

Date: 7/16/2017

Watts (2735, JP)

Exchange: TSE 1

Sector: Retail

Market Cap: JPY17.9 billion

P/B: 1.8x (8/16 act)

Recommendation: HOLD

Share Price: JPY1,287 (7/15/2017)

Target Price: JPY1,560

P/E: 19.2x (8/17 CE)

Div. Yield: 1.2% (8/17 CE)

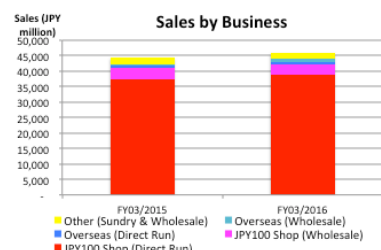


Highlight –maintained as Hold -

METRICAL maintains Watts (2735, JP) as HOLD for 12-month horizon. On valuation, the share price still seems to have upside potential in the mid-term but its earnings are expected to grow at moderate pace. Its 3Q financial result was in line with company projection for ongoing full year FY08/2017. Existing store sale maintains positive at +1.6% YoY that is higher than company projection of 0.0% YoY. Earnings forecast by METRICAL has been kept on hold as 'inline' for FY08/2017 (E) but slightly revised upward for mid-term projection for FY08/2020 (E) on its positive store growth. However, for revaluation, further earnings momentum/recovery would be a key. Currently, mid-term projection by the company on its mid-term management plan is currently unclear that Watts posted based on aggressive sundry store and overseas business.

Business Description

Watts was founded 1995 in Osaka and has grown to the 4th largest JPY100 shop in Japan, acquiring JPY100 shop operators such as Saitama based O-Three in 2007 and Okayama based Daisen in 2013 and an import sundry wholesaler Amano in 2010. Watts has expanded its JPY100 shop business to overseas market such as Thailand, China, Malaysia, Vietnam, Peru and etc. but most of revenue comes from domestic business as shown the bar Chart on left. Watts has set its basic business strategies such as low cost operation, low cost store development and great value of daily life goods in differentiation from other 3 competitors. In short, Watts runs low cost operation at small outlets of 230 square meters on average and providing great value daily items to customers, whereas competitors operate larger stores of 330–1,000 square meters. Daiso (privately owned) makes JPY395 billion sale from 3,000 stores, Seria (2783, JP) sells JPY130 billion at 1,352 stores, Cando (2698, JP) also earns JPY68 billion revenue from 976 stores for FY2015. Watts sells JPY46 billion at 1,059 outlets at store brand name as 'Silk', 'meets' and newly launched "Watts" and "Watts With."



	Daiso (Private)	Seria (2782, JP)	Cando (2698, JP)	Watts (2735, JP)
Sales (JPY million)	395,000	130,983	65,241	46,176
# of Stores	3,000	1,369	964	1,049
Sales/Store (JPY million)	132	96	68	44
Sale Space (sq meter)	330–1,000	330–1,000	330–1,000	230

Industry Overview and Competitive Positioning

Industry Overview

History of JPY100 shops

1990s

JPY100 shops rapidly grew in mid-1990s as Japan's economy deteriorated after bubble economy collapsed. Consumers that strengthened budget mind highly supported the emerging retailers in depression. Meantime, China's production increasingly improved and stronger JPY rates helped the retailers' cost of goods sold lower.

2000s

JPY100 shop was no longer niche business. Sales of Daiso increased from JPY48 billion for FY1997 to JPY281 billion for FY2003 but slowed to grow to single digit pace from FY2004. Tailwind of deflation economy and consumer's budget mind continued but customers come to buy goods more selectively, while other retailers such as super market, discount stores and DIY retailers developed private brand selling at low price. Low price goods were not selling at only JPY100 shops. JPY100 operators started to find differentiation strategy. Some JPY100 operators sold goods not only at JPY100 but multi prices. It was 2004 Seria introduced real time POS for the first time in this sector. Daiso, Cando and Watts followed far later after 2012.

2010s

JPY100 shops are expanding to shopping malls. Developers consider JPY100 shops as featured store that collect many consumers. In fact, food court and JPY100 shops are the most popular sites. Developers are very likely to lease shopping space to a shop that is anticipated to gather more consumers. GMS and Super Market chain are losing costumers and many of them make revenue from property leasing revenue like a developer. They also expect JPY100 shops to call customers into their stores. In this market trend, Seria has expanded stylish stores to bring young customers. Competitors are following the store development.

Change in Environment

Customer Value

Any goods were sold out easily at JPY100 shop in 1990s if just put price tag of JPY100. But low price commodities are not special after tons of private brand goods arrive at stores in mid-2000s. Customer value seems to be changing and diversified. Just cheap goods remain unsold at store. Conversely, 'premium' private brand at convenience stores are highly supported in these days. Customers are more likely to visit not only to buy daily items and expendables but to expect to find something new or something different goods even at JPY100 shop rather than. In fact, sale in months holding event such as Halloween, Christmas, Valentine Day is increasing year by year. Customers are expecting to buy special goods for their extraordinary event.

