

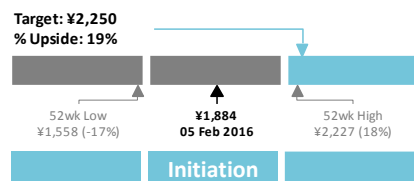
2 Growth Businesses + 1 Profitable VC + 1 Valuable Equity Stake = DG

Internet

Japan

5 Feb 2016

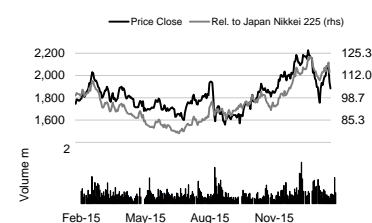
BUY



Basic Share Information

Market cap	¥89.09b / US\$0.76b
Daily volume (3mth)	US\$7.16m
Shares outstanding	47.02m
Free float	70%
Net debt-to-equity	-17.2%
1 yr high	¥2,227
1 yr low	¥1,558
Foreign shareholding	34%
Last HTI contact w/ Co	2 Feb 16

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-15.4%	1.6%	8.0%
Absolute USD	-14.6%	4.6%	7.8%
Relative to NKY	-8.2%	12.4%	10.6%



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Hard Catalysts Absent, But Soft Catalysts Should Surface

Summary: We initiate coverage of Digital Garage (DG) with a BUY rating as we think there is value trapped in its unconventional business model and the top-line growth we forecast for its payment business should help unlock some of the value. DG is a leader in technology venture capital (VC) investing with a successful track record, but the uncertain and non-recurring nature of VC investment returns have hampered DG's equity valuation, in our view. While we see VC investing as integral to DG's culture and investment gains should continue to be a swing factor, we think payment and advertising businesses will likely grow in importance to dampen revenue fluctuations and help shift DG to a growth stock in the next few years. We think investors predominantly value DG based on its stake in Kakaku.com (2371 JP) and undervalue its payment business, but increasing top-line growth visibility should correct this valuation gap, in our opinion.

Target Price and Catalyst: Our target price of ¥2,250 implies 19% potential upside from the last close. Key catalysts include improved accounting policies and disclosures, increased revenue growth visibility, pending listing transfer to the First Section of the Tokyo Stock Exchange (TSE), merger of its payment subsidiaries, and expansion of its financial technology (fintech) related VC portfolio.

Earnings: For FY6/16, we estimate advertising revenue of ¥17,671m, payment revenue of ¥16,635m, and incubation revenue of ¥7,000m, resulting in ¥41,306m total revenue. We expect GPM to be mostly flat at 28% but OPM to decline to 11.2% (from 12.6% in FY6/15) as high-margin incubation revenue decreases, leading to GP of ¥11,566m and OP of ¥4,635m. For FY6/17, we expect total revenue of ¥44,537m, of which advertising accounts for ¥19,438m, payment for ¥18,838m, and incubation for ¥6,261m, reflecting our view of the increasing importance of DG's operating segments.

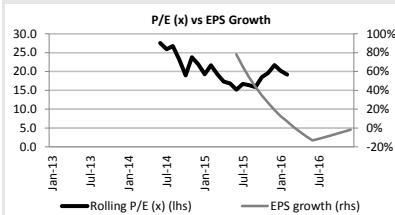
Valuation: We apply a sum-of-the-parts (SOTP) analysis to set our target price, cross-checked using DCF at the holding company level. We think DG's value lies in its 20.3% stake in publicly listed Kakaku.com, its advertising business, its payment business, and its incubation business; we estimate that those parts are respectively worth ¥57,246m, ¥8,208m, ¥64,260m, and ¥9,610m. Subtracting DG's latest net debt of ¥7,402m and a 20% holding company discount results in our SOTP valuation of ¥105,537m or ¥2,245 per share. We think investors have traded DG as a proxy to Kakaku.com, as evident in the high share-price correlation, but we think investors should bear in mind that we believe DG's payment business ranks second in Japan and a material part of DG's valuation should be benchmarked off GMO Payment Gateway (3769 JP).

	Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E	Trend
Total turnover (¥m)	33,752	38,087	41,306	44,537	48,994	■
Operating profit (¥m)	2,608	4,810	4,635	4,769	5,851	■
Pre-tax profit (¥m)	5,035	9,249	7,031	7,738	9,329	■
Net income to ord equity (¥m)	2,847	5,082	4,411	4,885	5,950	■
Net profit growth	0.0%	78.5%	(13.2%)	10.7%	21.8%	■
P/E (x)	31.26	17.53	20.19	18.23	14.97	■
Adj EV/EBITDA (x)	9.86	2.27	1.95	1.54	1.04	■
P/B (x)	2.92	3.11	2.75	2.44	2.16	■
ROE	10.1%	17.2%	14.4%	14.2%	15.3%	■
Dividend yield	0.3%	1.3%	0.7%	0.8%	1.3%	■
EPS HTI New (¥)	60.3	107.5	93.3	103.3	125.9	■
Consensus EPS (¥)	58.1	117.1	114.9	134.3	161.0	■
HTI EPS vs Consensus	3.8%	(8.2%)	(18.8%)	(23.1%)	(21.8%)	■

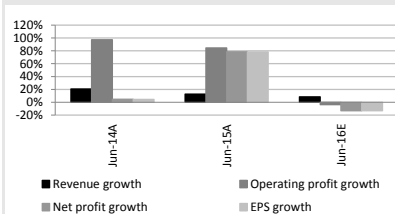
Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

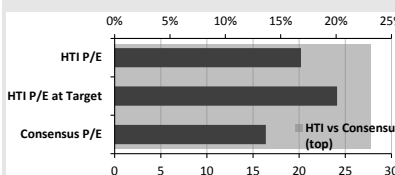
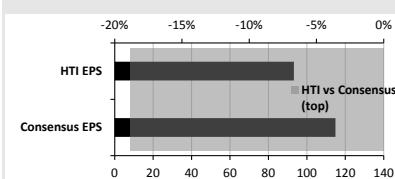
Valuation



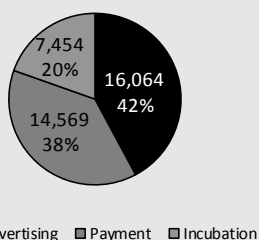
Earnings Trends



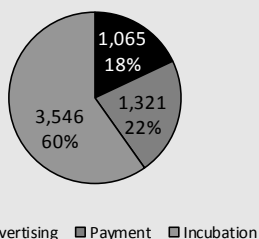
Earnings: HTI vs Consensus



FY6/15 Revenue Breakdown (¥m)



FY6/15 Operating Profit Breakdown (¥m)



Investment Thesis

BUY

- DG's operating businesses have a strong presence in secular growth markets.
- Assuming a 40% discount still values DG's stake in Kakaku.com at ¥57,246m, compared to DG's market cap of ¥89,093m. Considering the high share price correlation, we think Kakaku.com's stake not only serves as a floor value on paper, but also in practice. This implies DG's operating businesses are worth less than ¥50,000m.
- We think DG's payment business should be valued significantly higher because it is number two in Japan in terms of market share and the currently implied valuation is much lower than that of GMO Payment. We think the growth attributes of this segment are obscured by DG's accounting treatments and recent restructurings. We believe the strong underlying growth should surface in 2016.
- DG's advertising business is positioned in the fast growing performance-based digital advertising area and client numbers have been growing rapidly since 2013.
- DG's incubation business has an impressive track record in both the US and Japan. We expect the recent portfolio expansion to result in high-margin revenues in future years.
- We think DG's share performance should track Kakaku.com and GMO Payment; however, DG's shares have materially underperformed both in 1y, 2y, and 3y horizons. DG's PER has been mostly flat while those of Kakaku.com and GMO Payment have expanded in recent years.
- DG has a strong interest in investing in fintech ventures, an area where investors are assigning a high valuation, in our view.

Company Snapshot

DG is structured as a holding company with payment and advertising segments as operating businesses and an incubation segment as a venture investing vehicle. DG was founded in 1994 to build and invest in IT businesses in Japan. Technology venture investing remains an integral part of DG's culture. It currently has VC investment teams and seed accelerator programs in both Tokyo and San Francisco. Some of DG's notable investments include Twitter (TWTR US), Tumblr (unlisted), Path (unlisted), Kakaku.com, and Bengo4.com (6027 JP). Advertising business and payment business were developed as DG evolved. The advertising segment focuses on performance-based digital advertising, such as pay-per-action and pay-per-install advertisements. The payment segment provides merchant acquiring and payment processing services to ecommerce merchants.

Key Investment Metrics

Revenue Growth

Low Medium High

We expect total revenue growth to be driven by payment and advertising as incubation revenue stabilizes. For FY6/16, we expect payment revenue to increase by 14%, advertising revenue to increase by 10%, and incubation revenue to decrease by 6%, resulting in total revenue growth of 8%.

Profit Margins

Low Medium High

We expect OPM to decline to 11.2% in FY6/16 from 12.6% in FY6/15 as high-margin incubation revenue decreases. For FY6/17, we forecast OPM to be 10.7%.

Shareholder Returns

Low Medium High

We expect ROE of 14.4% and 14.2% in FY6/16 and FY6/17. We forecast a dividend payout of 15% in FY6/16 and FY6/17, lower than the 20% mentioned in DG's strategic plan. We do not expect any share buybacks in coming years.

Balance Sheet Risks

High Medium Low

We see little risk of equity issuance and debt level as acceptable. We estimate the average interest rate for DG's debt is close to 1% and debt servicing to be manageable. The risky part of the balance sheet is its VC investments, but a more-than-adequate loss provision has been made, in our view. Due to its accounting policies for its payment segment, we think DG's balance sheet appears to be significantly larger than it should be.

Barriers to Entry

Low Medium High

We think venture incubation and advertising businesses are not difficult to enter, but establishing a sizeable payment business is significant.

Export Exposure/Breakdown

Low Medium High

Physical export/import exposure is nil, but DG's incubation business is centered on "importing" intellectual properties from the US and "exporting" refined IT ideas to Asia.

FX Exposure

Low Medium High

DG has a sizeable VC investment business in San Francisco, so its US-related incubation revenues and costs are denominated in USD. Also, DG owns minority stakes in several payment processing companies in Southeast Asia, but their revenue contributions have so far been close to nil.

