

April 2019

PIALA Inc. (7044 JP / TSE Mothers)

SUMMARY

PIALA Inc. (“PIALA” - stands for Person, Innovation, Advanced, Linkage, and Attractive) is a direct marketing and advertising company that leverages e-commerce (EC) technology, including big data management platforms (DMP) and artificial intelligence (AI). The company specializes in two segments, namely “beauty & health” (such as anti-aging face creams and serums) and “food supplements” (such as dietary supplements and vegetable drinks). The market for these segments is expected to continue to expand, and should be resilient to economic cycles against the backdrop of the aging society and the population’s increased awareness toward health.

PIALA provides comprehensive marketing and advertising services for clients, including consulting and marketing activities. The company’s successful business model is unique from that of traditional ad agencies. Specifically, PIALA adopts a contingent fee system, and uses its database to identify the best advertising method for each product while minimizing risks.

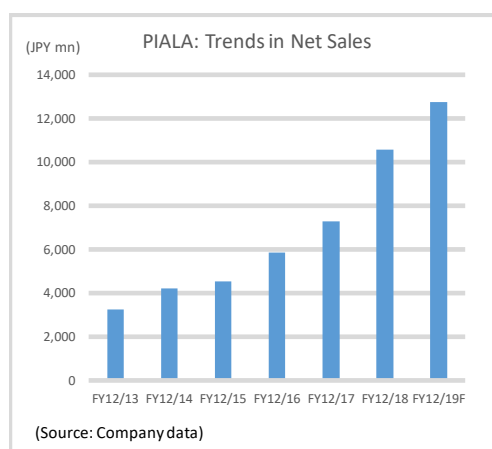
PIALA has more than 15 years of business track record. The company has grown significantly over the last five years, reaching the milestone of JPY10 bn in net sales in FY18. In our view, the company has entered a new stage of growth by winning the critical mass in the focus market segments in which it specializes. The company has entered a virtuous cycle; accumulation of data leading to accumulation of clients.

COMPANY PROFILE

PIALA was founded in 2004 by Mr. Takao Asuka, the current CEO. PIALA has focused on the “beauty & health” and “food supplement” segments since its founding. The company’s business has expanded particularly over the last five years, thanks to the growth of the EC market and the build-up of the marketing database.

PIALA launched its overseas operation in 2013, and currently has subsidiaries in Hangzhou (China), Hong Kong, Bangkok (Thailand), and Taiwan. PIALA is engaged in advertising and cross border EC marketing activities through overseas subsidiaries. The Thai subsidiary also handles IT system development and maintenance.

PIALA was listed on the TSE’s Mothers section in December 2018. As of March 29, 2019, the company’s market capitalization was JPY10 bn at share price @JPY2,827.



Koyo Ozeki

Financial
Research

MANAGEMENT

The CEO, Mr. Takao Asuka (44), leads the company (137 employees as of December 2018). Mr. Asuka started his career at Triumph International (Japan), where he was in a management role, demonstrating strong capabilities as a marketer and manager. PIALA’s business is based on Mr. Asuka’s extensive experience and insights. The board consists of four directors (including one outside director) and three auditors (including two outside auditors).

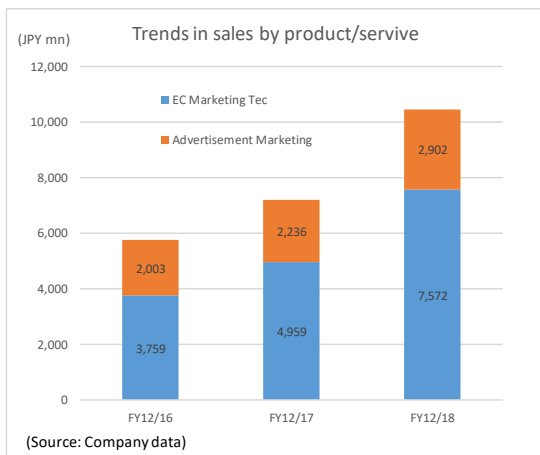
SHAREHOLDERS

Mr. Asuka (including his private asset management company) holds 48.8% stake in the company. Other major shareholders (with more than 5% stake) include BDashFund3 investment fund (12.8%) and two directors of the company (5.61% each).