METRICAL INC.

corporate governance, investment research & solutions



External Environment

Currency rates are one of the factors that have greatly influenced the profitability of JPY100 shop operators, as the retailers import many of goods from China. USD/JPY hit the bottom at 75 in 2011 and moved higher due to massive quantitative easing by Bank of Japan. When USD/JPY gets stronger, JPY100 shop chains try to make goods smaller or change to lower cost material (i.e. from glass to plastic). No one can expect the direction of currencies but company management should not run a company on optimistic view of further appreciation of JPY rates.



Competitive Positioning

Basic Business Strategy

Low cost store development

Watts expanded to 1,049 stores, most of which are smaller size stores of 230 sq meter on average. Its low cost store development system enables the company to run a small size site selling JPY3.6 million per month on average. A smaller site tends to lower rent, as competitors need larger site for larger sale. Low opening cost benefits to low closing cost, too. Lighter opening/closing cost enables quick decision of scrup and build and this helps flexible store expansion for growing to more than 1,000 outlets.

Basic Business Strategy



Low cost operation

Its store operation aims at a completely low cost operation. By eliminating waste work, store staff can focus on more customer service than other work. Watts standardized store works enable part-time employees to operate a store for themselves. A supervisor manages normally 6-7 stores in a area.

Great value daily goods

Above 2 lower cost operations boost product development. Watts has been promoting private brand goods named 'Watts Select' since 2010. 'Watts Select' appeals customers its great value, showing its more volume or made of higher quality than a similar product. Watts aims at increasing loyal customers, offering great value goods.



Watts has expanded business on its basic business strategy, but revised the strategy to meet change in market environment.

Revised Business Strategy

Low cost store development

Watts has focused on developing small size stores, which would benefit to differentiate from competitors. However, not only shopping mall but also super market is more likely to rent a tenant who calls more customers and different category of customers into its store, as super market cannot stop losing customers. While competitors are developing stylish outlets recently, competitive store design becomes a factor of renewing leasing and new rent contract. Due to this environment, Watts decided to develop more fashionable stores as 'Watts' store in August 2015. Performance of 'Watts' stores is so far so good, increasing approximately 20% sales for a year. Renovation of a new brand store is higher but positive sale and store design would be positive effect on leasing contract with landlord as company expected.

Low cost operation

Its 'Silk' and 'meets' stores have been well operated by part-time employees without POS. As its hot-seller items were normally regular items, even part-time staff could easily predict how many they should order. This saved IT system expenses. However, as customer need is diversified, in-store inventory was getting higher. POS data and automated order system help store staff to reduce workload at particular stores in large cities where it is not easy to hire part-time workers due to labor shortage. Installing POS will add a few hundred million Yen for the investment.

Great value daily goods

Watts has mainly targeted at a homemaker who lives in neighborhood and frequently buys daily items and expendables. To increase loyal customers, the company has promoted great value goods as 'Watts Select' from 2010 but the number of the private brand items decreased to 100 items in 2016 from its peak of 220 items in 2014 in line with depreciation of JPY rates. 'Watts Select' is like a bargain good for highly appealing customers, but has to decrease the number of items if profit margin comes under pressure on weaker JPY rates. OP margin of the company decreased to 2.6% in FY03/2016 from 5% in FY08/2012. In order to enhance profit margin, Watts is gradually to move to data based merchandizing helped by POS data, which collects customer need.

Competitive Positioning

In each business strategy, competitive positioning is analyzed further below.

Low cost store development (key: Sales growth)

Higher 'Watts' brand store development cost pulled SGA/Sales up to 35.8% in 1Q FY08/2016 from 34.4% in 1Q FY08/2015. After rebuilding development cost of a new store that is classified in cost/benefit, SGA/Sales came to stabilize slightly to 34.8% and 35.0% in 3Q and 4Q FY08/2016. But it remained slightly higher at 35.8% in 1Q and 34.3% in 2Q FY08/2017, compared with 35.7% in 1Q and 34.1% in 2Q FY08/2016. Store design necessarily became a part of important factor for maintaining competitiveness for both of store sale and sale space leasing with landlord. In renovation plan of 'Silk' and 'meets' stores that is located in super market, "Watts With"

