MIGALO HOLDINGS | 5535 **TSE Prime**

Initiation

Prepare for the new age of the facial recognition platform

MIGALO HOLDINGS

Summary

• **Company Overview:** MIGALO HOLDINGS Inc. pursues a company-wide growth strategy centered on digital transformation (DX) across all businesses by taking the cash flow gained from selling around 1,500 studio condominium units ("one-room" for investment and "compact" for residential properties) priced between ¥30-50 mn per unit, mainly in Tokyo and three prefectures within a 10-minute walk of train stations, and investing it in DX areas.

• **DX Stocks 2023:** PROPERTY AGENT, Inc., the company's effective predecessor, was selected in May 2023 as one of the 32 DX Stocks 2023 companies jointly selected by the Ministry of Economy, Trade and Industry, the Tokyo Stock Exchange, and the Information-technology Promotion Agency, Japan. This demonstrates that the company's DX expertise is appraised at the national level.

• **Impact of FreeiD:** The biggest differentiating and catalyst for creating greater added value of the MIGALO Group is its patented FreeiD facial recognition platform service, which connects various daily activities (building entry/exit, personal identification, payment, etc.) by registering a user's face once, creating a world where people can live without keys, wallets, or smart phones. Expectations are high for providing and deploying full facial recognition condominiums and smart city solutions using FreeiD. Society may transform once facial recognition spreads and becomes the norm nationwide by 2025, when all Osaka Metro stations begin using facial recognition gates, and the environment has become more favorable for the company's business model.

• **Earnings Trends:** Since its establishment, MIGALO HOLDINGS Inc. has consecutively grown both sales and profits through FY2023/3. However, the company's consolidated FY2024/3 forecast calls for a 12.7% YoY sales increase to ¥42.0 bn and a 14.4% YoY drop in operating profit to ¥2.5 bn. The company explained that although it expects sales to grow steadily, the forecast for lower operating profit reflects soaring construction costs in the DX Real Estate business stemming from high material costs and labor shortages, as well as a planned increase in upfront investment for accelerating growth in the DX Promotion business. The company has set a medium- to long-term sales target of ¥100 bn, but has maintained a policy of not disclosing its medium-term management plan since it first went public.

• **Share Price Insight:** Despite the company's ROE of about 18% and consecutive dividend increases, its current share price is substantially undervalued with a P/B ratio of about 1x and P/E ratio of less than 8x. SIR believes that the company's shares are a classic example of information asymmetry, and that there are broadly three interrelated factors resulting in the discounted share price. These three factors include (1) a lack of sufficient information on technology and systems to dispel uncertainty over the monetization strategy and business environment for the facial recognition platform, which is a pillar of the company's growth strategy, (2) the lack of support stemming from lack of disclosure policy of the company's medium-term management plan, and (3) investor concerns about the worst-case scenario in the event that the company fails to execute its plan for meeting the TSE Prime continued listing criteria. In any case, we look forward to seeing improvements in the substantial information asymmetry tying into a share price rerating.

Focus Point

The FreeiD service, which integrates with and supports a wide variety of facial recognition engines and enables the management of fragmented facial recognition IDs on a single platform, could be "a game-changer" for the facial recognition-related business in the state of "rivalry of local warlords". The chances of a share price rerating will grow if these expectations persist.

Key Indicators	
Share price (1/18)	1,401
YH (23/12/18)	1,644
YL (23/10/24)	1,111
10YH* (21/9/13)	3,460
10YL* (21/1/21)	328
Shrs out. (mn shrs)	7.316
Mkt cap (¥ bn)	10.249
Equity ratio (23/9)	24.4%
FY23/3 P/B* (act)	1.08x
FY24/3 P/E (CE)	7.8x
FY23/3 ROE* (act)	17.9%
FY24/3 DY (CE)	3.21%

Note*: Share price and financial data of predecessor PROPERTY AGENT, Inc. (3464)

Daily Stock Price Chart

Source: Trading view

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Y mn, %	Sales	YoY	Operating Profit	YoY	Ordinary Profit	YoY	Net profit	YoY	EPS	DPS
2020/3 NC	22,675	5.3	1,904	10.0	1,545	11.5	955	9.5	133.87	25.0
2021/3 C	27,524	21.4	2,093	9.9	1,791	15.9	1,170	22.5	161.72	26.0
2022/3 C	35,186	27.8	2,208	5.5	1,918	7.1	1,217	4.0	166.82	27.0
2023/3 C	37,259	5.9	2,919	32.2	2,518	31.3	1,576	29.5	215.92	40.0
2024/3 CE	42,000	12.7	2,500	(14.4)	2,120	(15.8)	1,310	(16.9)	180.20	45.0

Source: Compiled by SIR from the company IR material.

Company Profile

* The shares of PROPERTY AGENT, Inc., which became a MIGALO HOLDINGS Inc.'s wholly owned subsidiary, were delisted on September 28, 2023.

