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Ai Holdings Corporation

TSE 1st
Section

Initial Report

In April 2007, Ai Holdings Corporation (hereinafter Ai Holdings or the Company) was founded as a pure holding company through the merger between DODWELL B.M.S. LTD. (hereinafter DODWELL B.M.S.), a distributor of security systems and onsite IC card issuing systems, and GRAPHTEC Corporation (hereinafter GRAPHTEC), a manufacturer of measurement instruments and computer peripheral systems. The following is a summary of Trias Corporation's interview with Takeshi Kobayashi, Public Relations, General Manager at Ai Holdings, on an overview of the Company and its future direction.

Business Goals via M&A: Maximizing Existing Customer Base

Originally a trading house and formerly listed on the 1st section of the Tokyo Stock Exchange, DODWELL B.M.S. developed and sold security systems, including security cameras, and IC card issuing systems for hospitals, financial firms and retailers. When it began examining the possibility of setting up a pure holding company, DODWELL B.M.S. boasted a customer base of some 50,000 firms and an extensive service network of 33 branches nationwide manned by a technical staff of 180.

Meanwhile, GRAPHTEC, which was also formerly listed on the TSE's 1st section, operated since its founding in the measurement instruments market, a relatively stable field that underpins Japan's manufacturing sector. Following the widespread dissemination of personal computers, GRAPHTEC has come to handle a wide range of computer peripherals, including commercial cutting plotters, scanners and similar products, with over 50% of its sales coming from exports to North America and other foreign markets. While the firm grew as a player in niche markets as well as the global market, its business performance rapidly deteriorated after the peak year of 1991 due to mismanagement. It managed to tread water for some time, owing to ample internal reserves, the company could never regain traction as the restructuring measures it adopted, including office closures and the outsourcing of after-sales services, eroded its customer satisfaction quality.

The key to securing marketing success in the office equipment business is logistics and after-sales services. DODWELL B.M.S.'s extensive domestic service network held considerable appeal to GRAPHTEC that experiencing a major slippage in service quality. Incidentally, DODWELL B.M.S. not only provides maintenance services for its own products but also equipment made by other

makers, including Canon Inc. and KYOCERA MITA Corporation. At the same time, DODWELL B.M.S. was partnering with GRAPHTEC in CAD systems for steel-frame structures. The partnership led to the two companies entering into a capital tie-up and eventually, to integrate their management. While the business fields they engaged in and their corporate cultures were completely different, the integration proceeded smoothly in part because the similarities they shared in operating in niche markets. As mentioned earlier, DODWELL B.M.S.'s client base of some 50,000 firms enabled them to boost sales by strengthening ties with existing customers without the need of acquiring of new ones. This was the basic post-merger strategy for sales growth that was adopted. The final decision also took into account the fact that GRAPHTEC's balance sheet was fundamentally sound as a result of the rationalization initiatives it adopted, and that it carried a loss that could be transferred to secure tax benefits if they were to merge.

In July 2009, more than 90 engineers from DODWELL B.M.S. and GRAPHTEC were consolidated into the Group's integrated R&D division, which was later spun off as the subsidiary, Ai Engineering Co., Ltd. The upgrade in engineering expertise was another product of the integration.

Business Overview

Ai Holdings currently consists of six business segments: 1) security systems; 2) IC card issuing systems and other office equipment; 3) computer peripherals; 4) maintenance services; 5) architectural design; and 6) other businesses. The Company has a total of 16 affiliated companies, of which 14 are consolidated and two are non-consolidated, including DODWELL B.M.S., GRAPHTEC, and two equity method affiliates. Below are brief outlines of each segment's operations:

1) Security Systems: This segment, led chief by DODWELL B.M.S., engages in sales of digital security systems, including security cameras, to condominium management associations and corporate clients

2) IC Card Issuing Systems and Other Equipment: This segment is also led by DODWELL B.M.S. and engages in development and marketing of instant issuing systems for hospitals and credit cards issued by financial firms and retailers; also produces mailing systems, steel-frame structure CAD systems and other office equipment

