

Shinoken Group (8909) JASDAQ Standard

Much upside potential due to correction to eliminate undervaluation!

Using “pull sales” to increase real estate sales

Shinoken was established in June 1990 with its head office in Hakata-ku, Fukuoka. The primary business was the sale of apartments and one-room condominiums to individuals as an investment. Business operations are located only in large metropolitan areas like Tokyo and Fukuoka where there are many potential tenants. Distinguishing Shinoken is the use of pull sales activities, an unusual approach in the real estate industry. Shinoken uses advertisements (Internet, TV), seminars and private presentations to attract individuals with a strong interest in making an investment. A Shinoken Group company manages the rental properties following their sale, thus generating a steady stream of revenue that contributes to earnings

Returned to profitability in 2010

In 2010, Shinoken had sales of ¥19,650 million, operating income of ¥1,190 million, ordinary income of ¥810 million and net income of ¥110 million. Comparisons are not possible because the prior year was a 9-month transitional fiscal period. The company thus succeeded in returning to profitability at all levels of earnings. By focusing resources on the core real estate sales business and lowering the cost of purchasing real estate, Shinoken improved the gross profit margin. In 2011, Shinoken forecasts a 6% increase in sales to ¥21,000 million, no change in operating income at ¥1,200 million, a 4% increase in ordinary income to ¥850 million, and a 287% increase in net income to ¥450 million.

Investors can buy Shinoken with confidence because of the low forward PER

Many companies with similar operations are listed in Japan's stock markets. But we believe that small JASDAQ companies should be used as benchmarks because Shinoken warrants a discount due to its low liquidity compared with TSE 1st section stocks. From this standpoint, Starts Corporation and Riberesute Corporation are suitable peer companies. Compared with these two companies, Shinoken is clearly undervalued because of its low forward PER. This creates expectations for a correction that may raise Shinoken's stock price to a PER of about 7. The lack of a dividend is one cause for the stock's low valuation. However, measures to build a sound base of operations should give the company sufficient resources to pay a dividend. Stock repurchases are another possibility. As a result, we foresee growth in reasons for investors to take another look at Shinoken's stock price.

IR STREET
analyst
Yuya Okamura

Company profile

Location	Hakata-ku, Fukuoka
Representative	Hideaki Shinohara
Established	June 1990
Capital	¥2,222.15 million
Listing	Dec. 2002
URL	http://www.shinoken.co.jp/
Sector	Real estate

Stock price data (closing price on Feb. 15)

Stock price	¥20,500
Outstanding shares	87,182 shares
Trade unit	1 share
Market cap	¥1.79billion
Dividend (est.)	-
EPS (est.)	¥5,162
PER (est.)	3.9x
PBR (actual)	2.27x

Profile

Shinoken was established in 1990 in Hakata-ku, Fukuoka as Shinohara Construction Systems. The company grew steadily by taking actions that included the introduction of the Compartment House, which are apartments that are sold to investors. In 1997, the company became the largest builder of conventional wood-frame apartment buildings in the Fukuoka area.

Shinoken started operations in the Tokyo area in 2000 by opening a Tokyo branch office. Shares were listed on JASDAQ in 2002. The company started its high-rise condominium business in the Tokyo area. In 2005, the company was renamed Shinoken and the name was changed to Shinoken Group in 2007. A divestiture was used to switch to a holding company structure.

With the holding company structure, Shinoken Group includes Shinoken Produce and Nissho Harmony, which sell real estate, and affiliate En, which has had an equity and business alliance with Shinoken since 2009. These three companies handle business operations based on sales activities. Shinoken Group also has business operations that generate steady revenue streams. Shinoken Facilities manages rental properties, Shinoken Communications is a finance company, SK Energy supplies and sells LP gas, and KBM provides building management services.

Real estate sales are the primary component of Shinoken's sales-based business operations. For apartment buildings, Shinoken buys land from individual investors and receives a construction order at the same time. The building and land is then sold back to that investor once construction is completed. For condominium buildings, Shinoken has a general contractor perform construction. Following completion, condominium units are sold one by one to individual investors. Nissho Harmony handles sales in the Tokyo area and En sells properties in the Fukuoka area. After properties are sold, Shinoken provides services to owners and tenants that generate a consistent revenue stream. The basic concept for Shinoken's business operations is "to allow individuals to manage apartments and condominiums even without owning land or making a large investment." Using this concept has allowed Shinoken to assist people of many ages and income levels to own rental properties.