barand has been launched, which maintains current floor and wall design at lower renovation cost but looks very nicely. Such investment seems to be inevitable, as there are 6,000 JPY100 stores in this country and necessarily 3 or 4 stores competes each other in a area. 'Watts' stores widens customer base from 40s and 50s to 30s women due to new store design. Reviewing 2Q FY08/2017 result, OP margin fell to 3.4% from 3.8% a year ago after improved in 1Q although sales were up 3.6% YoY and COGS/Sales inched up 0.2pt YoY. This was due to remaining at higher SGA/Sales at 35.0% for the 6 month period 1-2Q FY08/2017, compared with that for 34.9% for the same period a year ago and 32.9% in 1Q FY08/2014 before opening 'Watts'. The Table below shows comparison of 3 companies in SGA/Sales and COGS/Sales. Both financial ratios of Watts and Cando are compares for the same period from September to December. Interestingly, Watts that states low cost operator shows higher numbers in SGA/Sales and COGS/sales. All 3 companies run 1,000 outlets and will have to spend renovation expense in future, although Watts does not plan to replace all stores to Watts' or 'Watts with.' The issue is top line growth how 'Watts' and 'Watts With' push sale higher. 'Watts' and 'watts with' accounts for only 17.5% (=184/1049) at this moment and should accelerate total sale of the company from 2.6% YoY growth for 2Q, as the number of the new brand store are increasing. In addition, when I visited stores of all 4 companies, display furniture of 'Watts' store was the tallest. These days, a number of large retailers set lower furniture, as Shimamura (8227, JP) replaced shorter display and performs well. Female customers can not reach items that are displayed at the top of it and feel lock up.

	Cando (2698, JP)	Watts (2735, JP)	Seria (2782, JP)
Sales	65,241	46,176	130,983
COGS/Sales	61.5%	62.2%	57.2%
SGA/Sales	35.1%	35.0%	32.2%
# of Stores	964	1,049	1,369

(Note) COGS/Sales and SGA/Sales of Watts are 2Q FY08/2017.

(Note) COGS/Sales and SGA/Sales of Can Do are 1Q FY11/2017.

(Note) COGS/Sales and SGA/Sales of Seria are 1-3Q of FY03/2017.

Low cost operation (key: Inventory control)

POS has been installed in 342 stores for FY08/2016 and is projected to complete installation in total 409 stores (38% of current total stores) for FY08/2017. The rest of 60% stores that are consigned to super market will not use Watts POS system. Although the company uses POS data of a similar store, location or same area instead, it takes some time to construct precise analysis on the operation. Another Table below shows inventory turnover of 3 companies for the latest full year period. Apparently, the number of Watts is the highest in Inventory/COGS. Reduction of inventory is the best way of low cost operation. Watts needs further improvement on this issue, including inventory control of 60% of stores that are in-super market with consignment sale contract and need indirect data analysis.

METRICAL INC.

corporate governance, investment research & solutions



	Cando (2698, JP)	Watts (2735, JP)	Seria (2782, JP)
Inventory	5,790	5,884	11,566
COGS	42,424	28,844	75,480
Inventory/COGS	1.64	2.45	1.84
total # of items	20,000	20,000	20,000

Great value daily goods (key: Combination of daily items and women items)
Seria has superior more than 10-years' experience in using POS data analysis. It would not easy to catch up with the IT aid merchandiser, although the software system and device are much improved than those in 10 years ago. Cando employed POS in 2012 that updated data overnight, and switched in 2015, whereas Watts newly adopted real-time POS in 2015. It takes some time to gather data and construct accurate analysis. Watts's customer base remains senior ages (mainly 40s-50s even slightly widened to 30s women) that buy daily items. If weaker JPY rates continue, the number of items and profitability of "Watts Select" will come under pressure. Seria enriches craftwork items and interior goods and Cando is selling beauty or cosmetic goods for young women by using Instagram. For instance, Cando lost 0.3% sale from male customers but increased sale from female customers by 5.4% YoY and overall sales and OP margin raised 4.3% YoY and 1.4pt for FY11/2016, as items for female customers are generally higher gross profit margin. If Watts aims at raising profit margin, the company should reinforce items for younger women. Watts is likely to reinforce women items. Pictures on left are St. valentines Day promotion in stores of 4 companies (Watts, Cando, Daiso, Seria: from top to bottom).

Investment Summary

Business Outlook

Full year earnings are likely to miss the company forecast for full year FY08/2017. The sale is expected to almost in line with the company guidance, but the operating profit is likely to move lower than it due to higher than SGA/Sales than company projection. In mid-term view, higher cost of 'Watts' store development is likely to put pressure on SGA expense, but if the new stores successfully expand sale, profit margin would move higher led by POS data. At this time, METRICAL does not includes contribution by POS in mid-term projection but includes SGA/Sales decreases 0.1pt a year a year alongside sales expansion by 4% a year.

Competitive Positioning and Risks

Watts has expanded its business on its basic strategy such as low cost store development, low cost operation and great value daily goods. However, the strategy has been revised recently in order to meet change in market environment. On peer comparison, it would not clearly say Watts is a low-cost operator. Strategic reform has just started and should be closely watched how it is working.