3) Computer Peripherals: Led primarily by GRAPHTEC, the segment engages in the manufacturing and sales of commercial cutting plotters, scanners and computer supply products in Japan and abroad (includes OEM sales)

4) Maintenance Services: A segment providing repair and maintenance services of DODWELL

B.M.S. and GRAPHTEC products in Japan and abroad

5) Architectural Design: This segment is led by SHIOMI SEKKEI Corporation (hereinafter SHIOMI SEKKEI), an expert in quakeproof structural designs that provides structural integrity testing and design, as well as architectural design services and construction site management, the company has been a Group subsidiary since February 2009

6) Other Businesses: A segment tasked with sales of measurement instruments and environmental testers developed and manufactured by GRAPHTEC, it also sells and leases hardware made by other firms in the Group

Q2 FY6/10 Consolidated Business Results

Ai Holdings' consolidated business results for 1H FY6/10 may be seen in the business results by segment chart below. In the past, more than half of the Company's profits came from its security systems operations because the computer peripherals segment had been incurring losses. This trend has been remedied in the current term, with all segments become profitable.

● Net Sales by Segment

(\$ million)		FY6/09	FY6/10	YoY Change	
		1H Actual	1H Actual	Amount	Ratio
Security System	Net sales	3,027	2,580	-447	-14.8%
	Operating income	498	266	-232	-46.6%
	Operating margin	16.5%	10.3%	-	-
Card Issuing System & Other Office Equipment	Net sales	2,549	1,439	-1,110	-43.5%
	Operating income	163	151	-12	-7.4%
	Operating margin	6.4%	10.5%	-	-
Computer Peripheral Equipment	Net sales	3,318	2,789	-529	-15.9%
	Operating income	-125	179	304	-
	Operating margin	-3.8%	6.4%	-	-
Maintenance Service	Net sales	1,528	1,305	-223	-14.6%
	Operating income	84	11	-73	-86.9%
	Operating margin	5.5%	0.8%	-	-
Architectural Design	Net sales	-	1,959	-	-
	Operating income	-	158	-	-
	Operating margin	-	8.1%	-	-
Other Businesses	Net sales	1,643	1,588	-55	-3.3%
	Operating income	97	39	-58	-59.8%
	Operating margin	5.9%	2.5%	-	-
Elimination	Net sales	-128	-138	-	-
	Operating income	105	84	-	-
Grand total	Net sales	11,939	11,525	-414	-3.5%
	Operating income	824	890	66	8.0%
	Operating margin	6.9%	7.7%	-	-

Although the security systems segment logged year-on-year declines in both sales and profit in the

1H due to slumping sales to corporate clients, its sales to condos fared well as it sold systems to 1,054 complexes (versus the full-year target of 2,150). The condo market is projected to enter a replacement cycle of systems installed a few years ago. The Company is therefore aiming to secure annual sales of over 3,000 complexes from both replacement and new sales from fiscal 2011 and beyond. In line with this expected market demand, Ai Holdings has shifted 15 of the 30 sales staff working in corporate sales to sales to condo management associations.

Meanwhile, the performance of the IC card systems and office equipment segment has been stable due to hospital sales, a market that has reached maturity for some time. In addition, shipment of onsite credit card issuing systems to Europe has begun and will likely contribute to future sales.

Because the computer peripherals segment had suffered losses, the Company infused managers above the department heads with younger blood and set up a more robust regime that can generate profit from lower sales, shifting priorities from sales to gross profits, while reducing costs. As a result, Ai Holdings was able to put an end to single-month losses. In October 1, 2009, the Company launched a fully-owned subsidiary, Silhouette AMERICA, Inc. (hereinafter Silhouette), in Utah. Silhouette provides design content for hobby crafts that are popular in the United States and Europe, including scrapbooks, card making and home décor, especially among middle-class women in their 30s to 50s who have children. Combined with other hobbies such as paper cutting and glass crafting, the market is worth some 580 billion yen as of 2008 in the U.S. alone. The only company in the U.S. to distribute such digital content online, Silhouette offers some 5,000 design items and is enjoying growth in membership and revenues. It is currently planning to branch into the United Kingdom and other European countries within the year.

