

Nohmi Bosai 6744

Nohmi Bosai has dominant share in fire alarm systems and fire extinguish systems in Japan. We think the following aspects fits your investment criteria: low PBR of 0.82x, double digit ROIC 12.1%, FCF yield 11.4% and margin expansion for the last five consecutive years including GPM, OPM and NI margin. Margin is expected to grow further owing to law change in the industry

| Key Metrics | | |
|------------------|--------|-----------|
| Share Price | ¥635 | 13-Mar-08 |
| Market Cap. (bn) | ¥38.63 | 13-Mar-08 |
| PER (CoE) | 16.8x | FY3/08 |
| PBR | 0.82x | FY3/07 |
| ROIC | 12.1% | FY3/07 |
| Adj FCF yield | 11.4% | FY3/07 |

1. Business Description:

- Nohmi Bosai is the largest manufacturer of disaster prevention systems including fire alarms (seg1) and fire extinguishing systems (seg2). These two segments suffered from large projects with low profitability while co generated earnings from the Maintenance segment (seg3), including after-the-sales services.
- Margin grew for Fire Alarm segment with strong demand for fire alarms, related with amended Fire Protection Law; –mandatory installation of fire alarms for both newly build houses (Jun/06~) and existing houses (Jun/08~Jun/11, due date depends on local government). While numbers of newly build houses are 1mn units/yr in Japan, co sold 2mn fire alarms in 1H/07. This boom is to continue till FY3/09, leading to continuous OP growth forecasts (CoE+2%yoy, consensus+8% in FY3/08, +2.3% in FY3/09).
- Secom (9735), a security service giant bought 50% share in '06, increases OEM orders of security equipment.

| Segment details by FY3/07 (yen bn) | | | | |
|------------------------------------|----------------------|---------|------|-----|
| | | Revenue | OP | OPM |
| (1) | Fire Alarm | 33.8 | 3.9 | 12% |
| (2) | Fire Extinguish | 20.6 | 0.9 | 4% |
| (3) | Maintenance | 20.5 | 3.7 | 18% |
| | Others & Subtractior | 4.9 | -4.7 | - |
| | Total | 79.7 | 3.8 | 5% |

2. Key Metrics:

- PBR: 0.82x. Co's PBR has been kept low between 0.7x-1x since FY3/02 due to low ROE between 3%-4.4%. However, Co's ROE has been improving five straight years from negative in FY3/02 to 4.4% in FY3/07, mainly backed by NI margin gain (also five consecutive years growth to 2.6% in FY3/07). ROE is stagnant due to low leverage with almost borrowing-free management but should recover by margin increase till FY3/09.
- Margin growth: OPM also grew from 2.3% in FY3/04 to 4.8% in FY3/07, mainly owing to GPM growth of 25.7% in FY3/04 to 27.6% in FY3/07. GPM growth is backed by shift to value-added products along with cost reduction.
- ROIC: 12.1%. ROIC improved from 6.0% in FY3/04 to 12.1% in FY3/07, while Co has kept capex for further growth at high level, keeping dominance in the industry. The figure is expected to grow to 13.0% based on co's OP estimate and 3Q/07 BS.

3. Five Forces Analysis:

- Few competitors, Co being No.1 in the market for fire alarms and fire extinguish systems. Big player Secom, possible market participant, has chosen a strategy to hold Co's share rather than directly entering the market.
- Main customers are "sub-contractors" such as Kandenko (1942) and Nippon Densetsu (1950), positioned under the "general-contractors" in the construction industry pyramid. While overall construction industry enjoyed high level orders of ¥50 trillion volume orders for the last five years or so, "general-contractors" suffered from low margin due to over capacity of 5mn companies from big to small, as well as regulation strengthened on bid-rigging with public works. On the other hand, "sub-contractors" and sub tier players are enjoying better margin, given less competition.

4. Further research topics:

- Amendment on Construction Standard Act caused negative impact on new housing starts, but should be blown over around 2H of FY3/09. Increase in housing start orders should have positive impact on Co's fire alarm sales.
- Regarding land value, difference between current values and book value is around ¥3.5 billion on our calculation, though all lands are utilized on business at the moment.
- Possible price down on popular products vs growth in high-margin value-added products, and market shares for each.
- Strategies among 30 subs including consolidated and non-consolidated.