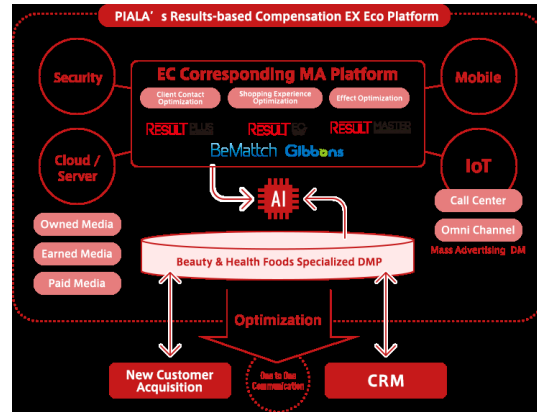
BUSINESS

PIALA’s business consists of two services, namely 1) e-commerce marketing (“EC Marketing Tech”) and 2) conventional marketing (“Advertisement Marketing”, including mail and insert ads). EC Marketing Tech is the mainstay business and the main driver of growth.

PIALA focuses on the two market segments; “beauty & health” and “food supplement”. Customer’s demand for such products (i.e. the desire to be beautiful and healthy) do not change dramatically over time and therefore products that cater to such needs are suitable for advertising based on analysis of accumulated historical data.



EC Marketing Tech is mainly based on DMP and AI technologies that allow the company to identify the best marketing method and to provide consulting services based on historical data.



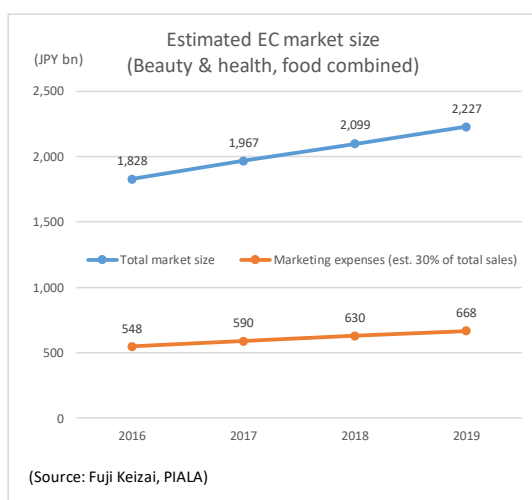
Given the effectiveness of EC Marketing Tech, PIALA is able to offer services to its clients based on a contingent fee system (as opposed to traditional contract-based fees). Under the contingent fee system, fees are calculated based on actual sales, and clients do not have to pay for unsuccessful marketing activities. Specifically, PIALA provides comprehensive advertising services, under which the company commits to achieving certain key performance indicators (KPIs) and makes discretionary decisions on the advertising method and budget allocation on behalf of clients (“KPI Guarantee” service).

PIALA’s competitive position improved dramatically over the last few years, thanks to the “KPI Guarantee” service. Major general ad agencies (such as Dentsu Inc.) and EC companies (such as Amazon), which used to be PIALA’s main competitors, are now using PIALA as a subcontractor. In other words, PIALA’s former competitors are now cooperating with PIALA under the “KPI Guarantee” system. Fees are generally shared evenly, achieving a win-win relationship. Recently, the proportion of these subcontracts (by number of clients) has increased to 40% (from 10% a few years ago) to become one of the major drivers of business growth at the company.

THE MARKET

The size of the EC market for “beauty & health” and “food supplement” has been growing and is

expected to continue to expand on the back of the aging society and the population's increased awareness toward health. The size of the market (by total sales) is currently estimated at around JPY2,000 bn and is forecasted to grow at 6-8% p.a. in the medium-term. Total marketing expenses that client companies are paying (i.e. total revenue of the ad industry) is estimated to be around JPY630 bn. Based on this number, PIALA's current market share is estimated at roughly 1.7% (net sales JPY10.6 bn in FY18).



GROWTH STRATEGY

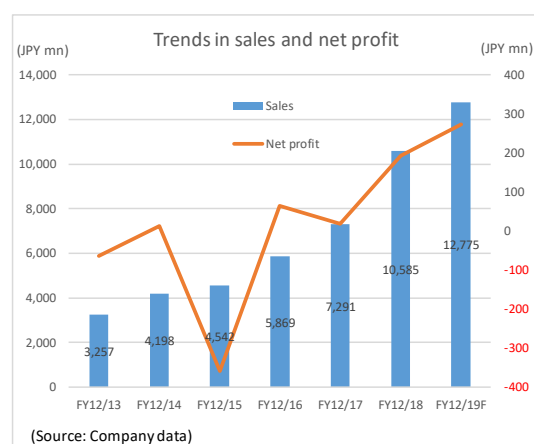
PIALA's medium-term growth strategy is two-fold; 1) further penetration of the "KPI Guarantee" business to expand its domestic market share to around 15%, and 2) establishing a scalable overseas operation.