Valuation

Examining EV/EBITDA, the share price does not look clearly undervalued in historical basis and peer comparison. EV/EBITDA is likely to rise from 8.2x for FY08/2016 to 9.7x for FY08/2017 (E), and remain at 7.9x for FY08/2020 (E) from 6.3x and 5.9x for FY08/2013 and FY08/2014, which is higher than that of Cando but lower than Seria. On Sum-Of-The-Parts valuation, applying 30x of FCF would be reasonable, as the earnings of the company is likely to improve in mid-term basis through its strategy reform. In case of mid-term projection for FY08/2017 (E), SOTP NAV is estimated to increase to JPY1,560 a share.

Financial Stability

Watts has strong balance sheet and positive free cash flow as well as positive net working capital. The company is financially stable.

Business Outlook

Monthly Store Sale

The company projects existing store sale to remain flat 0% YoY for FY08/2018, but actual sale grew more than company's projection to +2.1% YoY for 1Q and +1.5% YoY for 2Q and +1.4% YoY for 3Q. Positive growth maintains led by renovation to 'Watts' store at this moment. METRICAL keeps on hold its previous forecast of existing store sale at +1.6% YoY for FY08/2017 (E), +0.3% YoY for FY08/2018 (E), +1.3% YoY for FY08/2019 (E) and +0.3% YoY for FY08/2020 (E) (see Table below).

Existing Store Sales Growth (% YoY)

Month	FY2012/8	FY2013/8	FY2014/8	FY2015/8	FY2016/8	FY2017/8	FY2018/8	FY2019/8	FY2020/8
9	4.3	0.0	1.3	-1.0	0.2	1.3	0.3	1.3	0.3
10	4.2	-1.1	0.1	-1.2	2.8	1.8	-0.2	1.8	-0.2
11	1.9	0.4	3.1	-2.5	-1.8	3.2	-1.6	3.2	-1.6
12	3.0	-0.7	1.7	-1.7	1.3	1.9	-0.3	1.9	-0.3
1	0.5	-1.3	1.2	-3.5	1.6	3.2	-1.6	3.2	-1.6
2	2.5	-3.7	-0.7	0.8	3.4	-0.5	2.1	-0.5	2.1
3	-4.9	-0.1	12.3	-12.5	1.3	1.5	0.1	1.5	0.1
4	-1.5	-2.0	-2.7	2.0	2.3	1.8	-0.2	1.8	-0.2
5	-0.8	0.1	-0.4	1.4	0.9	0.8	0.8	0.8	0.8
6	-2.0	1.7	-2.3	-1.6	1.5	1.0	0.6	1.0	0.6
7	-0.5	-0.8	-2.0	0.2	3.8	-2.2	3.8	-2.2	3.8
8	0.1	1.1	0.3	0.5	-0.2	1.8	-0.2	1.8	-0.2

1Q	3.5	-3.8	1.5	-1.6	0.4	2.1	-0.5	2.1	-0.5
2Q	2.0	-1.9	0.7	-1.5	2.1	1.5	0.1	1.5	0.1
3Q	-2.4	2.4	3.1	-3.0	1.5	1.4	0.2	1.4	0.2
4Q	-0.8	2.9	-1.3	-0.3	1.7	0.2	1.4	0.2	1.4
YR	0.2	3.8	-0.1	-1.6	2.8	1.6	0.3	1.3	0.3

(Source) Watts, METRICAL

CE 2.0 0.0

Company Outlook for Full Year FY08/2017

The company kept on hold its full year outlook. Sale will be up 4.0% YoY to JPY48,000 million and OP, RP and NP are expected to gain 13.6% YoY to JPY1,370 million, 13.2% YoY to JPY1,350 million and 26.7% YoY to JPY910 million respectively.

METRICAL forecast for FY08/2017

Based on positive outlook of monthly sale as shown Table above, earnings for the full year will be in line with company forecast. Sales are expected to rise 3.0% YoY to JPY47,609 million and OP, RP and NP are expected to gain 15.4% YoY to JPY1,390 million, 20.6% YoY to JPY1,439 million and 16.6% YoY to JPY983 million respectively (see Table on appendix).

Mid-Term Outlook

Mid-term outlook is projected based on solid existing store sale, the sale is expected to maintain stable growth in the mid-term at +3.0% YoY for FY08/2018 (E), +3.7% YoY for FY08/2019 (E) and 3.0 YoY for FY08/2020 (E) led by new brand "Watts" stores. Alongside sales grows at moderate rate, SGA/Sales is expected to improve 0.1pt a year, while COGS/Sales remains flat. On this assumption, OP, RP and NP for FY08/2020 (E) are expected to grow to JPY1,797 million, JPY1,796 million and JPY1,179 million respectively. The mid-term projection does not fully include positive effect of employing POS data. If the IT technology successfully helps the sales higher and COGS and inventory lower, profit margin might will improve from current projection of rising to 3.4% for FY08/2020 (E) from 2.6% for FY08/2016. However, the company's ambitious mid-term projection for FY08/2018 and FY08/2019 seems hardly to achieve, as the competitive environment is getting intense and sundry specialty stores is unlikely to expand so easily.