Corporate Governance

Low Medium High

Governance policy appears to be standard. The IR team appears to be helpful. While DG's financial disclosures are widely available, we think DG should consider enhancing the transparency of its payment segment by increasing segment information and changing accounting policies, which unnecessarily obscure segment performance, in our view.

Our Model Assumptions

We expect payment market share of 9.0–9.5% in FY6/16–FY6/18; for incubation, we adopt guided revenue for FY6/16 and assume ¥3.5bn annual investment, a four-year horizon, and 25% IRR thereafter

Since we think a large portion of cost of revenue is pass-through, we assume no scale benefit and apply a constant rate of 72%

✓ Key P/L Takeaway

Top-line growth was driven by incubation in the past three years, but we expect payment to lead revenue growth going forward, which should cause a PER re-rating

Profit & Loss (¥m)	Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E
Total turnover	33,752	38,087	41,306	44,537	48,994
Cost of sales	(25,535)	(27,302)	(29,740)	(32,067)	(35,276)
Gross profit	8,217	10,786	11,566	12,470	13,718
Total operating costs	(5,609)	(5,976)	(6,931)	(7,702)	(7,868)
Operating profit	2,608	4,810	4,635	4,769	5,851
Operating EBITDA	3,995	6,276	6,021	6,131	7,180
Depreciation and amortisation	(1,387)	(1,465)	(1,386)	(1,362)	(1,330)
Operating EBIT	2,608	4,810	4,635	4,769	5,851
Net income from investments	1,779	2,099	2,608	3,123	3,613
Other recurring income	(0)	(292)	50	50	50
Interest expense	(88)	(98)	(262)	(204)	(185)
Exchange gains	144	1,091	-	-	-
Exceptional income - net	593	1,639	-	-	-
Pre-tax profit	5,035	9,249	7,031	7,738	9,329
Taxation	(1,887)	(3,855)	(2,320)	(2,554)	(3,078)
Minority interests	(301)	(312)	(300)	(300)	(300)
Net income to ord equity	2,847	5,082	4,411	4,885	5,950

Source: Company, HTI estimates

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With the limited level of disclosures and uncertain nature, we find it difficult to estimate DG's incubation revenue, which we believe will likely be a swing factor in future financial results. GP grew to ¥10.8bn in FY6/15 from ¥6.4bn in FY6/13, primarily caused by high-margin incubation revenue expanding to ¥7.5bn in FY6/15 from ¥2.5bn in FY6/13. We think IRR should moderate and expect incubation revenue to decline in FY6/16 and FY6/17, which should cause OPM to decline in the near-term. We assume advertising revenue to continue growing at 8–10%. We think segment restructuring and accounting complication obscure segment growth, but segment OP growth should become visible from FY6/16, in our view. For OP, we expect a slight decline to ¥4.6bn in FY6/16 from ¥4.8bn in FY6/15 although revenue grows; this is due to a changing revenue mix which is healthy, in our opinion.

Our Model Assumptions

We believe accounts receivable corresponds to the advertising segment and is 24% of segment revenue

Other current assets are mostly other receivables, which are pass-through to merchants; we assume other receivables to be 1.1% of transaction value

Kakaku.com shares are accounted for as equity method investment; we expect the amount to be changed by 20% of Kakaku.com's net income and dividends

We assume cash balances above ¥20bn, ¥21bn, and ¥22bn in FY6/16, FY6/17, and FY6/18, respectively, to be used to pay down debt

✓ **Key B/S Takeaway**

We expect the balance sheet to expand as the payment business grows, but the real size of the balance sheet is much smaller due to unnecessarily complex accounting treatment for DG's payment segment, in our view

Balance Sheet (¥m)	Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E
Total cash and equivalents	25,184	34,076	29,098	31,319	33,229
Inventories	21	99	106	117	126
Accounts receivable	3,604	3,765	4,144	4,559	4,923
Other current assets	9,091	12,023	12,576	14,191	15,901
Total current assets	37,901	49,964	45,924	50,186	54,179
Tangible fixed assets	5,778	6,452	6,399	6,357	6,324
Intangible assets	8,588	7,574	7,090	6,620	6,174
Total investments	18,190	21,960	25,661	28,580	31,595
Total other assets	553	554	554	554	554
Total non-current assets	33,109	36,540	39,705	42,111	44,646
Total assets	71,010	86,504	85,628	92,297	98,825
Accounts payable	1,630	2,039	2,307	2,685	2,705
Other current liabilities	17,824	23,286	23,490	26,538	29,930
Total current liabilities	19,453	25,325	25,797	29,222	32,634
Total long-term debt	12,532	29,080	23,984	23,074	21,431
Other liabilities	2,535	3,024	3,024	3,024	3,024
Total non-current liabilities	15,067	32,105	27,008	26,099	24,455
Total liabilities	34,520	57,430	52,805	55,321	57,089
Common stocks	7,399	7,426	7,426	7,426	7,426
Retained earnings reserve	9,616	14,439	18,188	22,340	27,100
Other reserves	13,427	6,787	6,787	6,787	6,787
Shareholders' equity	30,442	28,653	32,402	36,554	41,314
Minority interests	5,906	126	126	126	126
Other equity	141	296	296	296	296
Total equity	36,490	29,075	32,824	36,976	41,736
Total liabilities & shareholders' equity	71,010	86,504	85,628	92,297	98,825

Source: Company, HTI estimates

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DG's balance sheet appears to be complicated and large, but it is rather straight-forward in essence. Advertising segment is capital-light and does not occupy a large portion of the balance sheet. Incubation business creates investments and loss provisions as well as certain fixed assets (incubation center and venture offices). Since DG's payment segment does not engage in principal lending like GMO Payment, the balance sheet should be simple; however, we think the accounting treatment of merchants' revenues inflates the balance sheet and obscures the liquidity situation. We assume a minimum cash level and any cash balance above that level to be used in debt retirement. We expect no new debt to be added and debt repayment to be ¥5.1bn, ¥0.9bn, and ¥1.6bn in FY6/16, FY6/17, and FY6/18, respectively.

Our Model Assumptions

We expect ¥250m and ¥600m capex in tangible assets and software, respectively

We expect a 15% dividend payout ratio in FY6/16 and FY6/17 and 20% in FY6/18

✓ **Key Cash Flow Takeaway**
We expect dividend receipts from Kakaku.com to be a significant portion of DG's operating cash flow

Cash Flow (¥m)	Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E
Operating profit	2,608	4,810	4,635	4,769	5,851
Depreciation and amortisation	1,387	1,465	1,386	1,362	1,330
Changes in working capital	(2,310)	758	(1,201)	252	403
Operating cash flow	1,685	7,033	4,821	6,383	7,583
Interest paid	(88)	(98)	(262)	(204)	(185)
Tax paid		(2,779)	(3,076)	(2,414)	(2,764)
Cash flow from operations	1,597	4,156	1,483	3,765	4,635
Capex	(1,305)	(862)	(850)	(850)	(850)
Cash flow from investing activities	(1,305)	(862)	(850)	(850)	(850)
Dividends paid to ordinary shareholders	(235)	(1,176)	(662)	(733)	(1,190)
Proceeds from issue of shares	126	182	(0)	(0)	(0)
Increase in debt	5,427	16,549	(5,097)	(909)	(1,643)
Other financing cash flow	-	-	0	-	-
Cash flow from financing activities	5,317	15,555	(5,758)	(1,642)	(2,834)
Cash at beginning of period	15,329	24,295	30,956	27,249	29,226
Total cash generated	5,610	18,849	(5,125)	1,273	952
Implied cash at end of period	20,939	43,144	25,831	28,523	30,177
Free cash flow	292	3,294	633	2,915	3,785

Source: Company, HTI estimates

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Payment segment and headquarters generate significant depreciation and amortization annually. We expect software capex to drain cash at ¥600m annually as payment technology continues to evolve and digital advertising becomes more data-intensive.

Our Model Assumptions

DG's PER is low compared to those of GMO Payment or its advertising peers

Considering DG's ROE and growth profile, we view current PBR as low

We expect OPM to first contract and then expand as incubation stabilizes and scale benefits from the payment segment kick in



Key Driver Takeaway

We think DG is undervalued relative to its peers and absolutely to its asset values or future earnings; we expect multiple expansion to drive DG's share price towards our target price

Per Share Data	Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E
EPS (¥)	60.3	107.5	93.3	103.3	125.9
FDEPS (¥)	60.2	107.5	93.3	103.3	125.9
Revenue per share (¥)	715	806	874	942	1,036
Operating EBITDA per share (¥)	84.6	132.7	127.4	129.7	151.9
BVPS (¥)	644.5	606.1	685.4	773.2	873.9
DPS (¥)	4.97	24.86	13.99	15.50	25.17
Recurrent cash flow per share (¥)	33.81	87.91	31.37	79.64	98.04
Shares in issue (million)	47.23	47.28	47.28	47.28	47.28
Year end adjusted shares in issue (m)	47.23	47.28	47.28	47.28	47.28
Key Ratios	Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E
Valuation Measures					
P/Sales (x)	2.64	2.34	2.16	2.00	1.82
P/E (x)	31.26	17.53	20.19	18.23	14.97
P/CF (x)	55.72	21.43	60.05	23.66	19.22
P/B (x)	2.92	3.11	2.75	2.44	2.16
Adj EV/EBITDA (x)	9.86	2.27	1.95	1.54	1.04
Dividend yield	0.3%	1.3%	0.7%	0.8%	1.3%
Growth					
Revenue growth	0.0%	12.8%	8.5%	7.8%	10.0%
Operating profit growth	0.0%	84.4%	(3.6%)	2.9%	22.7%
Net profit growth	0.0%	78.5%	(13.2%)	10.7%	21.8%
Margins					
Gross margin	24.3%	28.3%	28.0%	28.0%	28.0%
Operating EBITDA margin	11.8%	16.5%	14.6%	13.8%	14.7%
Operating margin	7.7%	12.6%	11.2%	10.7%	11.9%
Pretax profit margin	14.9%	24.3%	17.0%	17.4%	19.0%
Tax rate	37.5%	41.7%	33.0%	33.0%	33.0%
Net profit margin	8.4%	13.3%	10.7%	11.0%	12.1%
Key Ratios					
ROE	10.1%	17.2%	14.4%	14.2%	15.3%
ROA	4.5%	6.5%	5.1%	5.5%	6.2%
Capex/revenue	3.9%	2.3%	2.1%	1.9%	1.7%
Current ratio (x)	1.95	1.97	1.78	1.72	1.66
Creditor days	23.29	27.26	28.39	30.56	27.99
Debtor days	38.98	36.08	36.72	37.36	36.68
Inventory days	0.30	1.32	1.30	1.33	1.30
Sales/avg assets	0.53	0.48	0.48	0.50	0.51
Credit analysis					
EBITDA/interest paid (x)	45.30	64.12	23.01	30.08	38.90
OCF/interest paid (x)	18.11	42.47	5.67	18.47	25.11
Debt/EBITDA (x)	3.14	4.63	3.98	3.76	2.98
Debt/equity	34.3%	100.0%	73.1%	62.4%	51.3%
Net debt to equity	(34.7%)	(17.2%)	(15.6%)	(22.3%)	(28.3%)

Source: Company, HTI estimates

Click For Interactive Model

In our opinion, investors see payment and advertising revenue growth as high-quality while viewing incubation revenue growth as low-quality, so EPS growth contributed by the incubation segment did not result in multiple expansion. We expect high-quality payment revenue growth to start surfacing and drive PER higher.