As for its architectural design operations, Ai Holdings had posted significant profits until the end of the previous term because SHIOMI SEKKEI had been using a completed-contract accounting principle. From this term, however, SHIOMI SEKKEI shifted to percentage-of-completion principle, which will enable the Company to report profits faster. SHIOMI SEKKEI is winning contracts on a pace that is meeting its planned target, particularly from government agencies, with more than 90% of orders coming in for quakeproof structural design projects. And because only a few architectural design firms in Japan specialize exclusively in quakeproofing structures, SHIOMI SEKKEI is expected to continue performing well.

In the other businesses segment, which includes measurement instruments, had slumped as Japanese makers were rocked by the Lehman Bros. collapse in the fall of 2008, but business has picked up since the latter half of 2009.

Turning to Ai Holdings' 2H results, while the forecast had the second half posting higher sales but lower profits than the first half, the actual results are that both sales and earnings continue to rise.

The reason why the Company has refrained from revising its full-year forecast is due to the fact that its operating environment remains uncertain. Moreover, it has been difficult to accurately predict profits because Ai Holdings has seen major differences in its projected and actual extraordinary income and losses due to valuation swings in marketable securities over the past few years. Although the Company has already logged an appraisal loss on its unlisted securities holdings, it is hard to say how valuation of its large listed securities holdings will turn out until the end of the term.

Future Business Plans: Perspectives on M&A

M&A is an important growth strategy for Ai Holdings and its policy governing acquisitions include whether a target enterprise has a sound balance sheet and possesses strengths in a niche market, while generating annual sales of several billions of yen—even if it should be incurring losses. Another principle is that the Company strictly adheres to its refusal to take on debt for a buyout. The reason behind this policy and guidelines is the belief that losses can be remedied as profitability issues are frequently due to mismanagement and that a firm with a sound balance sheet has a greater likelihood for a turnaround. In addition, the investment required to purchase an unprofitable company with annual sales of several billions of yen tends to be comparatively modest.

While the type of business is less relevant for a firm targeted by Ai Holdings, the optimal acquisition is an enterprise that operates in a field in which synergy effects can be expected from the Company's logistical and maintenance services network. In other words, the best candidate is one that makes or sells products that require after-sales services and can fully exploit Ai Holdings' 50,000-plus client base. While a large number of M&A deals are brought in every year, each case is thoroughly scrutinized and deliberated in-house before it is brought before CEO and Chairman Hidekichi Sasaki for a final decision. Among the companies that have come under the Company's aegis over the past several years are IC card related systems firm NEURON CORPORATION, measurement instruments software developer USTAGE Co., LTD. and SHIOMI SEKKEI. It has averaged one to two acquisitions a year during that period and will continue to pursue M&A deals at a reasonable pace.

As for its future activities, the Company's existing operations, which pivots on DODWELL B.M.S., has tended to key on logistical services so far. The business model adopted by the security systems segment, for example, relies primarily on lease sales, with maintenance services tied to each contract. While the Group employs some 170 service engineers at this time, they are being under-utilized. The degree to which Ai Holdings will be able to capitalize on these human resources and networks not only to proactively sell products but provide services to accompany them will be the key to future growth. As for its foreign operations, because GRAPHTEC is already conducting operations on a global basis, the Company aims to exploit its network to the fullest.