For the domestic business, management intends to continue to focus on the "beauty & health" and "food supplement" segments, rather than expanding into other areas. As the company's business achieves scale, the company should enjoy a virtuous cycle where the accumulation of data enhances AI learning. In the overseas business, the Asian region has significant potential. PIALA's management intends to increase the contribution from the overseas business to around 10% of total sales from the current 1.5%.

FINANCIAL POSITION

PIALA's financials improved significantly over the past two years, thanks to the increase in net

profits and the equity raise through the IPO in December 2018.



Income statement: Net sales recorded a sharp increase (+45% YoY), and the SG&A cost ratio improved to 14.7% from 17.6% in FY17. As a result, operating profit margin (OPM) improved to 3.0% in FY18 from 0.4% in FY17. Net sales is now high above the break-even point, and therefore OPM should further improve going forward. The management's OPM target is 10% for the medium-term. Gross profit margin has dropped slightly over the last couple of years (to 17.7% in FY18 from 20.2% in FY16), due particularly to the higher proportion of the subcontract business. However, the growth in business volume has contributed to strengthening the company's market position.

Balance sheet: Following the IPO and issuance of new shares (JPY821 mn) in December 2018, the balance sheet structure has improved dramatically. The shareholder's equity ratio has increased to 49.6%, from 22.3% at the end of the previous year. Interest-bearing debt against EBITDA is modest (117% at the end of FY18), and the company has ample cash reserves (JPY1,445 mn). The balance sheet is expected to improve further given the strong internal capital generation.

Cash flow: Free cash flow has been in negative territory in the last few years due to larger amounts of working capital and investments needed to support the growth of the business. However, the company has good access to bank loans and the capital markets. Ample cash in hand and improved operating cash flow should allow the company to make new investments in

the foreseeable future without relying heavily on new financing.

OUTLOOK AND VALUATION

Given the anticipated growth of the “beauty & health” and “food supplement” market (estimated to grow at 6-8% p.a.) and PIALA’s growing market share, the company’s business is expected to expand rapidly. Assuming a modest annual sales growth of 20% (compared to the average growth rate of 27% p.a. over the last five years), PIALA’s sales volume should

increase to JPY15.3 bn in FY20 (in two years), and net profits should reach JPY640 mn. The company’s profit margin should improve given the larger scale of its business and reduced cost ratio (see tables below). Hence, the company’s net profit may reach JPY1.2 bn in FY21 (in three years). Based on our forecast, the near-term intrinsic value of PIALA’s share is @JPY5,400. Our medium-term price target is JPY8,400 at PER 25x (see “intrinsic share value matrix” below).

GROWTH SCENARIO		(JPY mn)			
	FY12/18	FY12/19F	FY12/20E	FY12/21E	
Sales	10,585	12,775	15,300	18,400	
Gross profit	1,870	2,312	3,060	4,048	
SG&A	1,551	1,916	2,142	2,392	
Operating Profit	319	395	918	1,656	
Net profit	192	273	643	1,159	

(Source: Analyst estimation for simulation purposes only)

ESTIMATED MARGINS (AS % OF SALES)					
	FY12/18	FY12/19F	FY12/20E	FY12/21E	
Sales	100.0%	100.0%	100.0%	100.0%	
Gross profit	17.7%	18.1%	20.0%	22.0%	
SG&A	14.7%	15.0%	14.0%	13.0%	
Operating Profit	3.0%	3.1%	6.0%	9.0%	
Net profit	1.8%	2.1%	4.2%	6.3%	

(Source: Analyst estimation for simulation purposes only)

INTRINSIC SHARE VALUE MATRIX		(JPY)				
Net profit (JPY mn)	190	270	640	1,200	1,500	
# of shares in issue	3,542,455					
EPS (JPY)	54	76	181	339	423	
PER						
10	536	762	1,807	3,387	4,234	
15	805	1,143	2,710	5,081	6,352	
20	1,073	1,524	3,613	6,775	8,469	
25	1,341	1,905	4,517	8,469	10,586	
30	1,609	2,287	5,420	10,162	12,703	
40	2,145	3,049	7,227	13,550	16,937	
50	2,682	3,811	9,033	16,937	21,172	
60	3,218	4,573	10,840	20,325	25,406.1096	