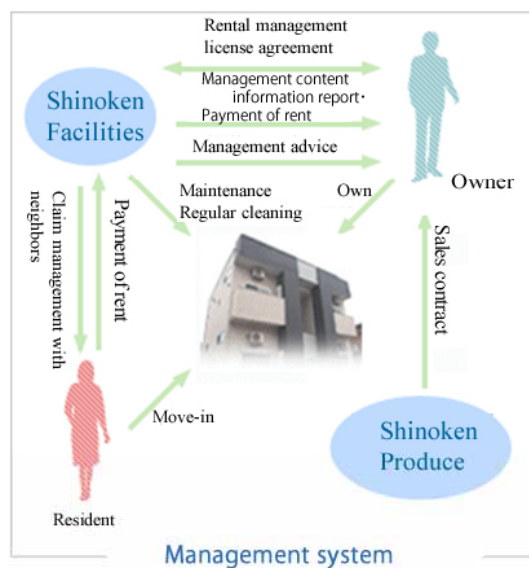
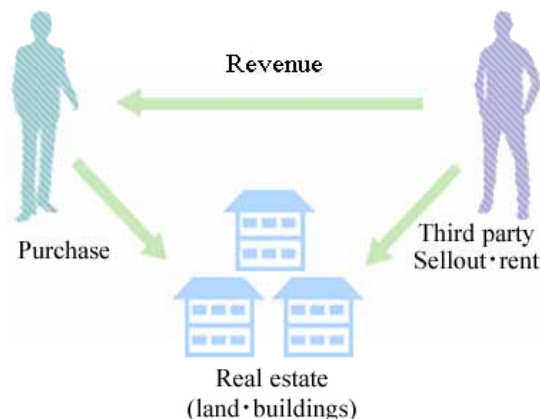
The Business Model

Shinoken's sales method is what differentiates the company's business most from those of its competitors. Most companies that sell condominiums to investors use telephone calls for sales activities. Most companies that sell apartments to investors sell their services by preparing a list of land owners and then going to the homes of these individuals. These activities are called push sales. Shinoken uses the opposite approach: pull sales. The Internet, TV commercials and other advertising is used to attract customers. Push sales also include seminars and private presentations. Very few real estate companies rely primarily on pull sales. In a sense, Shinoken has a virtual "patent" from having used pull sales consistently since its establishment. There is much resistance today to sales methods that use a forceful approach. With its accomplishments and expertise involving pull sales, Shinoken thus has a valuable advantage over its competitors.

Shinoken sells apartments and condominiums only in large metropolitan areas with many potential tenants (low vacancy rates). Apartment buildings are sold in Tokyo, Fukuoka, Nagoya and Sendai. The company sells one-room condominiums only in Tokyo and Fukuoka. Based on its concept of making property available to even for a small investment, Shinoken sells the majority of condominiums to individuals who invest ¥3 million to ¥5 million of their own funds. Most buyers of one-room condominiums are between the ages of 20 and 50. About 40% have an annual income of less than ¥7 million. Looking at occupations, company employees and government workers account for about 70% of buyers.

Shinoken Group companies handle the management of rental properties after their sale. Steady growth in the number of rental units managed is contributing to earnings by producing a consistent revenue stream. In addition, making KBM a subsidiary allows Shinoken to provide cleaning services, too. The finance business has a very high profit margin. This business has two components. One is back-up loans that are extended to some buyers of Shinoken properties. The other is a rent guarantee business that guarantees rent payments of tenants at properties under management. Back-up loans have only a small risk of default because rent payments of tenants are used for repayments. In the rent guarantee business, Shinoken has a delinquency ratio of less than 2%, the lowest level in the rent guarantee industry.

Selling real estate to overseas investors, particularly in China, is a key element of Shinoken's strategy for growth. To sell properties in China, Shinoken holds real estate seminars in Shanghai and uses Internet advertisements in China. Activities also include real estate tours. Shinoken has formed an alliance with a Chinese travel company concerning real estate tours to Japan. The first tour is scheduled for March. Shinoken is preparing to market its properties to investors in Hong Kong and Taiwan, too. Expansion plans also include a rental property brokerage business for Japanese living in Shanghai. Since very few Japanese companies operate this type of brokerage business in China, overseas operations are very likely to start contributing to Shinoken's earnings in 2011.