Valuation

There would be some room of revaluation for the share price. On Sum-of-the-Parts valuation, NAV is estimated to be JPY1,505 for FY08/2017 (E) and JPY1,560 a share for FY08/2018 (E). On the other hand, EV/EBITDA does not clearly show cheap on historical multiples, although it is lower than Seria, but higher than Cando.

Sum-of-the Parts Value

Sum-of-the-Parts (SOTP) value is business value of each business segment that uses normalized EBIT, EBITDA and FCF from FY08/2014 to FY08/2017(E), added to net cash and long-term investment securities and land. SOTP value for FY08/2017(E) is estimated to be JPY1,560 a share (17% higher than closing price of July 14th 2017). SOTP value for FY08/2020(E) is estimated to be JPY1,780 a share (28% discount of closing price of July 14th 2017) revised upward due to positive store sale growth, as shown table below. The business value was based on 30x of its normalized FCF for the period, as Market Cap/FCF is relatively similar of the 3 companies than Market Cap/EBIT and Market/EBITDA (see Table on Appendix).

METRICAL INC.

corporate governance, investment research & solutions

NAVs:			NAVs:		
Sum of the parts NAV FY08/2017 (E):			Future NAV FY08/2020 (E):		
Retail	1,259	30x FCF	Retail	1,398	30x FCF
	-			-	
Cash	379	1x Book	Cash	460	1x Book
Investment	17	0.75x Book	Investment	17	0.75x Book
Land	14	0.75x Book	Land	14	0.75x Book
Debt	(109)	1x Book	Debt	(109)	1x Book
Minority	-	1x Book	Minority	-	1x Book
Total SOTP NAV	JPY 1,560	82.5%	Total Future NAV	JPY 1,780	72.3%

EV/EBITDA

EV/EBITDA for FY03/2017(E) is estimated to be 9.7x that is lower than that of Seria but slightly higher than Cando, and is also expected to come down to 7.9x for FY08/2020 (E). Also, considering historical EV/EBITDA of the company, current multiple of 9.7x is higher than 6.3x and 5.9x for FY08/2012 and FY08/2013. (see Table below).

	Aug-13	Aug-14	Aug-15	Aug-16	Mar-17(E)	Aug-18(E)	Aug-19(E)	Aug-20(E)
Avg. Mkt. Cap	JPY 14,606	JPY 12,105	JPY 12,701	JPY 12,884	JPY 17,436	JPY 17,436	JPY 17,436	JPY 17,436
EV	JPY 10,315	JPY 6,815	JPY 8,947	JPY 9,374	JPY 13,667	JPY 13,350	JPY 12,981	JPY 12,530
EV/EBITDA	6.32	5.94	8.26	8.15	9.70	8.76	8.30	7.91
*EV (LT Invest	JPY 9,842	JPY 6,313	JPY 8,306	JPY 8,803	JPY 13,096	JPY 12,779	JPY 12,410	JPY 11,959
*EV/EBITDA	4.26	3.10	5.40	5.57	7.29	6.42	5.91	5.43
EV/EBIT	4.75	3.54	6.61	7.31	9.42	8.07	7.33	6.65
EV/FCF	3.88	5.52	-6.24	244.53	27.92	24.30	21.46	18.11

Financial Analysis

As shown key financial ratios in Table below and financial statements summary on Appendix, Watts has strong balance sheet and maintains positive free cash flow and working capital, although lower profit margin reduced operating cash flow from FY08/2014 and inventory and account receivables are higher than competitors. (see cash flow statement on Appendix).

Financial Ratios:	Aug-12	Aug-13	Aug-14	Aug-15	Aug-16	Mar-17(E)	Aug-18(E)	Aug-19(E)	Aug-20(E)
ROE	15.21%	14.55%	11.77%	8.05%	7.78%	10.44%	10.66%	10.94%	11.11%
Gross Margin	38.25%	38.30%	38.06%	38.98%	37.53%	37.73%	37.92%	37.92%	37.92%
EBITDA Margin	5.73%	5.54%	4.68%	3.46%	3.42%	3.77%	4.06%	4.12%	4.20%
EBIT Margin	5.04%	4.97%	4.09%	2.83%	2.61%	2.92%	3.23%	3.33%	3.43%
Return on Assets	6.46%	6.18%	5.00%	3.92%	3.84%	5.17%	5.30%	5.46%	5.59%
Return on Fixed Asset:	158.20%	150.94%	109.85%	72.31%	60.91%	84.46%	89.29%	95.32%	101.17%
Revenue / Assets	223.70%	229.56%	229.62%	248.74%	249.82%	250.37%	250.15%	250.28%	248.71%
Depreciation / Capex	51.29%	102.16%	38.40%	39.52%	54.34%	47.66%	47.66%	47.66%	47.66%
Depn / Sales	0.68%	0.57%	0.59%	0.63%	0.81%	0.85%	0.83%	0.80%	0.78%
Capex / Sales	1.33%	0.56%	1.52%	1.60%	1.50%	1.79%	1.74%	1.68%	1.63%
Depn / Net FA	37.37%	31.85%	29.55%	29.03%	32.30%	34.96%	34.95%	34.94%	34.93%
Asset / Equity	2.35	2.36	2.25	1.99	2.00	1.99	1.98	1.96	1.94
Equity / Asset	42.48%	42.34%	44.37%	50.15%	50.12%	50.31%	50.63%	50.94%	51.50%
Total Debt / EBITDA	0.85	0.86	0.70	0.91	0.96	0.85	0.76	0.72	0.69