■ Overview:

MIGALO HOLDINGS Inc. was established on October 2, 2023 through a sole-share transfer as the wholly owning parent company of PROPERTY AGENT, Inc. and was newly listed on the Prime Market of the Tokyo Stock Exchange on the same day*.
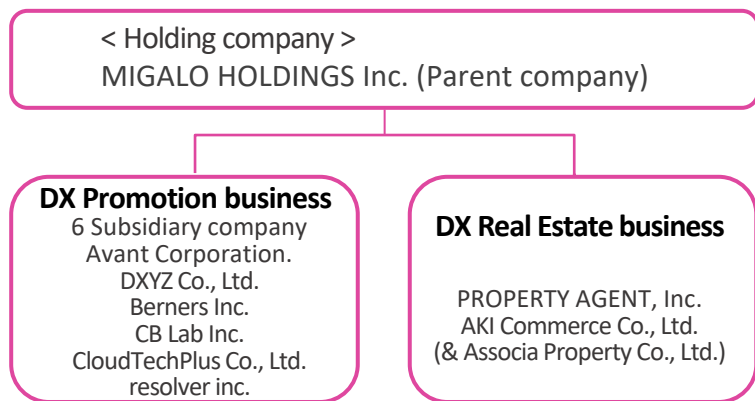
The company, which has become a listed holding company, upholds a management philosophy of "We contribute to solutions to society's problems by creating new value through the melding of digital and real". Based on this philosophy, it operates under the concept of a corporate group that creates value through digital transformation (DX) and real estate, and maintains two businesses under its umbrella: one that promotes DX with the aim of growing business in the DX domain (DX Promotion business) and a real estate business centered around DX (DX Real Estate business).

The DX Promotion Business broadly consists of two divisions. One is the facial recognition ID platform business, under which DXYZ Co., Ltd. provides smart city solutions (facial recognition platform) as a SaaS offering. The other is the cloud integration and system development business, which mainly handles Salesforce implementation services and AWS system construction.

Originally, PROPERTY AGENT, Inc. had improved its productivity by converting its old paper-based and face-to-face workflow into an electronic and online workflow, along with switching to centralized management of customer property information and implementing a system to manage KPIs. Leveraging its DX expertise gained from this experience as a core competency, the company decided it can build a business by helping other companies in a variety of industries improve productivity. This led to the launch of a business in the cloud integration and system development consulting domains, which turned into the DX Promotion business.

The figure on the right below illustrates this progression. The company supports and deploys DX promotion at other companies by taking the various expertise (productivity improvement, business transformation, labor reduction, etc.) gained through internal DX at PROPERTY AGENT, Inc., which operates a real estate business. This responsibility is assumed by a group of subsidiaries engaged in cloud integration and system development, each of which focuses mainly on Salesforce implementation services and AWS system construction.

The biggest differentiator and catalyst for the MIGALO Group to add greater value is DXYZ Co., Ltd.'s FreeiD facial recognition platform service. Expectations are high for providing and deploying full facial recognition condominiums and smart city solutions using FreeiD, which has the potential to transform society.

< Holding company >
MIGALO HOLDINGS Inc. (Parent company)

DX Promotion business
6 Subsidiary company
Avant Corporation.
DXYZ Co., Ltd.
Berners Inc.
CB Lab Inc.
CloudTechPlus Co., Ltd.
resolver inc.

DX Real Estate business

PROPERTY AGENT, Inc.
AKI Commerce Co., Ltd.
(& Associa Property Co., Ltd.)

Source: Complied by SIR from the company IR material.

Facial recognition ID platform
DXYZ
Facial recognition condominium growth

Know-how to increase productivity
Know-how to transform business

Digitalize one's own operations
Share know-how
PROPERTY AGENT
Digitalize one's own operations
Share know-how

Cloud integration
System development consulting

BERNERS resolver
CLOUDTECH+
AVANT CBLab.

Know-how to reduce man hours

Expand DX promotion know-how to other companies

■ **History - Focusing on the DX domain over the past few years and projecting consecutive sales growth since its establishment**

The company's passion to DX is particularly strong. According to Mr. Sei Nakanishi, the company's current president and representative director, who founded the company's predecessor PROPERTY AGENT, Inc. in February 2004, the company's definition of DX is productivity improvement (improvement of operation flow: introduce digital technology and put it online) and business transformation (create new business model).

The chart below shows sales trends and major business expansion events for the company's predecessor, PROPERTY AGENT, Inc.. In FY2024/3, the company plans to achieve its sales target of ¥42.0 bn as MIGALO HOLDINGS Inc., which would mark consecutive year of sales growth since its establishment.

The DX real estate business, which the company positions as a cash-cow pillar, is operated through PROPERTY AGENT, Inc. and AKI Commerce Co., Ltd. (and its subsidiary, Associa Property Co., Ltd.). The DX Promotion Business, positioned as a growth pillar, is operated through six subsidiaries: DXYZ Co., Ltd., Avant Corporation., Berners Inc., CB Lab Inc., CloudTechPlus Co., Ltd., and resolver inc.

The real estate business has been the driver of earnings growth to date, and in the DX domain, the company established DXYZ Co., Ltd. and Berners Inc. on its own, while also bringing Avant Corporation., CB Lab Inc., CloudTechPlus Co., Ltd., and resolver inc. into the Group through acquisitions from 2021 onward.