Company Outline and Operational Review

DG was founded by Mr. Kaoru Hayashi (CEO) and Mr. Joichi Ito (Director) as a company to develop, promote, and invest in technology companies. They are both well-known for technology innovations and have strong relationships in the IT space. Led by its management through a series of internal startups and acquisitions, DG has evolved to operate three business segments: payment, advertising, and incubation. The payment segment provides electronic payment processing services to electronic commerce (EC) merchants and is second in terms of market share. The advertising segment provides primarily performance-based digital ad agency services and is a partner with Dentsu (4324 JP). The incubation segment has been the center of DG and operates in both Japan and the US; the segment is a corporate venture capital vehicle investing in promising technology companies.

DG's Business Segments and Key Entities



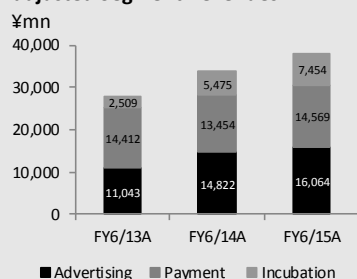
Payment	Advertising	Incubation
econtext veritrans	DG&Ibex Bl.Garage NaviPlus	DG Incubation Digital Garage US Neo Innovation

Source: Company data

The payment segment is structured under econtext Asia (unlisted), headquartered in Hong Kong, which also holds minority stakes in a few payment processing firms in Southeast Asia

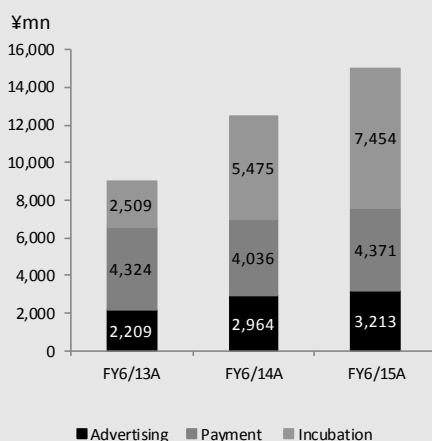
The incubation segment has dominated DG's financial results. Although DG has a proven investment record and VC-related revenues have grown significantly, we think the unpredictable and bumpy nature results in investors largely ignoring this segment in DG's valuation. The (unappreciated) dominance of incubation is evident if we adjust DG's reported segment revenues. DG's payment segment recognizes the entire merchant discount as revenue, and expenses interchange fee as cost of revenue, leading to a significantly inflated revenue figure. We estimate DG's net payment revenue is 30% of its reported segment revenue. For ad revenue, DG recognizes the entire advertiser's fee as revenue and subsequently expenses the media posting cost as cost of revenue. We estimate DG's net ad revenue is 20% of reported segment revenue.

Unadjusted Segment Revenues



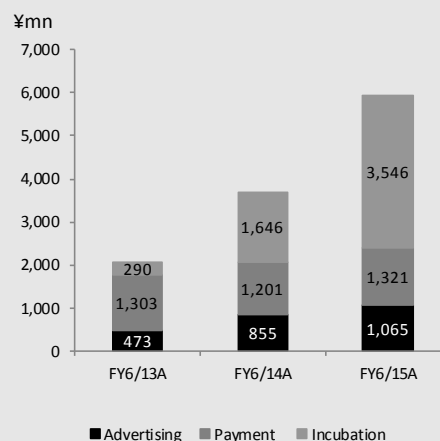
Source: Company data

Adjusted Segment Revenues



Source: Company data, HTI calculations

Segment Operating Profits



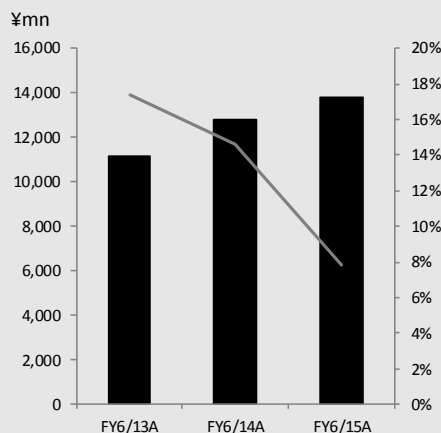
Source: Company data

Why We Expect Payment OP Growth in 2016 (After All These Years)

GMO Payment is the closet peer to DG's payment segment so we use its recent OP to contrast with DG. GMO Payment and DG's payment business are respectively the number 1

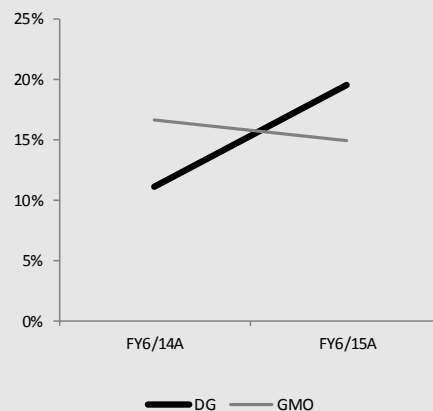
and 2 payment processors in Japan in terms of market share. They share similar growth factors, so should exhibit similar financial characteristics. The charts below show that the expanding B2C EC market has helped both DG and GMO Payment in growing their transaction values and client numbers, but DG's OP growth was substantially lower than that of GMO.

Japan B2C EC Market Size and YoY Growth



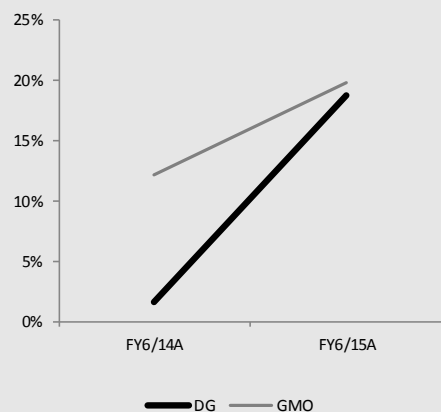
Source: Company data

YoY Growth of Processed Transaction Value



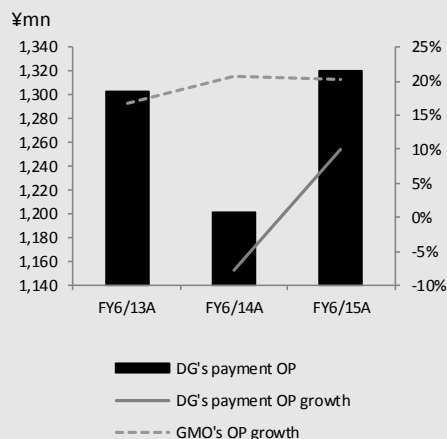
Source: Company data

YoY Growth of Client Numbers



Source: Company data

DG's (Lack of) OP Growth vs GMO



Source: Company data

We think DG's underlying growth profile should be similar to that of GMO, but has been obscured by its accounting treatment (which we find unnecessarily confusing) and segment restructuring. DG founded econtext in 2000 as a joint venture and made it wholly-owned in 2003. DG acquired veritrans from SBI Holdings (8473 JP) in 2012 to establish a payment segment. As veritrans had a March fiscal year-end, 15 months of results were reported in FY6/13 segment financials, inflating the starting base. DG then reorganized the payment entities into econtext Asia and listed it in Hong Kong in 2013 in an attempt to become a Pan-Asian payment processing company. The Asian ambition failed and DG delisted econtext Asia in 2015, which resulted in reorganization expenses that lowered segment OP. Therefore, FY6/14 and FY6/15 segment OP growth rates were distorted. We do not expect major reorganizations in the next two years, so we believe underlying OP growth should (finally) surface in FY6/16. Moreover, we think DG should merge econtext and veritrans operations in the medium to realize potential cost synergies, which could result in OPM expansion.

FY6/15 investments included 18 domestic ventures, 70 overseas ventures, and six funds

Hard Catalysts (Highly) Unlikely

While we think a partial divestiture of the Kakaku.com stake would significantly drive DG's shares up, we believe this scenario has a low probability of occurrence, at least in the next few years. DG invested in Kakaku.com at an early stage and we expect the cost base to be significantly lower than the current market price, so tax consequences would be material. More importantly, DG views Kakaku.com as a key strategic partner in its operating segments. For example, the ad segment utilizes Kakaku's vast consumer data in its big data marketing and the payment segment develops payment methods in partnership with Tabelog. We think DG is likely to maintain Kakaku as an equity-method investment, so its current 20.3% stake provides minimum room for divestment. Also, DG has adopted a takeover defense scheme, which we think strongly discourages potential activist investors.

Medium-Term Plan

DG announced its three-year plan in 2015, which calls for organic growth in existing segments. For advertising, the plan identifies data-driven marketing, growth hacking, and enhanced mobile capability as key development areas. For payment, DG expects Japan's B2C EC market to continue expanding, resulting in strong electronic payment processing demand; DG aims to develop its payment business into a general fintech business.