Investment Risks

3 middle-high risks are listed that are likely to hurt its earnings.

Competition in industry (Very Likely, Middle-High Risk)

Watts has developed niche market, expanding small size stores. Competition is getting intense, as rivals are more likely to develop smaller size stores than before. Seria announces it plans to double its market share going forward. Also, Cando closed down its diversified business in the previous year and focuses on its core business. If the competitors really accelerate small size stores, it would be significant risk for the company.

Weaker JPY currency (Likely, Middle Risk)

As mentioned earlier, depreciation of JPY rates will hurt gross profit margin of 'Watts Select' items, although Watts tries to reduce negative impact on its earnings as much as possible. However, "Watts Select" is its major products and highly supported by frequent customers. Therefore, weaker JPY rates are very likely to put the earnings downward pressure for the company. Recently, the number of items of 'Watts Select' is decreasing and tries to change to data based merchandising by using POS data.

Landlord (Likely, Middle Risk)

In these days, business consolidation and scrap and build of super market chains are not surprised. In fact, shut down of a super market operator in the previous year dragged on the company's sales negatively. This is not cause by the company not landlord, but such risk would be possibly remained as Watts runs a lot of outlets in super market.

Aki Matsumoto, CFA
akimatsumoto@metrical.co.jp

METRICAL INC.