History and Sales of the Group
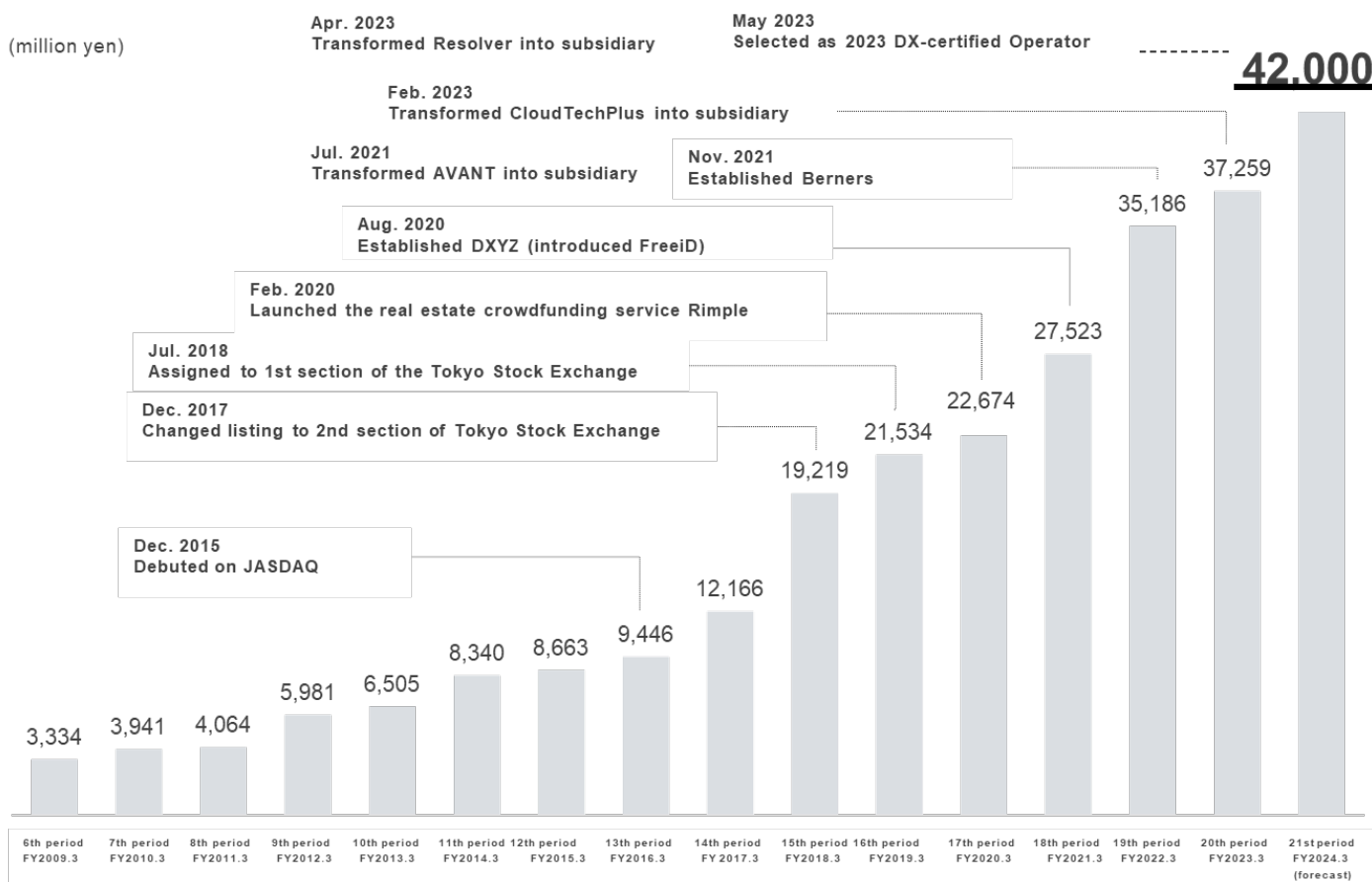
Source: The company IR material.

■ MIGALO's DX expertise is appraised at the national level

MIGALO's DX initiatives and expertise have been highly appreciated by outside parties, and in May 2023, the Ministry of Economy, Trade and Industry (METI), in collaboration with the Tokyo Stock Exchange and the Information-technology Promotion Agency, Japan, selected predecessor PROPERTY AGENT, Inc. as one of the 32 _DX Stocks 2023_* companies. The METI designates DX Stocks as "companies that are engaged in DX initiatives that fundamentally transform their business models and other aspects of their operations based on digital technology in order to achieve new growth and boost competitiveness," thus validating the company's DX initiatives and capabilities.

The company's commitment and passion for DX is consistent, with the new holding company's corporate philosophy of "We contribute to solutions to society's problems by creating new value through the melding of digital and real". The company aims to create value by leveraging the power of digital technology, continues to innovate discontinuously, and develops optimal solutions for society. The company's long-term vision is to become a "visionary company that continues to innovate" and aims to achieve further corporate growth by integrating social and environmental values with the value of its business activities to create a sustainable society and enhance corporate value.

■ Medium- to long-term sales growth target of ¥100 bn

The company has set a medium- to long-term sales target of ¥100 bn. The company limited its description of the timeline for achieving this target to "around 2029 at the latest".

In addition, the company states that it reviews its internal three-year plan every year on a rolling basis, but does not disclose this plan. The reason it does not disclose the plan is that there is a strong belief within the company that if the external environment of the real estate business were to change dramatically beyond expectations or if there were delays in property sales or revenue recognition, the medium-term management plan itself could inadvertently cause misleading results, since each single fiscal year earnings could be significantly different from targets set in the plan. Accordingly, the company has not announced a medium-term management plan since its IPO. This is another important factor to keep in mind when evaluating the company's stock.