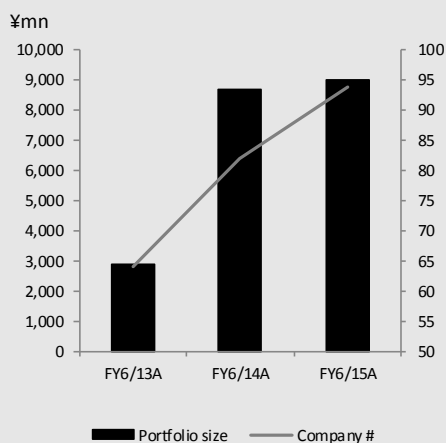
In terms of financial targets, DG aims to grow its pre-tax profit and ROE to ¥15.0bn and 20% in FY6/18, from ¥9.2bn and 17% in FY6/15, respectively. However, we think these targets are too optimistic and estimate pre-tax profit and ROE of ¥9.3bn and 15% in FY6/18.

Incubation Segment

Before establishing its two operating segments, DG was primarily a corporate VC investor, sourcing and investing in promising technology companies as well as helping overseas IT companies develop a presence in Japan. DG has developed a successful investment track record and a strong sourcing network in the US and Japan.

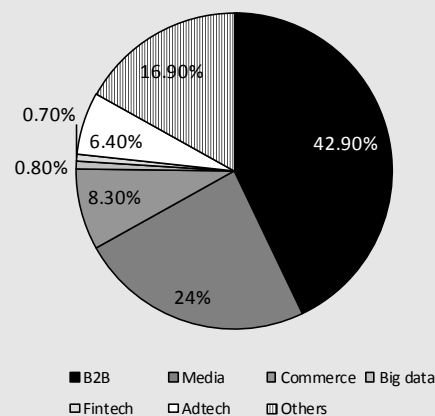
DG has an established presence in San Francisco to be close to technology trends, develop business ideas, and source venture investments. DG has invested in 500 Startups (unlisted), a startup accelerator in the US, and runs its own accelerator program in Japan. Over the past three years, six portfolio companies went public including aucfan (3674 JP), Twitter, Media Do (3678 JP), Bengo4.com, CrowdWorks (3900 JP), and iRidge (3917 JP). Key existing portfolio companies include AdStage (unlisted), AnyPerk (unlisted), Goodpatch (unlisted), Chartbeat (unlisted), and Blockstream (unlisted). We expect fintech to be a key investment area in the coming years.

Venture Capital Portfolio



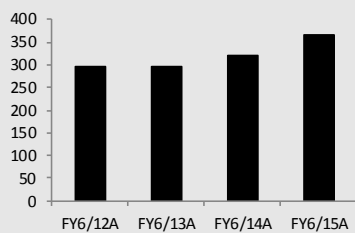
Source: Company data

Invested Sectors as of FY6/15



Source: Company data

Number of Advertising Clients



Source: Company data

Big4 channels refer to TV, newspapers, magazines, and radio

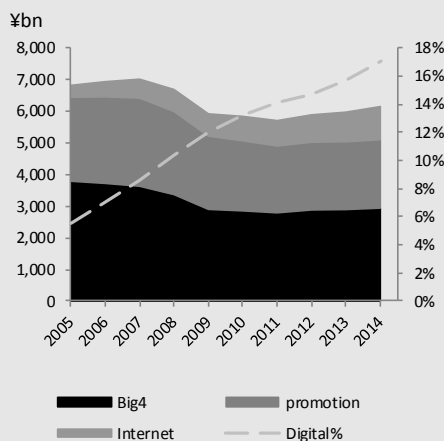
Advertising Segment

DG focuses on performance-based digital ad agency, which primarily involves predictive analytics and directing ads to performance-based media (affiliate service providers). An affiliate service provider sources performance-based ad spaces from website operators and bloggers. A “success” is generally defined as an ad viewer purchases a product from the advertiser (cost-per-action) or downloads of a software advertised (cost-per-install). When a success occurs, the advertiser pays the ad agent a percentage fee, who then pays the affiliate service provider for the ad space provided.

Compared to impression-based ads, performance-based ads emphasize audience behaviors. Performance ads require sophisticated predictive, tracking, and measurement technologies in order to optimize view response and evaluate performance. Google’s *AdSense* is a well-known example of a cost-per-click (CPC) medium. DG also provides marketing promotion, social media marketing, and other data-driven marketing services.

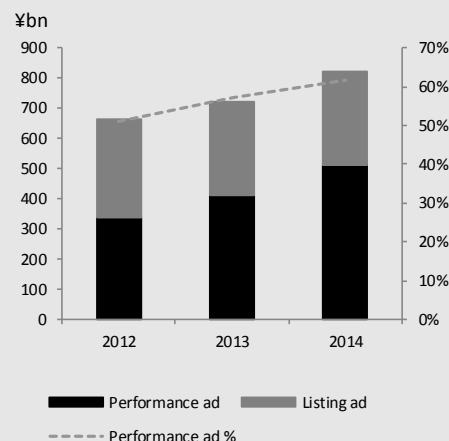
Digital ads account for an increasing share of total advertising expenditures. Within digital ads, performance-based ads have been gaining share and accounted for 62% of internet ads in 2014. We think this growth is likely to continue, albeit at a more moderate rate, and that DG is well-positioned to capture opportunities in this secular growth market.

Advertising Spend in Japan



Source: Dentsu

Performance Ads versus Listing Ads



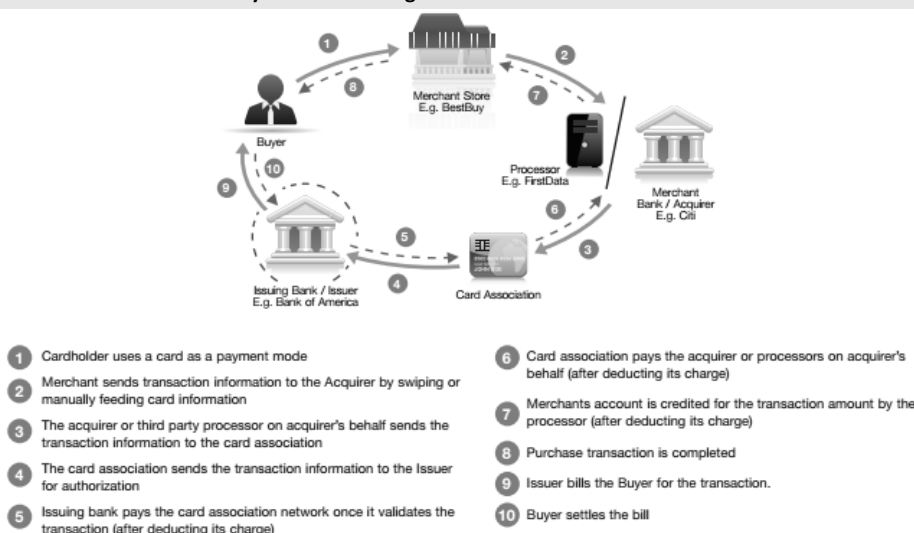
Source: Dentsu

Payment Segment

Upon acquiring veritrans, DG has expanded to become a major payment processor in Japan. The segment provides a comprehensive suite of payment processing services to EC clients. DG authorizes, clears, settles and provides reporting for electronic payment transactions. Payment methods accepted include all major credit card brands, Japanese electronic money, Paypal, Alipay, and convenient store payments.

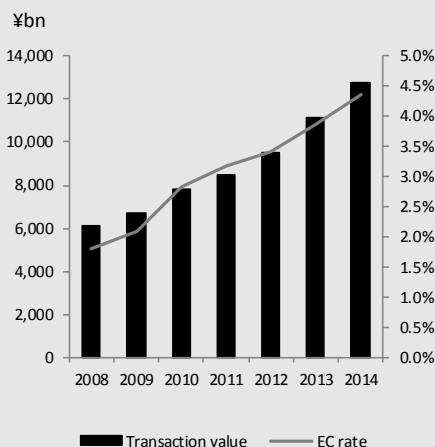
We expect the B2C EC market to expand rapidly in Japan, creating strong growth opportunities for leading payment processors. As this market requires significant fixed-cost investment, we see material economies of scale, resulting in increasing market share concentration in top players. While we think the acquirer fee is likely to face downward pressure, we see increasing transaction volumes as likely to more than offset any margin compression. Besides GMO Payment, Softbank Payment (unlisted), Sony Payment (unlisted), and Paygent (unlisted) are other leading payment processors in Japan.

Overview of Credit Card Payment Processing



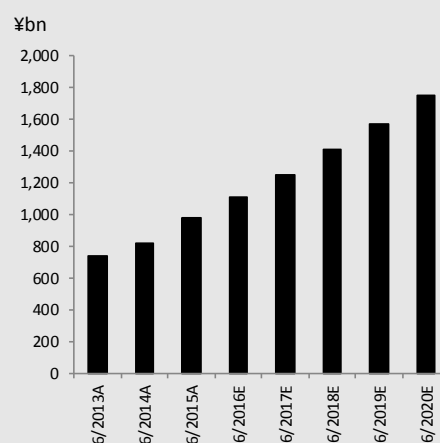
Source: First Data

B2C EC Market in Japan



Source: Ministry of Economy, Trade, and Industry (METI)

DG's Transaction Processing Values



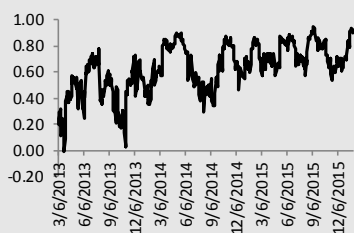
Source: Company data, HTI estimates

In estimating market shares, we apply METI's B2C EC market size statistics and subtract the transaction values of Rakuten (4755 JP) and Yahoo! Japan (4689 JP) because they have internal payment processing operations. Amazon Japan (unlisted) directs payment processing overseas, so should also be excluded but we cannot obtain its transaction information. For 2014, the B2C EC market was estimated at ¥12.8trn, excluding the transaction values of Rakuten and Yahoo! Japan results in ¥10.4trn. Using reported transaction values of GMO Payment and DG, we estimate a market share of 14% for GMO Payment and 9% for DG. We cannot obtain transaction data from other major processors, but our conversations with industry participants indicate that DG is number two in terms of market share.