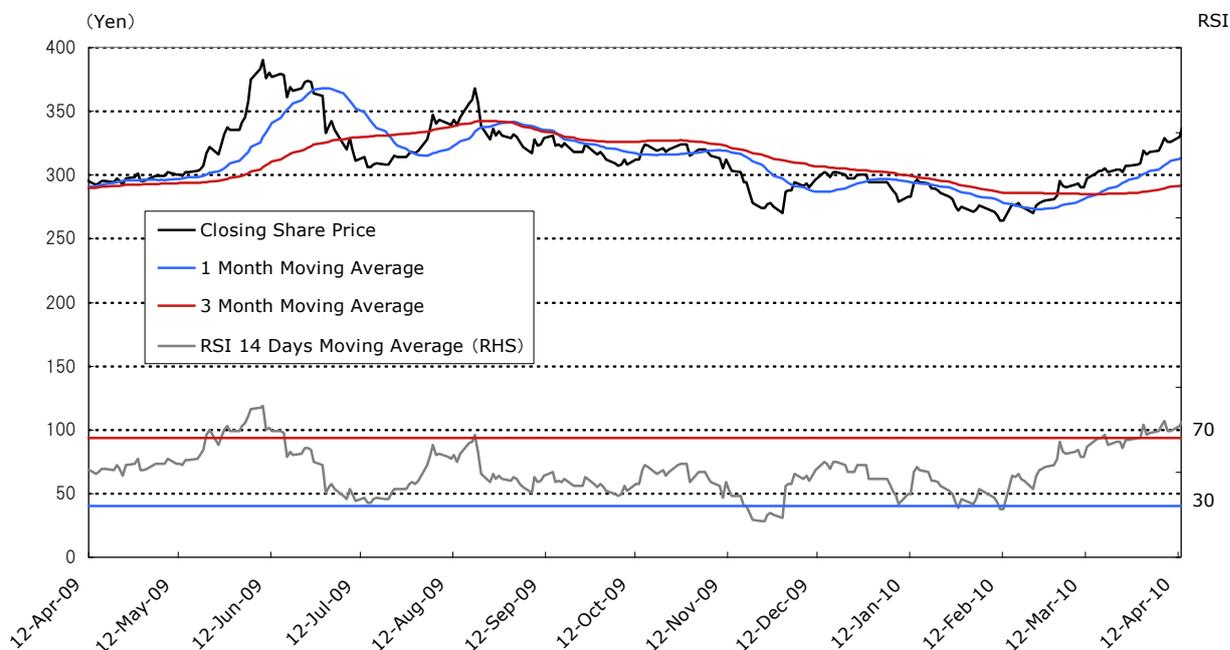
Key Financial Data (Consolidated)

Key Stock Indicators (Consolidated)			Key Financial Data (Consolidated)		
No. of Shares Issued	June. 09	56,590,410	Total Assets (¥million)	June. 09	27,906
No. of Treasury Stock	June. 09	1,694,511	Shareholders' Equity (¥million)	June. 09	20,205
Market Value (¥million)	Apr.12, 2010	19,071	Interest-Bearing Debt (¥million)	June. 09	8
BPS (¥)	June. 09	368.1	Equity Ratio (%)	June. 09	72.4
ROE (%)	June. 09	4.7	Ratio of Interest-Bearing Debt (%)	June. 09	0.0
ROA (%)	June. 09	3.4	Free Cash Flows (¥million)	June. 09	587
PER (times)	FY6/10 est.	14.2	ROE=Current Net Income÷Averaged Shareholders' Equity of beginning of term and term end		
PCFR(times)	June. 09	13.1	ROA=Current Net Income÷Averaged Total Assets of beginning of term and term end		
PBR (times)	June. 09	0.9	PCFR=Market Value÷(Current Net Income+Depreciation)		
Share Price (¥)	Apr.12, 2010	337	Average Daily Volume=Average Daily Volume for previous 12months		
Unit Share (shares)	Apr.12, 2010	100	Ratio=Interest-Bearing Debts÷Shareholders' Equity		
Average Daily Volume (shares)	Apr.12, 2010	100,097	Free Cash Flows=Operating CF+Investment CF		

Consolidated (¥ million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend per Share (¥)
FY6/07	7,588	-1,175	-988	996	18	8
FY6/08	23,674	1,797	1,934	609	11	20
FY6/09	23,308	1,548	2,076	966	18	20
FY6/10 Interim fcst.	11,525	890	1,183	911	17	8
FY6/10 fcst.	24,500	1,600	2,050	1,300	24	16

Note: FY6/10 forecasts announced on Feb. 12, 2010.

Share Price Charts and RSI



Source: Prepared by Trias Corp. with Bloomberg data.

Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices.

In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.

RSI=averaged share price appreciation for N days÷(averaged share price appreciation for N days + averaged share price decline for N days)×100