*_**DX Stocks 2023**_*

https://www.meti.go.jp/english/press/2023/0531_002.html

Business developed by the Group
Deepen core businesses and create new businesses with DX as their foundation
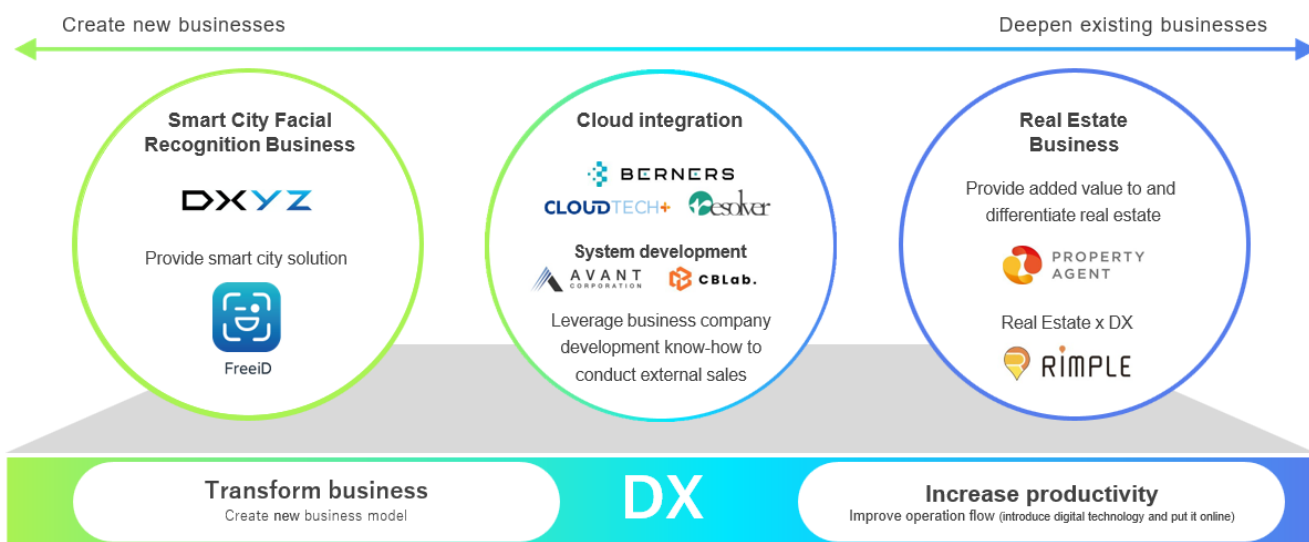
Source: The company IR material.

Business Model

■ Pursue company-wide growth centered on DX across all businesses

In October 2023, the company became a holding company. The main purpose of this change was to clarify the Group's DX-based business development and to clearly state the Group's stance of growing each business based on DX. In addition, another objective of this change was to encourage the independent management of Group companies and create an environment and workforce that can grow together and maximize performance, thereby speeding up decision-making and ensuring efficient and flexible business development.

MIGALO's business segments consist of the DX Real Estate business and the DX Promotion business. Since the holding company will begin disclosing earnings result from Q3 FY2024/3 (October–December), we use PROPERTY AGENT, Inc.'s 1H earnings for segment results. According to this, the DX Real Estate business is the cash cow of the entire company, accounting for about 96% of net sales and 98% of operating profit before adjustments. On the other hand, the DX Promotion Business, the growth pillar, is in a phase of going back and forth between breaking even and churning a profit, but with the increase in the number of projects coming online, it should only be a matter of time that the business generates profits consistently.

MIGALO's business model involves a company-wide growth strategy centered on carrying out DX across all businesses by generating steady cash flow and investing it in growth areas (DX).

Segment Information

Segment	(¥mn)	2021/3	2022/3	2023/3	2023/3 中間	2024/3 中間	増減率 (%)
DX Real Estate	Net Sales	**27,523**	**34,462**	**35,639**	17,492	23,209	32.7
	Operating Profit	**3,488**	**3,600**	**4,302**	2,541	3,066	20.7
	OP Margin	12.7%	10.4%	12.1%	14.5%	13.2%	
DX Promotion	Net Sales	n.a.	**833**	**1,799**	743	1,160	56.1
	Operating Profit	n.a.	**(9)**	**51**	45	(64)	N/M
	OP Margin	-	(1.1%)	2.8%	6.1%	(5.5%)	
Total	Net Sales	**27,524**	**35,186**	**37,259**	18,149	24,330	34.1
	Operating Profit	**2,093**	**2,208**	**2,919**	1,963	2,292	16.8
	OP Margin	7.6%	6.3%	7.8%	10.8%	9.4%	

Source: Compiled by SIR from the company IR material and SPEEDA data.
Note: FY2021/3 segment results for the DX Promotion business segment are not shown as the company changed its segment disclosure to the current name and classification starting from FY2022/3.

■ Business model of expanding DX Real Estate membership to grow the MIGALO Group real estate economy

PROPERTY AGENT, Inc. is involved in the development and sale of actual real estate, and is also developing *Rimple**, a real estate investment crowdfunding service that enables investors to invest as little as ¥10,000 per unit in rental condominiums.

The company sells around 1,500 studio condominiums (one-room type for investment and "a compact" for residential use) at a price of ¥30-50 mn per unit, generating annual sales of ¥35-¥40 bn. The breakdown of unit sales is roughly half from the purchase and resale of existing properties (owner-change) and half from in-house development.