Valuation

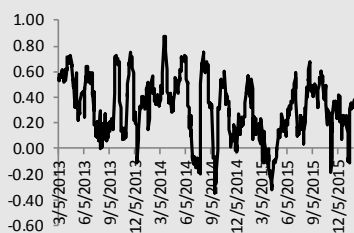
We derive our target price of ¥2,250 using our base-case SOTP analysis. We apply discounts to individual segment valuations as well as a discount at the holding company level to derive our SOTP valuation. We think that the majority of DG's value derives from Kakaku.com and DG's payment segment, so DG's share performance could be approximated as a linear combination of those of Kakaku.com and GMO Payment. However, DG shares have materially underperformed both Kakaku.com and GMO Payment in the past year. For internet-sector and growth investors that own both Kakaku and GMO Payment, we think they can gain similar factor exposures at a lower valuation via DG.

20-day Share-price Correlation with Kakaku.com (Too High?)



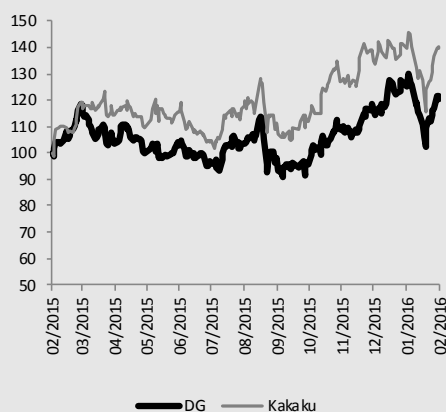
Source: Bloomberg

20-day Share-price Correlation with GMO Payment (Too Low?)



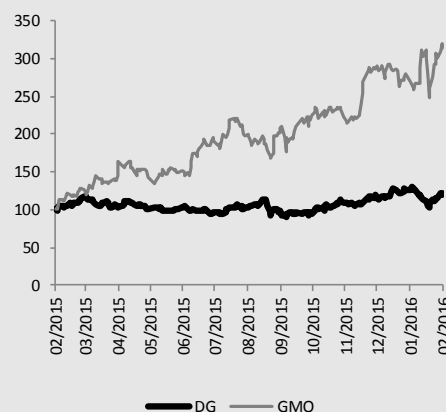
Source: Bloomberg

DG's Share Performance vs Kakaku



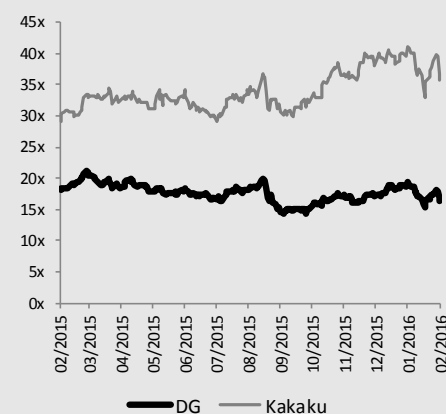
Source: Bloomberg

DG's Share Performance vs GMO



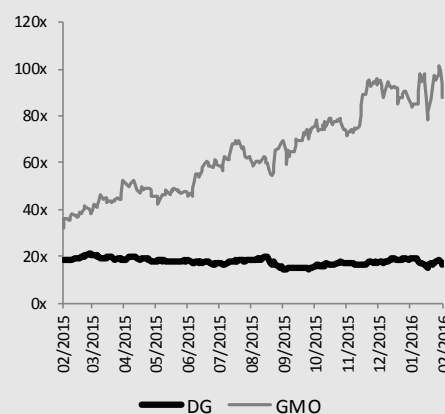
Source: Company data, Bloomberg, HTI estimates

DG's PER vs Kakaku



Source: Bloomberg

DG's PER vs GMO



Source: Bloomberg

Not only has DG's PER failed to benefit from either Kakaku or GMO Payment's expansions, it has also stayed stagnant despite strong OP growth in the past three years. If DG's payment revenue starts growing as we expect, we think investors should start reflecting this high-quality growth by awarding a higher multiple or shift towards a SOTP methodology, either should help move DG's share price towards our target price.

Segment Profit & Loss (¥m)		Jun-14A	Jun-15A	Jun-16E	Jun-17E	Jun-18E
Revenue	Payment	13,454	14,569	16,635	18,838	21,169
	Advertising	14,822	16,064	17,671	19,438	20,993
	Incubation	5,475	7,454	7,000	6,261	6,832
EBIT (pre-HQ)	Payment	1,201	1,321	1,580	1,884	2,223
	Advertising	855	1,065	1,325	1,652	1,994
	Incubation	1,646	3,546	2,870	2,379	2,801
Operating cost	Headquarters	1,094	1,122	1,141	1,147	1,168
EBIT (post-HQ)	Payment	837	947	1,200	1,502	1,834
	Advertising	490	691	945	1,270	1,605
	Incubation	1,281	3,172	2,490	1,997	2,412
Depre. & amort.	Total	1,387	1,465	1,386	1,362	1,330
D&A allocation	Payment	887	937	886	871	850
	Advertising	195	206	195	192	187
	Incubation	305	323	305	300	293
EBITDA	Payment	1,723	1,884	2,086	2,373	2,684
	Advertising	685	897	1,140	1,462	1,792
	Incubation	1,587	3,495	2,795	2,297	2,705

Source: Company data, HTI estimates

To value DG's advertising and payment segments, we reference the EV/EBITDA multiples of advertising and payment peers.

Advertising Peer Valuations (5 February 2016)

Company	Market Cap (mn)	Price / Earnings		Valuation Multiples Price / Book		EV/EBITDA	
		LFY	CFY	LFY	CFY	LFY	CFY
CYBERAGENT INC	341,984	22.9x	19.3x	5.07x	4.28x	8.1x	7.8x
SEPTENI HOLDINGS CO LTD	72,918	28.3x	24.6x	6.02x	4.71x	19.9x	13.9x
F@N COMMUNICATIONS INC	57,967	15.8x	14.6x	4.86x	3.98x	7.6x	7.0x
DA CONSORTIUM INC	35,539	30.7x	20.8x	2.09x	NA	8.8x	NA
ADWAYS INC	25,615	36.6x	40.2x	1.96x	1.94x	11.5x	11.6x
OPT HOLDING INC	17,718	57.2x	34.4x	0.94x	0.93x	4.4x	6.1x
Mean		31.9x	25.7x	3.49x	3.17x	10.06x	9.29x
Median		29.5x	22.7x	3.48x	3.98x	8.47x	7.83x

Source: Bloomberg

Payment Peer Valuation (5 February 2016)

Company	Market Cap (mn)	Price / Earnings		Valuation Multiples Price / Book		EV/EBITDA	
		LFY	CFY	LFY	CFY	LFY	CFY
GMO PAYMENT GATEWAY INC	212,872	108.9x	88.2x	13.15x	11.48x	55.8x	44.2x

Source: Bloomberg

SOTP Analysis: Base Case (¥m)

Base case				
Kakaku.com	Market value	DG stake	Discount (tax/liquidity)	Value to DG
	470,000	20.3%	40%	57,246
Incubation business	Segment asset value	VC portfolio book value	P/B multiple	Estimated equity value
	0	9,610	1.0x	9,610
Payment business	FY16E EBITDA	GMO multiple	Discount to GMO	Estimated EV
	2,086	44x	30%	64,260
Advertising business	FY16E EBITDA	Peer multiple	Discount to peers	Estimated EV
	1,140	8x	10%	8,208
Net debt	Cash	Merchant payables (net)	Debts	Net debt
	26,343	6,536	27,208	7,402
SOTP valuation				131,922
Per share value				2,806
HoldCo discount				20%
HTI per share valuation				2,245

Source: HTI Estimates

We conservatively assume incubation is only worth its book value

The 1.4x PBR is referenced from the five-year average of Dream Incubator (4310 JP)

Our conservative bear case indicates 16% downside from the last close, but this is premised on Kakaku's share price being stable

SOTP Analysis: Bull Case (¥m)

Bull case				
Kakaku.com	Market value	DG stake	Discount (tax only)	Value to DG
	470,000	20.3%	33%	63,925
Incubation business	Segment asset value	VC portfolio book value	P/B multiple	Estimated equity value
	100	9,610	1.4x	13,594
Payment business	FY16E EBITDA	GMO multiple	Discount to GMO	Estimated EV
	2,086	44x	20%	73,440
Advertising business	FY16E EBITDA	Peer multiple	Discount to peers	Estimated EV
	1,140	8x	0%	9,120
Net debt	Cash	Merchant payables (net)	Debts	Net debt
	26,343	6,536	27,208	7,402
SOTP valuation				152,677
Per share value				3,247
HoldCo discount				20%
HTI per share valuation				2,598

Source: HTI Estimates

SOTP Analysis: Bear Case (¥m)

Bear case				
Kakaku.com	Market value	DG stake	Discount (tax/liquidity)	Value to DG
	470,000	20.3%	50%	47,705
Incubation business	Segment asset value	VC portfolio book value	P/B multiple	Estimated equity value
	0	9,610	0x	0
Payment business	FY16E EBITDA	GMO multiple	Discount to GMO	Estimated EV
	2,086	44x	50%	45,900
Advertising business	FY16E EBITDA	Peer multiple	Discount to peers	Estimated EV
	1,140	8x	20%	7,296
Net debt	Cash	Merchant payables (net)	Debts	Net debt
	26,343	6,536	27,208	7,402
SOTP valuation				93,499
Per share value				1,988
HoldCo discount				20%
HTI per share valuation				1,591

Source: HTI Estimates

We apply DCF to check the reasonableness of our SOTP results. As in SOTP, the Kakaku.com stake accounts for 40–60% of DG's value. The DCF base-case result largely agrees with the SOTP base-case valuation, but the proportion of value contributed from incubation is significantly higher in DCF than in SOTP. Because we hold Kakaku.com value constant across DCF cases, the bull case and bear case results are less varied than in SOTP.