corporate governance, investment research & solutions

Appendix

	Sales	Sales chg	COGS	COGS/S	GP	SGA	SGA/S	OP	OPM	RP	EBT	Tax	Minority	NP	EPS	Existing Store
FY2015/8 1Q	10,931	1.9%	-6,782	-62.0%	4,149	-3,764	-34.4%	383	3.5%	401	396	-89	0	307		-1.6%
2Q	11,080	2.4%	-6,868	-62.0%	4,212	-3,797	-34.3%	416	3.8%	399	372	-186	0	186		-1.5%
3Q	11,293	1.2%	-7,121	-63.1%	4,172	-3,840	-34.0%	333	2.9%	332	308	-147	0	161		-3.0%
4Q	11,158	2.7%	-6,963	-62.4%	4,195	-4,069	-36.5%	125	1.1%	131	98	-51	0	47		-0.3%
Full Year	44,462	2.0%	-27,734	-62.4%	16,728	-15,470	-34.8%	1,257	2.8%	1,263	1,263	1,193	-	701	51.73	-1.6%
FY2016/8 1Q	11,329	3.6%	-7,133	-63.0%	4,196	-4,046	-35.7%	149	1.3%	158	169	-57	0	112		0.4%
2Q	11,566	4.4%	-7,182	-62.1%	4,384	-3,947	-34.1%	437	3.8%	427	385	-150	0	235		0.0%
3Q	11,622	2.9%	-7,271	-62.6%	4,351	-4,048	-34.8%	303	2.6%	282	277	-107	3	173		0.0%
4Q	11,659	4.5%	-7,258	-62.3%	4,401	-4,085	-35.0%	316	2.7%	326	330	-137	6	199		0.0%
Full Year	46,176	3.9%	-28,844	-62.5%	17,332	-16,126	-34.9%	1,205	2.6%	1,193	1,190	-121	9	719	53.07	2.8%
FY2017/8 1Q	11,609	2.5%	-7,221	-62.2%	4,388	-4,153	-35.8%	235	2.0%	258	220	-121	33	132		2.1%
2Q	11,875	2.7%	-7,395	-62.3%	4,480	-4,071	-34.3%	409	3.4%	437	429	-87	14	356		0.0%
3Q	12,142	4.5%	-7,584	-62.5%	4,558	-4,189	-34.5%	369	3.0%	367	361	-145	25	241		0.0%
4Q (E)	12,003	3.0%	-7,460	-62.2%	4,543	-4,166	-34.7%	377	3.1%	377	377	-123	0	254		0.2%
Full Year (E)	47,629	3.1%	-29,660	-62.3%	17,969	-16,579	-34.8%	1,390	2.9%	1,439	1,387	-476	72	983	72.58	1.6%
Full Year (CE)	48,000	4.0%						1,370		1,350				910	67.17	0.0%
FY2018/8 1Q (E)	11,893	2.5%	-7,375	-62.0%	4,518	-4,241	-35.7%	278	2.3%	278	237	-77	0	160		-0.5%
2Q (E)	12,214	2.9%	-7,583	-62.1%	4,631	-4,174	-34.2%	458	3.7%	458	458	-149	0	309		0.1%
3Q (E)	12,504	3.0%	-7,786	-62.3%	4,718	-4,300	-34.4%	418	3.3%	418	418	-136	0	282		0.2%
4Q (E)	12,462	3.8%	-7,721	-62.0%	4,740	-4,311	-34.6%	430	3.4%	430	430	-140	0	290		1.4%
Full Year (E)	49,073	3.0%	-30,465	-62.1%	18,608	-17,024	-34.7%	1,584	3.2%	1,584	1,543	-503	0	1,040	76.76	0.3%
Full Year (CE)	51,000	6.3%						1,760		1,720				1,100		
FY2019/8 1Q	12,407	4.3%	-7,694	-62.0%	4,714	-4,412	-35.6%	302	2.4%	302	257	-84	0	173		2.1%
2Q	12,692	3.9%	-7,880	-62.1%	4,813	-4,324	-34.1%	489	3.8%	488	488	-159	0	329		1.5%
3Q	12,978	3.8%	-8,081	-62.3%	4,897	-4,450	-34.3%	447	3.4%	447	447	-146	0	301		1.4%
4Q	12,830	3.0%	-7,949	-62.0%	4,880	-4,425	-34.5%	455	3.5%	455	455	-148	0	307		0.2%
Full Year (E)	50,908	3.7%	-31,604	-62.1%	19,304	-17,611	-34.6%	1,693	3.3%	1,692	1,647	-537	0	1,110	81.95	1.3%
Full Year (CE)	54,000	5.9%						2,100		2,070				1,360		
FY2020/8 1Q	12,711	2.5%	-7,882	-62.0%	4,829	-4,507	-35.5%	322	2.5%	322	274	-89	0	185		-0.5%
2Q	13,055	2.9%	-8,105	-62.1%	4,950	-4,435	-34.0%	516	3.9%	515	515	-168	0	347		0.1%
3Q	13,364	3.0%	-8,322	-62.3%	5,043	-4,569	-34.2%	474	3.5%	473	473	-154	0	319		0.2%
4Q	13,320	3.8%	-8,253	-62.0%	5,067	-4,581	-34.4%	486	3.6%	486	486	-158	0	327		1.4%
Full Year (E)	52,451	3.0%	-32,562	-62.1%	19,889	-18,091	-34.5%	1,797	3.4%	1,796	1,749	-570	0	1,179	87.01	0.3%

(Source) Watts, METRICAL

Cash Flow Analysis	Aug-12	Aug-13	Aug-14	Aug-15	Aug-16	Mar-17(E)	Aug-18(E)	Aug-19(E)	Aug-20(E)
Net Income	1,177	1,123	948	700	709	983	1,040	1,110	1,179
Depreciation*	278	237	255	281	376	407	407	407	407
Amortization*	89	37	0	0	0	0	0	0	0
Other non-cash charge	290	-12	226	-154	-252	0	0	0	0
Changes in WC	93	1,384	379	-1,448	-105	-67	-67	-85	-72
Operating Cash Flow	1,927	2,769	1,808	-621	728	1,323	1,380	1,432	1,514
Per share	JPY 305.48	JPY 218.40	JPY 133.45	(JPY 45.84)	JPY 53.74	JPY 97.65	JPY 101.86	JPY 105.72	JPY 111.77
Capex	-542	-232	-664	-711	-692	-854	-854	-854	-854
Free Cash Flow	1,385	2,537	1,144	-1,332	36	469	526	578	660
Per share	JPY 219.56	JPY 200.10	JPY 84.44	(JPY 98.32)	JPY 2.66	JPY 34.62	JPY 38.82	JPY 42.68	JPY 48.73
Beginning Cash	3,039	4,086	6,280	6,714	5,149	5,030	5,290	5,606	5,975
Net cash used	1,047	2,194	434	-1,565	-119	260	317	369	451
Ending cash	4,086	6,280	6,714	5,149	5,030	5,290	5,606	5,975	6,426

METRICAL INC.