DX Real Estate's customer base, which the company calls its business core, is the DX Real Estate membership consisting of more than 160,000 members. The company operates *Rimple*, a real estate investment crowdfunding service based on the Real Estate Specified Joint Enterprise Act, as a means of attracting members. It also serves as a tool for attracting customers so that those who invest in real estate can first experience success (2-3% yield after six months to a year of operation) before becoming buyers or investors in actual properties in the future.
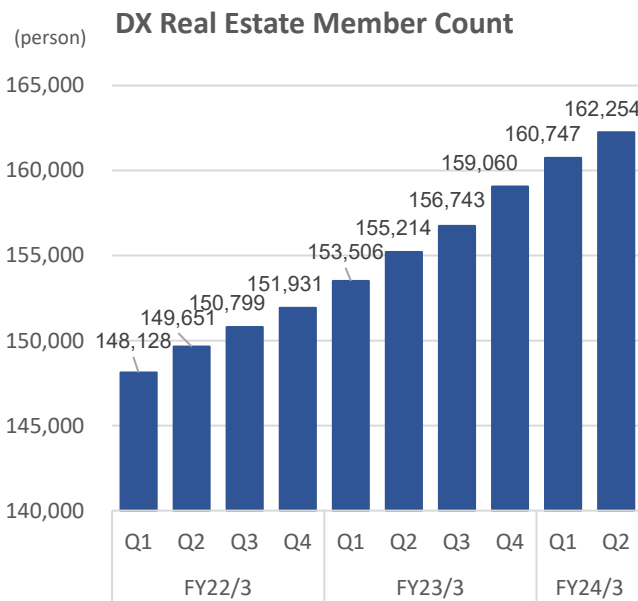
*Rimple, a real estate investment crowdfunding site**

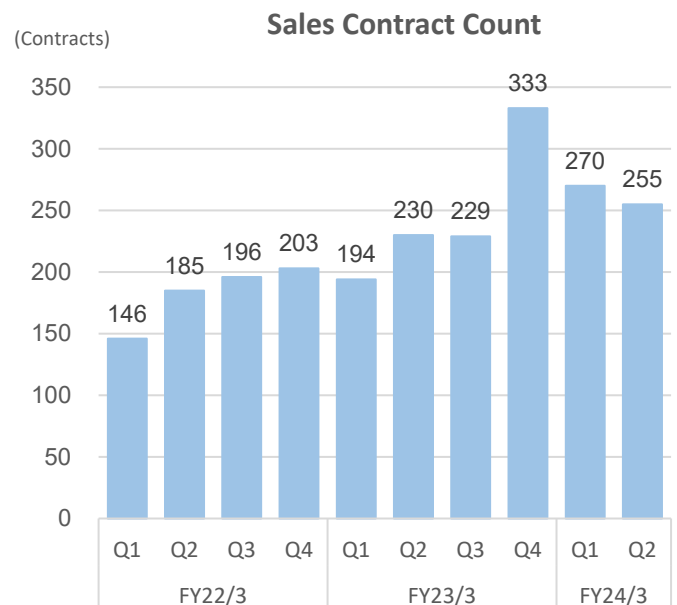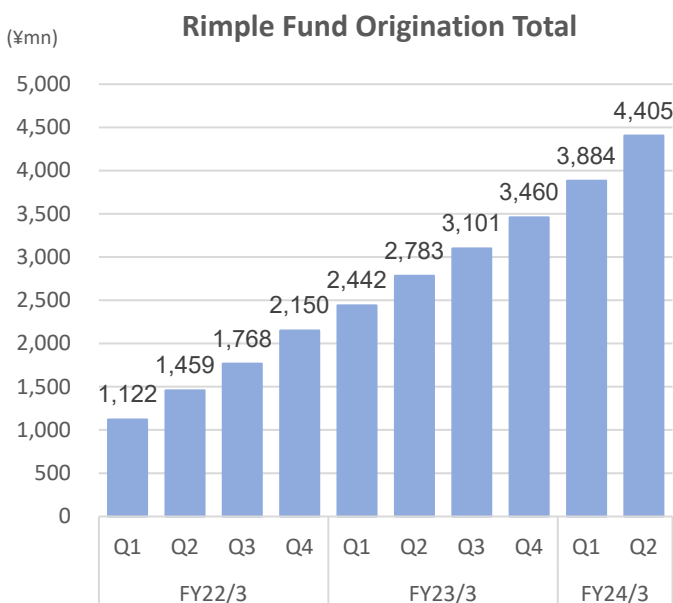https://funding.propertyagent.co.jp/

Previously, people could only invest in real estate by buying actual condominium properties, but the service enables people to invest through a smartphone app, starting at ¥10,000 per unit using points called Real Estate Coins (an example of implementing DX in real estate investment).

Another way of attracting members is by having people subscribe to the Real Estate Investment Times, the company's owned media, which includes an online magazine and blog that publishes various real estate investment-related topics and the company's information. Through proactive advertising and word-of-mouth, etc., the company is increasing its membership organically at around 7,000 members per year.

The reason the company considers its DX Real Estate members as its business core is that with crowdfunding, the company (1) raises a portion of the funds from its members, (2) can use the funds raised to purchase or acquire properties, (3) develop and sell the purchased properties, and (4) distribute them (purchase and resale of pre-owned properties), while the property owners (5) entrust the company with the rental management of their properties and pay commissions to the company. In addition, the company generates rental income from some of the properties it purchases and holds, and the business expands through this cycle that begins with the DX Real Estate members. Expanding data stocked on DX Real Estate members alone serves as a business model to grow the MIGALO Group's real estate circular ecosystem.