Results of Operations

In 2010, Shinoken had sales of ¥19,650 million, operating income of ¥1,190 million, ordinary income of ¥810 million and net income of ¥110 million. Comparisons with the prior fiscal year are not possible because Shinoken used a transitional period in 2009 covering the nine-month period from March to December. However, one significant comparison is possible. Shinoken returned to profitability at all levels of earnings in 2010 following the losses the company reported in the transitional 2009 fiscal period. Net income in 2010 is small because of an investment security valuation loss caused by the bankruptcy filing of Incubator Bank of Japan, where Shinoken is a shareholder.

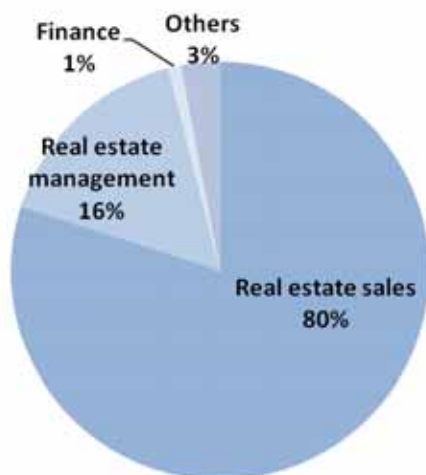
In 2009, Shinoken concentrated resources on the core real estate sales business and cut costs across the entire group. There was also a decline in the cost of purchasing real estate. The result was a big improvement in the gross profit margin from 12.4% in the nine-month 2009 fiscal period to 17.9% in 2010.

Shinoken's performance in 2010 will show investors whether or not the company can build on the 2010 return to profitability to establish base for sustained growth in sales and earnings. The company's initial plan for 2011 calls for a 6% increase in sales to ¥21,000 million, no change in operating income at ¥1,200 million, a 4% increase in ordinary income to ¥850 million and a 287% increase in net income to ¥450 million. The big increase in net income includes the effect of an extraordinary loss in 2009.

Performance (million yen, %)

Fiscal year end	Net sales	YoY	Ordinary income	YoY	Net income	YoY	EPS (¥)
March 2009	15,102	-49%	-2,191	-	-4,145	-	-
December 2009 (9 months)	11,982	-	-848	-	-953	-	-
December 2010	19,659	-	814	-	116	-	1,345
December 2011(est.)	21,000	6%	850	4%	450	287%	5,162

% of sales by segment



% of operating income by segment



Stock price valuation (Multiple)

Stock valuations are based on the assumption that a company will achieve its earnings goals. At Shinoken, this will depend on whether or not the core real estate sales business performs as expected. Shinoken plans to sell 100 apartment buildings to investors in 2011. At the end of January, the company already had orders for 46 buildings and one finished building had been sold. For investment condominiums, Nissho Harmony plans to sell 400 units in 2011. Again, performance is strong thus far. At the end of January, there were orders for 35 units and 32 units had been sold. We believe that Nissho Harmony's 2011 sales plan is conservative because the company sold 469 units in 2010. Any sales above the planned 400 units will thus probably produce earnings above the initial plan. (We estimate that each unit sold above 400 will produce additional earnings of about ¥3 million.) Furthermore, En is consistently selling 450 to 500 condominium units every year, so this company's 2011 goal of 480 appears to be well within its reach.

We can compare Shinoken with other listed companies that sell apartments and condominiums, although the company has different sales and operating methods. Since Shinoken is a small-cap company that is traded on JASDAQ, the stock probably deserves a discount due to its low liquidity compared with TSE 1st section stocks. This is why we believe that JASDAQ-traded Starts Corporation and Riberesute Corporation are suitable companies for valuation comparisons.

From the standpoint of Shinoken's conservative 2011 forecast as well, we believe there is considerable room for an upward correction in the stock price. Shinoken's stock currently has a much lower valuation than the stocks of the two peer companies. We must take into account the difference in fiscal years with these two companies because Shinoken ends its year in December. After factoring in this difference, we believe that an appropriate target for the time being is a forward PER of about 7 in relation to the stocks of the two peer companies. This multiple results in a target price of between ¥35,000 and ¥40,000.