We apply a 10% discount to account for the above-market risk of DG's VC returns

DCF Valuation: Base Case (¥m)

	Projection Period				
	6/2016E	6/2017E	6/2018E	6/2019E	6/2020E
Revenue	41,306	44,537	48,994	53,564	58,296
Cost of revenues	29,740	32,067	35,276	38,566	41,973
Operating expenses	6,931	7,702	7,868	8,119	8,338
EBIT	4,635	4,769	5,851	6,879	7,984
Tax rate	33%	33%	33%	33%	33%
NOPAT	3,105	3,195	3,920	4,609	5,350
Add: Depreciation	1,386	1,362	1,330	1,293	1,256
Less: Capex	850	850	850	850	850
Less: Working capital increase	0	292	613	568	629
Free cash flows	3,642	3,415	3,787	4,483	5,126
Present value	3,528	3,008	3,032	3,263	3,392
Terminal value					
Stage 1 growth	6.0%	Equity value			
Stage 1 period	4	Enterprise value			
Terminal growth	2.0%	Less: Debt			
Discount rate	10.0%	Plus: Cash			
Terminal value	70,487	Plus: Nonoperating assets			
PV terminal value	46,638	Equity value			
		Per share			
		103,163			
		2,194			

Source: HTI Estimates

We vary our forecast assumptions in our bull and bear cases. Major variables include B2C market growth, B2C EC rate, DG's payment market share in data processing, incubation IRR, advertising revenue increase, cost of revenue, and operating cost ratio.

DCF Valuation: Bull Case (¥m)

	Projection Period				
	6/2016E	6/2017E	6/2018E	6/2019E	6/2020E
Revenue	42,387	47,481	53,385	59,620	66,261
Cost of revenues	30,307	33,949	38,170	42,628	47,377
Operating expenses	7,157	8,133	8,526	8,787	9,174
EBIT	4,923	5,399	6,689	8,205	9,710
Tax rate	33%	33%	33%	33%	33%
NOPAT	3,299	3,617	4,481	5,497	6,506
Add: Depreciation	1,386	1,362	1,330	1,293	1,256
Less: Capex	850	850	850	850	850
Less: Working capital increase	0	272	759	738	836
Free cash flows	3,835	3,858	4,203	5,202	6,075
Present value	3,715	3,397	3,365	3,786	4,020
Terminal value					
Stage 1 growth	6.0%	Equity value			
Stage 1 period	4	Enterprise value			
Terminal growth	2.0%	Less: Debt			
Discount rate	10.0%	Plus: Cash			
Terminal value	83,537	Plus: Nonoperating assets			
PV terminal value	55,273	Equity value			
		113,859			
		Per share			
		2,421			

Source: HTI Estimates

DCF Valuation: Bear Case (¥m)

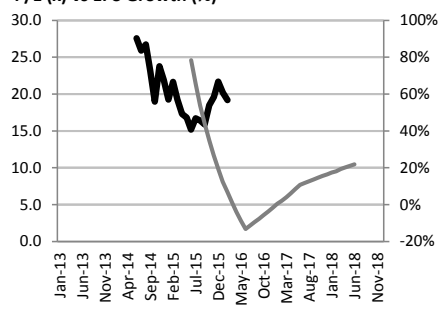
	Projection Period				
	6/2016E	6/2017E	6/2018E	6/2019E	6/2020E
Revenue	40,243	39,909	42,893	45,861	48,838
Cost of revenues	29,377	29,133	31,312	33,479	35,652
Operating expenses	6,623	6,797	6,812	6,897	7,084
EBIT	4,243	3,978	4,770	5,485	6,103
Tax rate	33%	33%	33%	33%	33%
NOPAT	2,843	2,665	3,196	3,675	4,089
Add: Depreciation	1,386	1,362	1,330	1,293	1,256
Less: Capex	850	850	850	850	850
Less: Working capital increase	0	323	467	407	437
Free cash flows	3,379	2,855	3,208	3,711	4,058
Present value	3,274	2,514	2,569	2,701	2,685
Terminal value	Equity value				
Stage 1 growth	6.0%	Enterprise value			50,661
Stage 1 period	4	Less: Debt			33,744
Terminal growth	2.0%	Plus: Cash			26,343
Discount rate	10.0%	Plus: Nonoperating assets			47,705
Terminal value	55,797	Equity value			90,964
PV terminal value	36,918	Per share			1,935

Source: HTI Estimates

Risks to Our Rating and the Attainment of Our Target Price

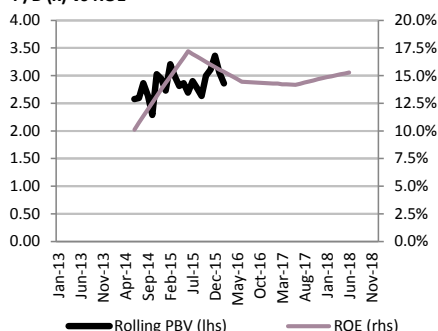
We think key risks include a decline in Kakaku.com's share price, poor performance of the incubation segment, payment revenue growth failing to re-rate DG's multiple, and a lack of investor interest in gaining mixed-sector exposures even at a large discount to NAV.

P/E (x) vs EPS Growth (%)



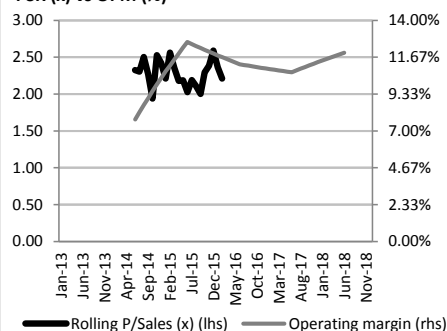
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



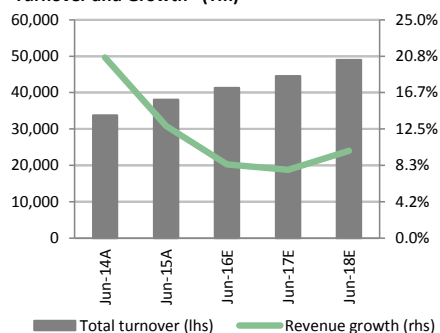
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



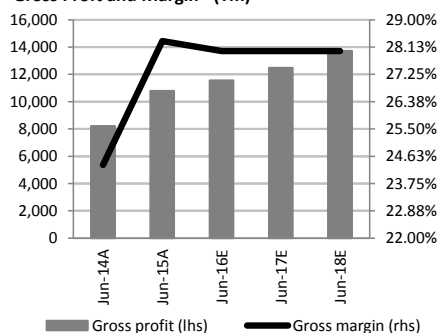
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth - (¥m)



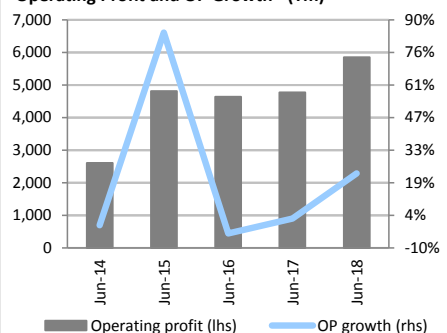
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin - (¥m)



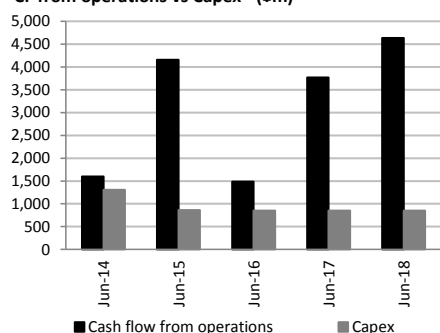
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth - (¥m)



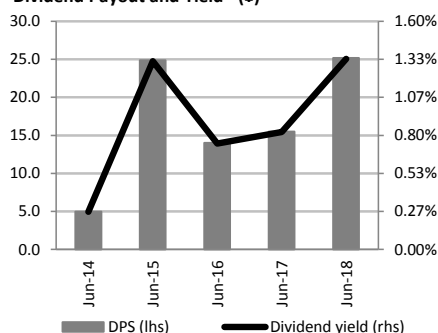
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex - (¥m)



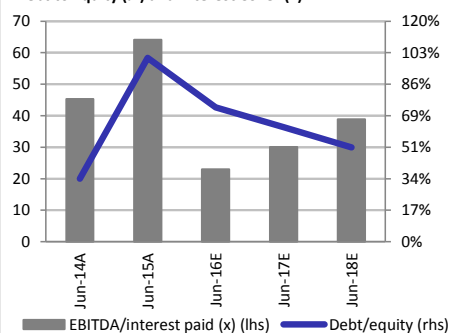
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield - (¥)



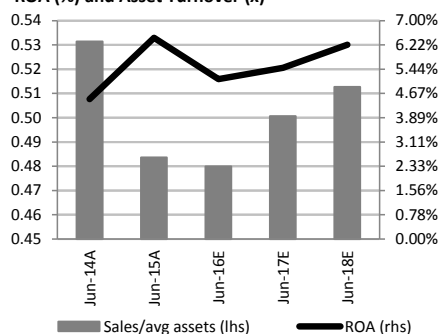
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



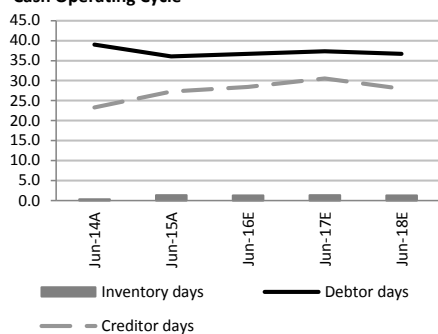
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



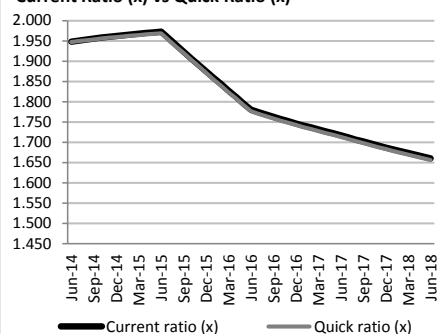
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

Revenue Growth

We expect total revenue growth to be driven by payment and advertising as incubation revenue stabilizes. For FY6/16, we expect payment revenue to increase by 14%, advertising revenue to increase by 10%, and incubation revenue to decrease by 6%, resulting in total revenue growth of 8%.

Profit Margins

We expect OPM to decline to 11.2% in FY6/16 from 12.6% in FY6/15 as high-margin incubation revenue decreases. For FY6/17, we forecast OPM to be 10.7%.

Shareholder Returns

We expect ROE of 14.4% and 14.2% in FY6/16 and FY6/17. We forecast a dividend payout of 15% in FY6/16 and FY6/17, lower than the 20% mentioned in DG's strategic plan. We do not expect any share buybacks in coming years.