DX Real Estate Member Count

(person)

Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
148,128	149,651	150,799	151,931	153,506	155,214	156,743	159,060	160,747	162,254
FY22/3				FY23/3				FY24/3	

Expand MIGALO Group Real Estate Business Zone

Rimple Fund Origination Total

(¥mn)

Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
1,122	1,459	1,768	2,150	2,442	2,783	3,101	3,460	3,884	4,405
FY22/3				FY23/3				FY24/3	

Sales Contract Count

(Contracts)

Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
146	185	196	203	194	230	229	333	270	255
FY22/3				FY23/3				FY24/3	

Source: Compiled by SIR from the company IR material.

Since its establishment, the company has focused on high asset quality properties located near train stations in around Tokyo. The main areas it deals in are the 23 wards of Tokyo, Yokohama, and Kawasaki, and most of its properties are located within a 10-minute walk of train stations.

In general, it is not always easy to purchase land or pre-owned properties that meet these requirements. However, in the company's case, its competitive advantage lies in the' track records of relationship with various vendors (acquiring information on sites that could be cleared and simulating business profitability from the counter party's perspective) and the financial trust it has built up over its 20-year history of focusing on purchasing properties in the heart of Tokyo. In the purchasing stage, the company thinks about its development strategy by taking a sales inventory and sales period plan so that it can create a stable sales growth trajectory while adjusting the timing of final completion and sale of the property. There is often talk about the intensifying competition with foreign players in acquiring land for development in central Tokyo, but these players typically only operate in areas featured in tourist guidebooks (such as Asakusa, Roppongi, Akasaka, etc.). The company avoids acquiring land in these areas, and has been developing in areas such as the Nakano Station area, where redevelopment projects are taking place around the station. In addition, the company generally does not participate in bidding, which drives up prices.

The company is not necessarily optimistic about its profitability given the ongoing increase in the cost of building materials and manpower, as well as the cost of acquiring land. It has been managing costs, albeit gradually, by passing on the cost increases to its selling prices and fine-tuning the specifications of its condominiums.

■ The Power of DX:
The Development Potential of All Facial Recognition Condominiums

The real estate industry has many competitors, and although it is a unique asset, it is difficult to differentiate the product beyond design and functionality, and this is a factor that makes the competitive environment more challenging.

Accordingly, the company developed the FreeiD* facial recognition system, which it rolled out in its real estate business. The company now offers all facial recognition condominiums, an IoT condominium that adds unprecedented value by eliminating the need for a key, making it contactless and making it easy to lend access remotely, thereby differentiating itself from its competitors. Specifically, these condominiums enable residents to access the entrance, parking lot, garbage collection area, package and mail boxes, elevators, and unit doors with only facial recognition and no keys.
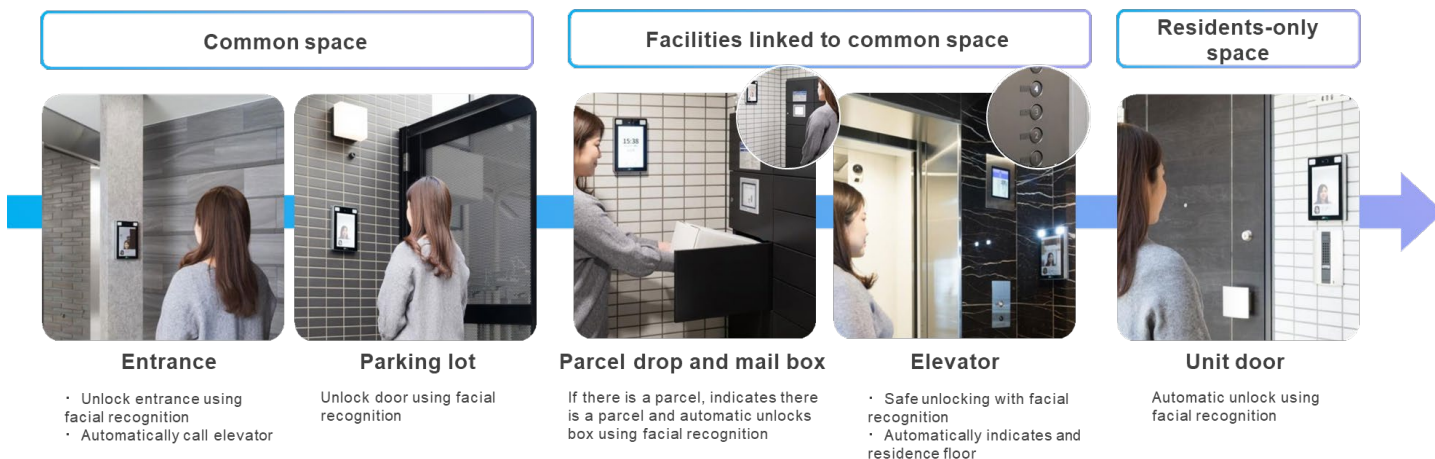
FreeiD is a platform that enables the previously separate functions of using a key, making payments, and other such functions to be completed with a single facial recognition ID.

Once facial information is registered using the app, users can smartly and securely enter an office, receive visitors, unlock the auto-lock of a condo, and make a payment for purchases by using facial recognition.

*As of the end of October 2023, the company had completed 33 **all facial recognition condominiums** and had installed FreeiD in approximately 50 condominiums, including some using facial recognition only at entrances.