Peer comparison

Name	Code	Market	FY end	P E R (est.)	P B R
Shinoken Group	8909	J Q	FY12/11	3.9x	2.27x
Daito Trust Construction	1878	TSE1	FY03/11	17.6x	2.88x
Starts	8850	JASDAQ	FY03/11	7.3x	0.86x
Riberesute	8887	JASDAQ	FY05/11	8.2x	0.85x
F J Next	8935	TSE2	FY03/11	9.4x	0.47x
S B I Life	8998	TSE Mothers	FY03/11	10.0x	1.47x
Peer companies (5-company avg.)				10.5x	1.31x

Feb. 15 closing price
basis

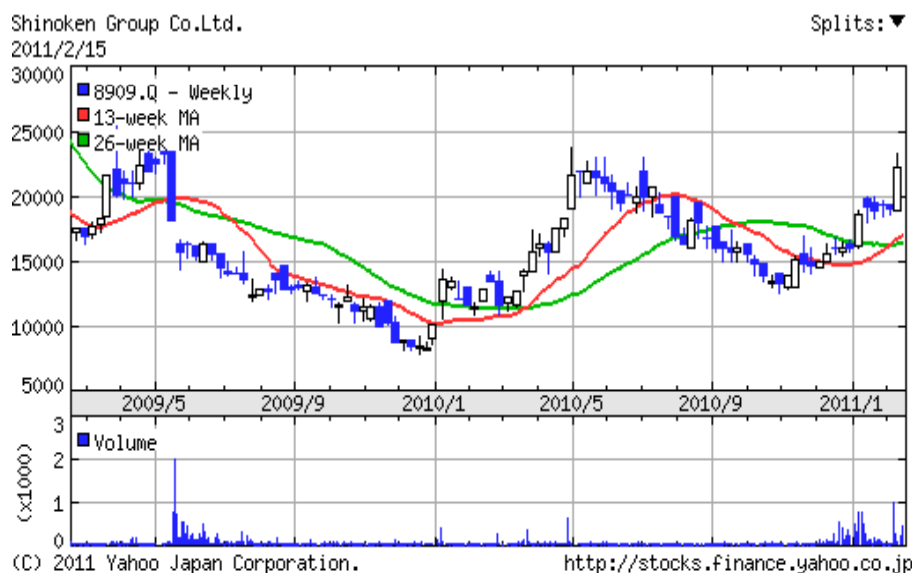
Stock price valuation (Supply/Demand and Other Items)

[Supply/demand]

In the fourth week of January, the weekly chart's 13-week and 26-week moving averages formed a golden cross. Both the 13-week moving average (about ¥17,750) and 26-week moving average (about ¥16,420) are currently climbing. These two moving averages will probably function as support lines for the time being. Investors will probably view the range that combines the March 2009 peak of ¥26,600 and the April 2010 peak of ¥23,780 as the upside resistance zone. Since the stock price broke through this resistance zone in the first week of February, there are strong expectations for the price to continue to climb. Cumulative trading volume since 2009 is very high in the ¥15,000-¥16,000 price range (meaning a large number of investors holding stock bought at this range). As a result, we can conclude that supply/demand dynamics are favorable when Shinoken's stock price is above this range.

[Other items]

Credit risk involving Shinoken has been greatly reduced now that the "precaution concerning going-concern assumption" that was included with the 2009 financial statements has been removed. In 2010, Shinoken expects to eliminate its losses carried forward (¥3,480 million). Now investors will shift their attention to whether or not the company can make consistent progress in improving financial soundness. Many of Shinoken's publicly owned peer companies pay dividends as one way to hold up their stock prices. The lack of a dividend at this time may therefore be one reason that Shinoken's stock has a low valuation. However, current initiatives to strengthen operations may produce sufficient resources to pay a dividend. Furthermore, the company now has sufficient resources to repurchase its stock. These developments give investors two more reasons to take another look at Shinoken's stock price.



Stock price (historical)

Year high	¥23,780
Year low	¥10,700
Highest since the IPO	¥1,410,000
Lowest since the IPO	¥8,000

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For inquiries regarding this report, please contact:

IRSTREET FinanTec Co., Ltd.

Mail: report@irstreet.com

2F, Akasaka Long Beach Bldg. 21-20, Akasaka 3-Chome, Minato-ku, Tokyo, 107-0052

TEL:03-3560-5469 FAX:03-3560-5510