Balance Sheet Risks

We see little risk of equity issuance and debt level looks acceptable. We estimate the average interest rate for DG's debt is close to 1% and debt servicing appears to be manageable. The risky part of the balance sheet is its VC investments, but a more-than-adequate loss provision has been made, in our view. Due to its accounting policies for its payment segment, we think DG's balance sheet appears to be significantly larger than it should be.



Key Takeaway

With DG's mix of unrelated exposures, we think investors should continue to prefer pure plays and demand a valuation discount from DG, but its growing payment business should create soft catalysts to narrow the discount to SOTP value

Investment Thesis – Target Price – Share Price Catalysts

We think DG has developed two fast growing operating segments (payment and advertising) in recent years, but investors largely continue to value DG as a listed shell holding a Kakaku.com stake and a VC portfolio. We think payment segment growth will likely visibly accelerate in the next few years to increase investor awareness of this exposure. While we think investors likely prefer GMO Payment for the exposure to increasing EC payment processing, we believe the current valuation gap should start attracting some investors into DG's shares. While we see DG's discount to SOTP value existing for a good reason, we think a narrower level would be justified. Catalysts include visibility to payment revenue growth, improved financial transparency, a merger of econtext and veritrans, and continued investment in the currently popular fintech area.

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BUY> 15% absolute upside performance expected within the next 12 months

SELL> 15% absolute downside performance expected within the next 12 months

NEUTRAL: A stock under coverage with insufficient upside or downside to justify a BUY or SELL rating. For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category.

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- Hold: Target price within 0% to +15% of the current price
- Sell: Target price below the current price

The Rating Distribution pie chart for the most recent full quarter is based on the new HTIRL rating system and the prior full quarter on the legacy HTIRL rating system.

Haitong International Equity Research Ratings Distribution, as of December 31, 2015

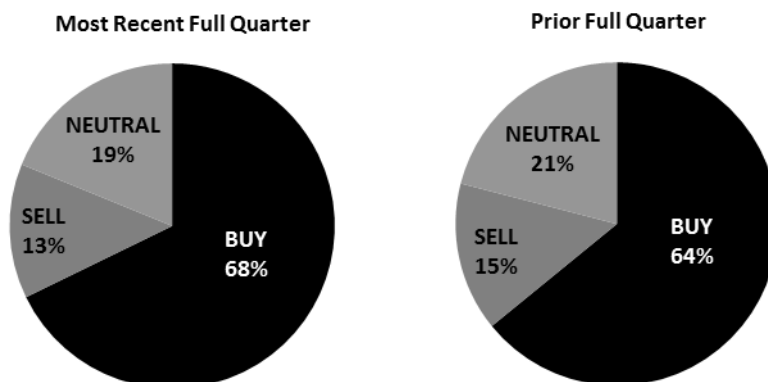
	BUY	Neutral (hold)	SELL
HTIRL Equity Research Coverage	68%	19%	13%
IB clients*	1%	4%	0%

*Percentage of investment banking clients in each rating category.

For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category. Please note that stocks with an NR designation are not included in the table above.

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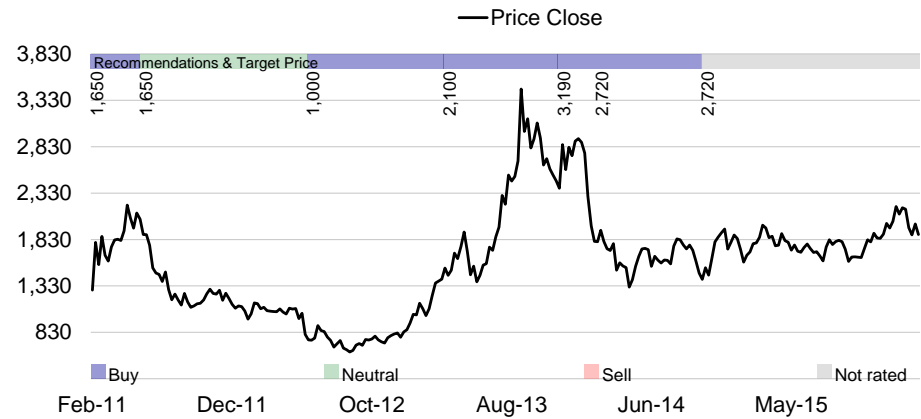
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Recommendation Chart



Date	Recommendation	Target (JPY)	Price (JPY)
2014-10-15	Not rated	-	1,467
2014-02-25	Buy	2,720	1,934
2013-12-03	Buy	3,190	2,509
2013-03-27	Buy	2,100	1,585
2012-05-31	Buy	1,000	769
2011-05-30	Neutral	-	2,033
2010-03-10	Buy	1,650	-

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity

Haitong International Coverage as of 1 Feb 2016

*Pan Asia Resources***Core Coverage Universe****Sam Thawley (Team Leader)**

Angang Steel (347 HK)
 China Shenhua Energy (1088 HK)
 CNOOC (883 HK)
 Daido Steel (5471 JP)
 Daikin Industries (6367 JP)
 Fuji Seal International (7864 JP)
 Fujitsu General (6755 JP)
 Glory (6457 JP)
 Hanwa (8078 JP)
 Hitachi Construction Machinery (6305 JP)
 IHI (7013 JP)
 Kawasaki Heavy Industries (7012 JP)
 Kawasaki Kisen (9107 JP)
 Komatsu (6301 JP)
 Kubota (6326 JP)
 KYB (7242 JP)
 Kyoel Steel (5440 JP)
 Makita (6586 JP)
 Mitsubishi Heavy Industries (7011 JP)
 Mitsui O.S.K. Lines (9104 JP)
 Nippon Steel & Sumikin Bussan (9810 JP)
 PetroChina (857 HK)
 Riso Kagaku (6413 JP)
 Sanyo Special Steel (5481 JP)
 SMC (6273 JP)
 THK (6481 JP)
 Tokyo Steel Mfg. (5423 JP)
Fook Tat Cho
 Anton Oilfield Services (3337 HK)
 China Datang (1798 HK)
 China Longyuan Power (916 HK)
 China Singyes (750 HK)
 China Suntien (956 HK)
 CIMC Enric (3899 HK)
 CLP Holdings (2 HK)
 GCL-Poly (3800 HK)
 Hilong (1623 HK)
 Honghua Group (196 HK)
 Huadian Fuxin Energy (816 HK)
 Huaneng Renewables (958 HK)
 Xinjiang Goldwind (2208 HK)

Non-Coverage Universe

CGN New Energy Holdings (1811 HK)
 Dowa Holdings (5714 JP)
 GCL New Energy Holdings (451 HK)
 Iino Kaiun Kaisha (9119 JP)
 Maruichi Steel Tube (5463 JP)
 Mie Holdings (1555 HK)
 Nippon Coke & Engineering (3315 JP)
 NS United Kaiun Kaisha (9110 JP)
 Osaka Steel (5449 JP)
 Sino Oil and Gas Holdings (702 HK)

*Pan Asia TMT***Core Coverage Universe****Neil Juggins (Team Leader)**

Alibaba Group Holdings (BABA US)
 China Mobile (941 HK)
 China Telecom (728 HK)
 China Unicom Hong Kong (762 HK)
 Chunghwa Telecom (2412 TT)
 Ctrip.com International (CTRP US)
 Far EastOne Telecommunications (4904 TT)
 KDDI (9433 JP)
 NetEase (NTES US)
 Nippon Telegraph & Telephone (9432 JP)
 NTT DoCoMo (9437 JP)
 Softbank (9984 JP)
 Taiwan Mobile (3045 TT)
 Tencent Holdings (700 HK)
 Yahoo Japan (4689 JP)
Steve Myers
 Canon (7751 JP)
 Fujitsu (6702 JP)
 Hon Hai Precision Industry (2317 TT)
 Keyence (6861 JP)
 Konica Minolta Holdings (4902 JP)
 LG Electronics (066570 KS)
 Mediatek (2454 TT)
 Nikon (7731 JP)
 Samsung Electronics (005930 KS)
 Taiwan Semiconductor Mfg. Co. (2330 TT)
 Toshiba (6502 JP)

Jones Ku

AAC Technologies (2018 HK)
 BYD Electronic (285 HK)
 China Communications (552 HK)
 Coolpad Group (2369 HK)
 Sunny Optical (2382 HK)
 TCL Communication (2618 HK)
 Tongda Group (698 HK)
 ZTE (763 HK)

Jean-Louis Lafayeedney

Advanced Semiconductor Engineering (2311 TT)
 ASM Pacific Technology (522 HK)
 Asustek Computer (2357 TT)
 Casetek Holdings (5264 TT)
 Largan Precision (3008 TT)
 Lenovo (992 HK)
 Nidec (6594 JP)
 Siliconware Precision Industries (2325 TT)
 Skyworth Digital Holdings (751 HK)

*Pan Asia Autos, Machinery & Industrial***Core Coverage Universe****Ole Hui (Team Leader)**

China Communications Construction (1800 HK)
 China Railway Construction (1186 HK)
 China Railway Group (390 HK)
 China Railway Signal & Communication (3969 HK)
 CRRC (1766 HK)
 Dongfeng Motor (489 HK)
 Guangzhou Automobile (2238 HK)
 Shenzhen International (152 HK)
 Zhuzhou CSR Times Electric (3898 HK)

Tony Moyer

Amada (6113 JP)
 Azbil (6845 JP)
 Chiyoda (6366 JP)
 Daifuku (6383 JP)
 Fanuc (6954 JP)
 JGC (1963 JP)
 Nabtesco (6268 JP)
 Tsugami (6101 JP)
 Yaskawa Electric (6506 JP)
 Yokogawa Electric (6841 JP)

Steve Usher

Brilliance China (1114 HK)
 BYD (1211 HK)
 Geely Automobile (175 HK)
 Great Wall Motor (2333 HK)
 Honda Motor (7267 JP)
 Hyundai Mobis (012330 KS)
 Hyundai Motor (005380 KS)
 Kia Motors (000270 KS)
 Nissan Motor (7201 JP)
 Toyota Motor (7203 JP)
 Yamaha Motor (7272 JP)

