out in Toyama Prefecture where the Company is based. The Company's business model does not require massive tangible fixed assets while carrying decently high profit margins against sales. The Company has kept on implementing this business model over the past years, having held collective high liquidity assets of ¥22.0bn (including cash as well as quasi-cash assets) equating to 63% of total assets ¥35.1bn as of the end of May 2010. The future continuation of the current business model shall further increase its effective cash with the Company. The long-term target with the Company is to maintain annual sales of ¥40.0bn and recurring profit margins of 30% by the current business model.

Meiko Network Japan (4668)

Towards Even Higher Market Share

In Q3 FY08/2010 results, released on 8 July, sales came in at ¥9.0bn and operating profit ¥1.8bn. Full-year forecasts calling for ¥12.8bn and ¥3.0bn, respectively, remained unchanged. An operator of individual-guidance cram school "Meiko Gijuku" (for students in elementary, junior-high and high schools), has set up its nation-wide network to date, together with its directly-run classrooms and FC classrooms. In the Q3 results, the former accounted for some 20% of operating profit while the latter some 80%. "Meiko Gijuku" comprised collective 1,863 classrooms (directly-run: 211, FC: 1,652) or collective 125,065 students enrolled as of the end of February 2010, and is the third largest in the market after Kumon and Gakken. The key drivers for earnings are currently the openings of new classrooms by existing FC owners, and this will be the case in the foreseeable future. Over the past 13 years since the stock market listing in 1997, the Company's operations consistently expanded with no exceptional years in terms of the numbers of classrooms as well as of the number of students enrolled, having resulted in increases by 2.3x and 3.2x, respectively, when compared with the levels at the listing. The market for cram schools and prep schools, to which the Company is exposed, is estimated at over ¥0.9 trillion pa, but the lowering birth rates have been gradually suppressing the market and this will be the case in the foreseeable future. However, the Company succeeded in consistent increases in its classrooms and students enrolled, having increased its market share up to 4.7% to date. Its strategy is to focus upon volume-zone students whose grades are mediocre and efficiently guides them one by one with each individual's needs at the market average fees while offering premium results, consequently having led to consistent market share increases and then consistent increases in both sales and earnings. Such trends are anticipated to keep on going in the foreseeable future.

Minimum Fixed Costs Load

The Company reduces its exposure to the minimal levels as one of the key strategies. The Company frequently uses university student part-timers as teachers for its directly-run classrooms while the restricted number of own employees are allocated in there. Future growth potentials mainly hinge on developments on the FC front that does not have a lot to do with fixed costs. The strengths of the Company relate to its know-how and capability in educating and training pure amateurs so that they should be successful FC owners. Many new FC owners have done well, and increasing number of FC owners are trying and then starting the second, then, third classrooms under the FC scheme. As of the end of February 2010, the number of FC classrooms stood at 1,652 versus 472 for the number of FC owners, suggesting the average number of classrooms per owner 3.5, while 52.8% of the owners were running two or more classrooms. The historical performance of the Company suggests that the implementations of the Company's know-how for FC owners just led to the market share increases with the Company. Still, the most recent market share remains low on an absolute basis, implying a decent room to get even higher. Thus, the Company will see the minimal fixed costs load while should see steady increases in cash flow in the foreseeable future.

BIC CAMERA (3048)

Better Earnings and Turnaround

Sales came in at ¥454.8bn (up 2.0% YoY) and operating profit ¥10.8bn (up 55.1%) in Q3 FY08/2010, released on 9 July, and the results were better-than-expected. There was an improvement of 0.8% points at the gross profit margins to 24.6%, driven by decreasing sales of relatively low-margin items such as PC hardware etc. and increasing sales of relatively high-margin items such as home appliances (refrigerators, washing machines etc.). Nevertheless, recurring profit was limited to ¥6.8bn (down 5.4% YoY) due to equity-accounted losses ¥4.6bn at the non-operating levels, stemming from net losses ¥37.4bn (in FY02/2010) of Best Denki (8175), 15% held by the Company. Such huge losses were mainly attributable to one-off restructuring expenses with Best Denki, and they have been incorporated in the Company's forecasts in FY08/2010. The equity-accounted affiliate has moved into profit at the net levels in Q1 FY02/2011 while it is expected to do so, on a full-year basis, and thus there should be a meaningful turnaround at the Company's non-operating levels in FY08/2011 versus FY08/2010. At present, the Company calls for sales of ¥600bn (up 1.8% YoY) in FY08/2010, and this equates to 7.5% of the domestic retail market for consumer electronics (¥8.0 trillion yen, according to the Company data). The Company is one of the largest-sized urban-type consumer electronics retailer chains, together with Yodobashi Camera (8.8% share).

Pursuing Margins, Reporting Net Inflow of Free Cash Flow

It could be the case that "eco-point", introduced by the government, has already started to slowdown in terms of its positive impacts to sales of televisions, refrigerators and air-conditioners, while the domestic market for consumer electronics would not be described as something with high growth potential. The retailer chains have grown to date on the expense of smaller players including local papa-mama-shop operators to a large extent. The retailer chains may continue doing so, but the rates of growth from here should dwindle. One of the strategies with the Company, under such environment, is to try to enhance exposure to relatively high-margin items such as home appliances. When compared with suburban-type retailer chains, represented by Yamada Denki (9831), the Company's exposure to home appliances has remained relatively small. The Company has continued acquiring know-how associated with home appliances by suburban-type retailer chains from Best Denki since 2007 when the Company got stakes in it. On the other hand, only one new shop has been decided to be opened in FY08/2011, on top of 34 shops as of the end of August 2010. Still, in the real picture, there should be more openings, given the fact that the Company is more aggressively inclined to new openings based on existing shop takeover (requiring far less time to open after decision making) than before and the other fact that the rates for the rents have come down in metropolitan areas across the board, suggesting more opportunities for new openings than before. Basically, the Company sticks to a policy to take advantage of rents for new openings now, and this will be the case for the future too. As a result of such trends while given a one-off factor, the Company saw net inflow of free cash flow (operating CF plus investing CF) as much as ¥14.0bn in Q3 FY08/2010. Financing cash flow came in at net outflow of ¥12.4bn, mainly due to reductions in interest-bearing debts outstanding. The Company used to use excessively aggressive financing measures in a sense, but the things have changed so dramatically to date, and will not change back in the foreseeable future.

Disclaimer

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