All Facial recognition* condominium
Offers pleasant condominium life with highly secure facial recognition-based entry function

Common space	Facilities linked to common space	Residents-only space

Entrance
· Unlock entrance using facial recognition
· Automatically call elevator

Parking lot
Unlock door using facial recognition

Parcel drop and mail box
If there is a parcel, indicates there is a parcel and automatic unlocks box using facial recognition

Elevator
· Safe unlocking with facial recognition
· Automatically indicates and residence floor

Unit door
Automatic unlock using facial recognition

Source: The company IR material.

According to the company, customer satisfaction with the all facial recognition condominium is very high, with 97% of respondents answering "Yes" to the question, "Is the facial recognition system more convenient than conventional key?" When asked, "Do residents want facial recognition entry control in their next residence?" 95% of the respondents answered "Yes". It is easy to imagine that the convenience and likability of the system will not only add value to the company's DX real estate business, but also expand business opportunities in areas other than condominiums.

The company estimates that the potential domain for introducing a common facial recognition ID management platform to condominiums and offices in Japan is approximately ¥50 billion per year. The breakdown is as follows.

The company's approach is to provide a facial recognition key service to approximately 130,000 condominium buildings, with a total of over 6 million units in Japan, for a monthly fee of ¥200-250 per unit, which would yield up to approximately ¥20 bn per year. Since about half of this amount will be concentrated in around Tokyo, the potential annual flow comes out to about ¥10 bn. The company would collect revenue from the management association in the case of rental studio condominiums. The scheme is that the facial recognition key usage fee is incorporated into the condominium management fee paid by the owner of the rental condominium. The facial recognition condominiums attract tenants even when the monthly rent is ¥1,000 to ¥3,000 higher than that of the surrounding properties. Thus, even owners who bought properties at prices that are ¥1 mn to ¥2 mn higher than the surrounding properties appear to be satisfied with the service, according to the company.
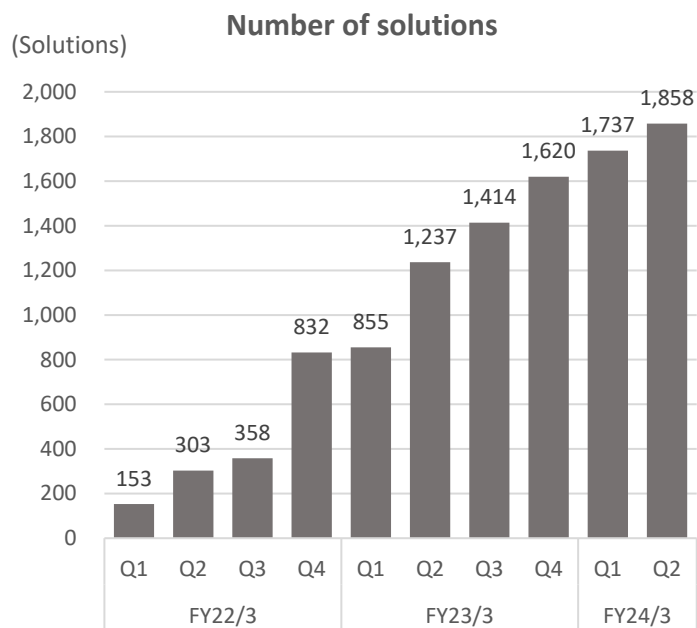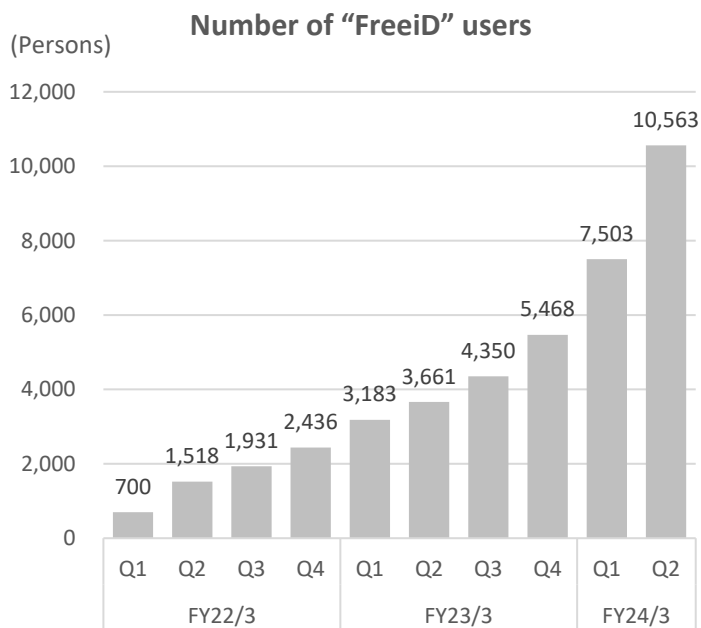
Another potential development is in the office sector, where the Ministry of Internal Affairs and Communications estimates that there are approximately 65 million corporate businesses in Japan. If we assume that about half of them (30 million) are in urban areas, and multiply this by a monthly user unit price (assumed at ¥99), the annual flow of facial recognition office equipment in urban areas alone could be as much as ¥35 bn.

Those are just the recurring revenue portion, and the business model also includes the sale of facial recognition devices (solution: about ¥1 mn per unit) at the time of installation, so one-time revenues will be recorded.