Gary Cheung

Advantech (2395 TT)
 Airtac International Group (1590 TT)
 Delta Electronics (2308 TT)
 First Tractor (38 HK)
 Giant Manufacturing (9921 TT)
 Hiwin Technologies (2049 TT)
 Merida (9914 TT)
 Techtronic Industries (669 HK)
 Teco Electric and Machinery (1504 TT)
 Weichai Power (2338 HK)

Kosuke Matsuda

Bridgestone (5108 JP)
 Denso (6902 JP) — Kosuke Matsuda
 Fuji Heavy Industries (7270 HK)
 Isuzu Motors (7202 JP)
 Mazda (7261 JP)
 Mitsubishi Motors (7211 JP)
 Nexteer (1316 HK)
 Suzuki Motor (7269 JP)
Lily Li
 Minth (425 HK)

*Japan Real Estate***Core Coverage Universe****Mark Brown (Team Leader)**

Daito Trust Construction (1878 JP)
 Daiwa House Industry (1925 JP)
 Lixil Group (5938 JP)
 Mitsubishi Estate (8802 JP)
 Mitsui Fudosan (8801 JP)
 Noritz (5943 JP)
 Obayashi (1802 JP)
 Sekisui House (1928 JP)
 Sumitomo Realty & Development (8830 JP)
 Taisei (1801 JP)
 Tokyo Tatemono (8804 JP)

Non-Coverage Universe

BeijingWest Industries International (2339 HK)
 Calsonic Kansei (7248 JP)
 China Harmony New Energy Auto (3836 HK)
 China Yongda Automobiles Services (2558 HK)
 DMG Mori (6141 JP)
 Eagle Industry (6486 JP)
 Frontier Services Group (500 HK)
 Kato Works (6390 JP)
 Keihin (7251 JP)
 Makino Milling Maching (6135 JP)
 Mitsui Engineering & Shipbuilding (7003 JP)
 Nachi-Fujikoshi (6474 JP)
 Nishio Rent All (9699 JP)
 Press Kogyo (7246 JP)
 Shanghai Prime Machinery (2345 HK)
 Takeuchi Mfg. (6432 JP)
 TPR (6463 JP)
 TS Tech (7313 JP)
 West China Cement (2233 HK)
 Xingda International Holdings (1899 HK)

*China Real Estate***Core Coverage Universe****Andy So (Team Leader)**

Agile Property (3383 HK)
 China Overseas Land & Investment (688 HK)
 China Resources Land (1109 HK)
 Country Garden Holdings (2007 HK)
 Dalian Wanda Commercial Properties (3699 HK)
 Greentown China Holdings (3900 HK)
 Guangzhou R&F Properties (2777 HK)
 KWG Property Holding (1813 HK)
 Nanjing Gaoke (600064 CH)
 Shimao Property Holdings (813 HK)
 Longfor Properties (960 HK)

Peter Yang

Shenzhen Investment (604 HK)

Non-Coverage Universe

Times Property Holdings (1233 HK)
 Yuzhou Properties (1628 HK)

Haitong International Coverage as of 1 Feb 2016

China Consumer**Core Coverage Universe****Nicolas Wang (Team Leader)**

China Medical System (867 HK)
 China Mengniu Dairy (2319 HK)
 China Resources Enterprise (291 HK)
 China Traditional Chinese Medicine (570 HK)
 CSPC Pharmaceutical Group (1093 HK)
 Hengan International (1044 HK)
 Kweichow Moutai (600519 CH)
 Shanghai Pharmaceuticals (2607 HK)
 Sinopharm Group (1099 HK)
 Tingyi Cayman Islands Holding (322 HK)
 Tsingtao Brewery (168 HK)
 Uni-President China (220 HK)
 Want Want China Holdings (151 HK)
 Zhejiang Huahai Pharmaceutical (600521 CH)
Donald Cheng
 Galaxy Entertainment (27 HK)
 Macau Legend Development (1680 HK)
 MGM China (2282 HK)
 Sands China (1928 HK)
 SJM Holdings (880 HK)
 Wynn Macau (1128 HK)

Non-Coverage Universe

China Huiyuan Juice Group (1886 HK)
 China LotSynergy Holdings (1371 HK)
 China Shineway Pharmaceutical Group (2877 HK)
 Dynam Japan Holdings (6889 HK)
 Shanghai Fudan-Zhangjiang Bio-Pharm (1349 HK)
 Tenwow International (1219 HK)

Japan Consumer**Core Coverage Universe****James Moon (Team Leader)**

Aoyama Trading (8219 JP)
 Asics (7936 JP)
 FamilyMart (8028 JP)
 Fast Retailing (9983 JP)
 Japan Tobacco (2914 JP)
 Laox (8202 JP)
 Rakuten (4755 JP)
 Seven & I Holdings (3382 JP)
 Start Today (3092 JP)
 Unicharm (8113 JP)

Non-Coverage Universe

Aeon Mall (8905 JP)
 Avex Group Holdings (7860 JP)
 DCM Holdings (3050 JP)
 H2O Retailing (8242 JP)
 Honeys (2792 JP)
 Parco (8251 JP)

Latest Additions to Coverage

Advantech (2395 TT) — Gary Cheung
 China Railway Signal & Communication (3969 HK) — Ole Hui
 CLP Holdings (2 HK) — Fook Tat Cho
 Denso (6902 JP) — Kosuke Matsuda
 Li Ning (2331 HK) — Jessica Ye
 Mandom (4917 JP) — Hiroyuki Terada
 Mediatek (2454 TT) — Steve Myers
 Nanjing Gaoke (600064 CH) — Andy So
 Zhejiang Huahai Pharmaceutical (600521 CH) — Nicolas Wang

Latest Drops from Coverage

Sung Kwang Bend (014620 KS)
 TK Corp. (023160 KS)

Latest Transfers of Coverage

China Communications Construction (1800 HK) — to Ole Hui
 China Railway Construction (1186 HK) — to Ole Hui
 China Railway Group (390 HK) — to Ole Hui
 Fuji Heavy Industries (7270 JP) — to Kosuke Matsuda
 Shenzhen International Holdings (152 HK) — to Ole Hui
 Suzuki Motor (7269 JP) — to Kosuke Matsuda
 Zuozhou CSR Times Electric (3898 HK) — to Ole Hui

Asia ex Small Cap**Core Coverage Universe****Yuanquan Ji (Team Leader)**

Best Pacific International (2111 HK)
 Century Sage Scientific (1450 HK)
 China Aircraft Leasing Group (1848 HK)
 Pacific Textiles Holdings (1382 HK)
 Pax Global Technology (327 HK)
 Sa Sa International Holdings (178 HK)
 Shanghai Fudan Microelectronics (1385 HK)
 Shenzhou International Group (2313 HK)
 SITC International Holdings (1308 HK)
 Wasico Group Holdings (3393 HK)

Walden Shing

APT Satellite (1045 HK)
 Fu Shou Yuan International (1448 HK)
 Man Wah Holdings (1999 HK)

Justin Kim

Aerospace Technology of Korea (067390 KS)
 Cuckoo Electronics (192400 KS)
 Duzonbizon (012510 KS) — Justin Kim
 Fila Korea (081660 KS)
 Kepco Plant Service (051600 KS)

Jaesong Woo

Hansae (105630 KS)
 Hy-Lok (013030 KS)
 Inbody 041830 KS)

Korea Kolmar (161890 KS)
 Osstem Implant (048260 KS)
 Youngone (111770 KS)

Jessica Ye

Anta Sports Products (2020 HK)
 Li Ning (2331 HK)

Japan Small Cap**Core Coverage Universe****Hiroyuki Terada (Team Leader)**

Accordia Golf (2131 JP)
 Accretive (8423 JP)
 Dentsu (4324 JP)
 Gulliver International (7599 JP)
 Kameda Seika (2220 JP)
 Mandom (4917 JP)
 Pigeon (7956 JP)
 Pola Orbis (4927 JP)
 Recruit Holdings (6098 JP)
 Sanrio (8136 JP)
 Shiseido (4911 JP)
 Sohgo Security Services (2331 JP)
 Technopro Holdings (6028 JP)
 Yamato Holdings (9064 JP)
 Yumeshin Holdings (2362 JP)

Yusuke Suzuki

Ain Pharmaciez (9627 JP)
 Doutor Nichires Holdings (3087 JP)
 FP (7947 JP)
 Nihon Nohyaku (4997 JP)
 Nihon Parkerizing (4095 JP)
 Optex (6914 JP)
 Sky Perfect JSAT Holdings (9412 JP)
 Sun Frontier Fudousan (8934 JP)
 Takara Leben (8897 JP)
 Tosei (8923 JP)
 Wowow (4839 JP)

Tony Tanaka

China Galaxy Securities (6881 HK)
 GCA Sawian (2174 JP)
 GF Securities (1776 HK)
 Hong Kong Exchanges and Clearing (388 HK)
 Huatau Securities (6886 HK)
 Nihon M&A Center (2127 JP)
 Zenkoku Hosho (7164 JP)

Non-Coverage Universe

Bonjour Holdings (653 HK)
 C.banner International Holdings (1028 HK)
 China Maple Leaf Educational Systems (1317 HK)
 Cuchen (225650 KS)
 Goldpac Group (3315 HK)
 Hotel Shilla (008770 KS)
 Maoye International Holdings (848 HK)
 Modetour Network (080160 KS)
 Orange Sky Golden Harvest (1132 HK)
 Orbitech (046120 KS)
 Pou Sheng International Holdings (3813 HK)
 PS TEC (002230 KS)
 Samchully Bicycle (024950 KS)
 Sinosoft Technology Group (1297 HK)
 Texhong Textile Group (2678 HK)
 TK Group Holdings (2283 HK)
 Tsui Wah Holdings (1314 HK)
 Value Added Technologies (043150 KS)
 VST Holdings (856 HK)
 Xia Nan Guo Restaurants Holdings (3666 HK)

Non-Coverage Universe

Autobacs Seven (9832 JP)
 China Financial International Investments (721 HK)
 Fanci (4921 JP)
 HIS (9603 JP)
 Istyle (3660 JP)
 Luzheng Futures (1461 HK)
 Meitec (9744 JP)
 Nichii Gakkan (9792 JP)
 Tohokushinsha Film (2329 JP)
 VT Holdings (7593 JP)