corporate governance, investment research & solutions

	2012/8	2013/8	2014/8	2015/8	2016/8	2017/8(E)	2018/8(E)	2019/8(E)	2020/8(E)
Consolidated Balance Sheets									
Assets									
Current Assets									
Cash and Cash Equivalents	4,086	6,280	6,714	5,149	5,030	5,290	5,606	5,975	6,426
Short-Term Investments	-	-	-	-	-	-	-	-	-
Notes and Accounts	1,812	2,320	2,318	2,052	2,163	2,231	2,299	2,385	2,457
Allowance for Doubtful	(21)	(24)	(24)	(22)	(20)	(21)	(21)	(22)	(23)
Inventories	4,642	4,975	5,233	5,642	6,126	6,319	6,510	6,754	6,958
Deferred Income Taxes	272	261	238	237	233	240	248	257	265
Other Current Assets	456	469	383	409	376	388	400	415	427
Total Current Assets	11,247	14,281	14,862	13,467	13,908	14,447	15,041	15,763	16,510
Property, Plant and									
Land	80	257	257	257	257	257	257	257	257
Buildings	773	879	944	1,092	1,208	1,208	1,208	1,209	1,209
Machinery and Equipment	2,208	2,366	2,587	2,761	2,975	2,975	2,975	2,975	2,975
Construction in Progress	-	-	-	-	-	(0)	(0)	(0)	(0)
Total	3,061	3,502	3,788	4,110	4,440	4,440	4,440	4,440	4,440
Accumulated Depreciation	(2,284)	(2,501)	(2,668)	(2,885)	(3,019)	(3,019)	(3,019)	(3,018)	(3,018)
Net Property, Plant and	777	1,001	1,120	1,225	1,421	1,421	1,422	1,422	1,422
Software & Other intangible	28	28	33	54	61	61	61	61	61
Goodwill	44	-	-	-	-	-	-	1	2
	72	28	33	54	61	61	61	62	63
Other Assets									
Investments in and Advances	-	-	-	-	-	-	-	-	-
Investment Securities	84	216	245	384	314	314	314	314	314
Software & Others	(30)	(27)	(29)	(30)	(3)	(3)	(3)	(3)	(3)
Deferred Income Taxes	93	88	98	124	122	122	122	122	122
Other	2,560	2,589	2,647	2,651	2,661	2,661	2,661	2,661	2,661
Total Other Assets	2,707	2,866	2,961	3,129	3,094	3,094	3,094	3,094	3,094
Total	14,803	18,176	18,976	17,875	18,484	19,023	19,618	20,341	21,090
Liabilities and Stockholders'									
Current Liabilities									
Bank Loans	140	140	100	100	100	100	100	100	100
Notes and Accounts Payable,	4,433	6,578	7,170	5,842	6,129	6,322	6,514	6,757	6,962
	-	-	-	-	0	0	0	0	0
Accrued Expenses	-	-	-	-	-	-	-	-	-
Income Taxes	782	346	448	285	261	269	277	288	296
Other Current Liabilities	816	1,302	1,248	1,133	1,026	1,058	1,090	1,131	1,165
Current Portion of Long-Term	1,267	957	679	565	626	626	626	626	626
Total Current Liabilities	7,438	9,323	9,645	7,925	8,142	8,375	8,607	8,902	9,150
Long-Term Debt	1,102	644	403	468	534	534	534	534	534
Deferred Income Taxes	-	-	-	-	-	-	-	-	-
Termination and Retirement	201	248	242	262	260	260	260	260	260
Other Long-Term Liabilities	247	266	267	255	284	284	284	284	284
	2,509	1,741	1,182	1,133	1,260	1,260	1,260	1,260	1,260
Total Liabilities	8,988	10,481	10,557	8,910	9,220	9,453	9,685	9,980	10,228
Stockholders' Equity									
Common Stock	440	440	440	440	440	440	440	440	440
Additional Paid-in Capital	876	1,583	1,583	1,583	1,583	1,583	1,583	1,583	1,583
Legal Reserve	4,783	5,716	6,434	6,905	7,393	8,167	8,997	9,898	10,868
Retained Earnings	-	1	1	1	1	1	1	1	1
Treasury Stock	(268)	(84)	(84)	(84)	(84)	(84)	(84)	(84)	(84)
Total Stockholders' Equity	5,831	7,656	8,374	8,845	9,333	10,107	10,937	11,838	12,808
Comprehensive Income	(15)	39	46	121	(67)	(537)	(1,005)	(1,478)	(1,946)
Minority Interests in	-	-	-	-	-	-	-	-	-
Total Stockholders' Equity	5,816	7,695	8,420	8,966	9,266	9,570	9,933	10,361	10,862
Total	14,804	18,176	18,977	17,876	18,486	19,023	19,618	20,341	21,090

METRICAL INC.

Suite 3113, 28-10 Ebisu 2 chome, Shibuya-Ku, Tokyo 150-0013 Japan

Phone: +81-3-4405-6223 Email: akimatsumoto@metrical.co.jp

<http://www.metical.co.jp/>