(Source: Analyst estimation for simulation purposes only)

Current level

Intrinsic price

Medium-term target price

FINANCIAL DATA

INCOME STATEMENT		(JPY mn)			
	FY12/16	FY12/17	FY12/18	FY12/19F	
Sales	5,869	7,291	10,585	12,775	
Gross profit	1,187	1,311	1,870		
SG&A	1,092	1,280	1,551		
Operating profit	94	31	319	395	
Non-operating income	10	15	1		
Non-operating expense	14	13	19		
Recurring profit	90	33	301	389	
Extraordinary profit	3	0	2		
Extraordinary loss	27	19	50		
Pre-tax profit	66	14	252		
Taxation	1	-5	60		
Net profit	65	19	192	273	

(Source: Company data)

PROFIT MARGIN		FY12/16	FY12/17	FY12/18	FY12/19F
Sales		100.0%	100.0%	100.0%	100.0%
Gross profit		20.2%	18.0%	17.7%	
SG&A		18.6%	17.6%	14.7%	
Operating profit		1.6%	0.4%	3.0%	3.1%
Recurring profit		1.5%	0.5%	2.8%	3.0%
Pre-tax profit		1.1%	0.2%	2.4%	
Taxation		0.0%	-0.1%	0.6%	
Net profit		1.1%	0.3%	1.8%	2.1%

(Source: Company data)

EBITDA		(JPY mn)		
	FY12/16	FY12/17	FY12/18	
Pre-tax profit	66	14	252	
Depreciation and amortization	21	38	52	
Interest payment	7	9	7	
EBITDA	94	61	311	
EBITDA margin (as % of sales)	1.6%	0.8%	2.9%	
Interest-bearing liabilities/EBITDA	304.3%	347.5%	117.0%	

(Source: Company data)

CASH FLOW		(JPY mn)		
	FY12/16	FY12/17	FY12/18	
Operation	-35	29	30	
Investment	-13	-76	-155	
Free cash flow	-48	-47	-125	
Financing	49	433	1,127	
Total	1	386	1,002	

(Source: Company data)

FINANCIAL RATIOS		FY12/16	FY12/17	FY12/18
ROA		7.7%	1.2%	6.2%
ROE		-39.4%	5.2%	12.4%
Equity / Total assets		-19.6%	22.3%	49.6%

(Source: Company data)

BALANCE SHEET		(JPY mn)		
	FY12/16	FY12/17	FY12/18	
Current assets				
Cash and deposits	60	445	1,445	
Receivables	519	837	1,211	
Work in process	2	52	0	
Advance payment	70	27	35	
Deferred tax assets	0	31	53	
Others	25	36	54	
Allowance for bad debt	-19	-10	-12	
Total current assets	656	1,418	2,787	
Fixed assets				
Tangible fixed assets	19	26	23	
of which buildings	17	23	20	
Intangible fixed assets	89	96	96	
of which software	54	81	71	
of which software in progress	35	14	67	
Investments and other	76	90	165	
of which security deposit	65	76	94	
of which long-term loans	26	26	0	
of which guarantee deposits		11	62	
of which allowance for bad debt	-26	-26	0	
Total fixed assets	184	212	326	
Total assets	840	1,630	3,113	
Current liabilities				
Payables	468	650	750	
Short-term debt	94	68	190	
Current portion of long-term debt	100	98	92	
Accounts payable	47	74	120	
Tax payable	1	35	83	
Provision for bonuses	21	36	43	
Provision for loss on order received	0	52	0	
Others	81	107	116	
Total current liabilities	813	1,121	1,394	
Fixed liabilities				
Long-term debt	192	144	174	
Total fixed liabilities	192	144	174	
Total liabilities	1,005	1,265	1,569	
Net assets/Shareholders equity				
Paid-in capital	92	348	842	
Capital reserves	54	310	805	
Retained earnings	-318	-299	-106	
Total shareholders equity	-172	359	1,541	
Foreign currency translation adjustment	7	5	3	
Total net assets	-165	364	1,544	
Total liabilities and net assets	840	1,630	3,113	

(Source: Company data)

INTEREST-BEARING LIABILITIES		(JPY mn)		
	FY12/16	FY12/17	FY12/18	
Total	386	310	456	

(Source: Company data)

DISCLAIMER

This information has been provided for informational purposes only and should not be used or construed as a solicitation, an offer to sell, or an offer to buy any security.