To expand sales of FreeiD and its devices, the company partners with a variety of companies. Major partners include Tokyu Community (which manages approximately 870,000 condominium units) and Osaki Electric, developer of the OPELA smart lock. The company currently estimates the potential number of FreeiD unit installations through its partner companies to be over 2 mn units.

On the other hand, from a cost perspective, since the company has already completed the development of the underlying system, it will likely incur a certain amount of fixed costs such as additional maintenance costs. However, for the business as a whole, the gross profit margin on device installation alone, not including system amortization costs, is approximately 40%, and the gross profit margin for recurring revenue has reached 60% to 80%.

Nonetheless, the number of FreeiD users currently exceeds 10,000, and due to the cost of sales personnel to expand sales and upfront advertising expenses, this business has yet to break even at the operating profit level on its own. The company expects the business to be profitable in FY2026/3, and believes it will be able to break even once annual sales reaches around ¥1 bn.

Number of "FreeiD" users

(Persons)

Chart — Number of "FreeiD" users by quarter:

- FY22/3 Q1: 700
- FY22/3 Q2: 1,518
- FY22/3 Q3: 1,931
- FY22/3 Q4: 2,436
- FY23/3 Q1: 3,183
- FY23/3 Q2: 3,661
- FY23/3 Q3: 4,350
- FY23/3 Q4: 5,468
- FY24/3 Q1: 7,503
- FY24/3 Q2: 10,563

Number of solutions

(Solutions)

Chart — Number of solutions by quarter:

- FY22/3 Q1: 153
- FY22/3 Q2: 303
- FY22/3 Q3: 358
- FY22/3 Q4: 832
- FY23/3 Q1: 855
- FY23/3 Q2: 1,237
- FY23/3 Q3: 1,414
- FY23/3 Q4: 1,620
- FY24/3 Q1: 1,737
- FY24/3 Q2: 1,858

Source: Compiled by SIR from the company IR material.

Creating New Business Models

■ Smart City Concept based on a Facial Recognition ID Platform

As part of its efforts to further enhance the added value of the all facial recognition condominium offering, the company is promoting a smart city concept based on a Facial Recognition ID Platform.

MIGALO-subsidiary DXYZ Co., Ltd. aims to create a "world connected by your face" through its FreeiD facial recognition platform. It is working to build a world where people can live without keys, wallets, or smartphones, by simply registering your face once and using facial recognition to connect various daily activities (such as building entry/exit, personal identification, payment, etc.).

The number of facial recognition service implementations has been increasing considerably in Japan. Familiar examples that many people have experienced include the facial recognition gate at Haneda Airport's Terminal 3 immigration checkpoint (checking against IC passports) and the facial recognition entrance/exit system at Fuji-Q Highland. In addition, installation of walk-through facial recognition ticket gates for Osaka Metro employees began at Namba Station on the Midosuji Line of Osaka Metro in November 2023, and all Osaka Metro stations are proceeding with installation gradually, with the aim of launching the service for regular passengers by the end of FY2024*. This is part of the cashless/ticketless ticket gate initiative for 2025 the Osaka-Kansai Japan Expo, and the number of people actually using the facial recognition service is projected to skyrocket after the spring of 2025.

Thus, it is fair to say that the business environment is favorable for the company's business, as there is a growing interest in introducing facial recognition across Japan. Against this backdrop, the company has begun to see business results from its facial recognition service business, through which it sells devices under a SaaS* or PaaS* model to be used as part of the FreeiD platform. The company has already completed installations for marimo and Mitsubishi Estate for condominiums, and for Tokyu Community and Raito Kogyo for office buildings. One example of an original customized installation is RED TOKYO TOWER, an esports park inside the Tokyo Tower, where facial recognition and tickets are linked so that visitors can pass through the entrance gate using facial recognition. In terms of its PaaS platform offering, the company provides its platform as an OEM only for facial recognition to Mitsubishi Estate's Pachi Pass Face in Marunouchi. In December 2023, the company implemented FreeiD into a logistics facility for the first time in Japan at LogiCross Zama, a large multi-tenant logistics facility operated by Mitsubishi Estate. This not only made it easier to authorize entry and exit even for the flexible work arrangements typically seen in logistics facilities and enabled access to offices and warehouses without security cards, but the company is also considering a facial recognition payment service with a view toward eliminating the need to bring wallets and smartphones into the facility in the future.

*Osaka Metro Facial Recognition Solution

https://www.osakametro.co.jp/page/kao_ninsyou_solution.php

https://subway.osakametro.co.jp/news/news_release/20231121_kaoninsyou_kaisatsuki.php

*SaaS (Software as a Service) is a service where users can use software over the cloud.

*PaaS (Platform as a Service) is a service where users can use a platform over the cloud.

Main cases of providing facial recognition services

Source: The company IR material.

Through FreeiD, the company provides facial recognition services for access and authentication to condominiums, offices, kindergartens/nursery schools, golf courses, theme parks, and other facilities, and the company essentially aims to evolve this service as a marketing platform as well.

For example, if restaurants in the suburbs of the aforementioned Logicross Zama were to implement FreeiD, these restaurants would be able to send discount coupons to the facility's workers before lunch time. These workflows and systems can create a marketing platform that can attract and send customers. This is the company's vision. Note that when purchasing goods through facial recognition, the creditworthiness is linked to the user's credit card, etc., so the user's face simply serves as a substitute for the credit card number or QR code.

Smart City Concept

Marketing Platform

FreeiD Facial Recognition ID Platform
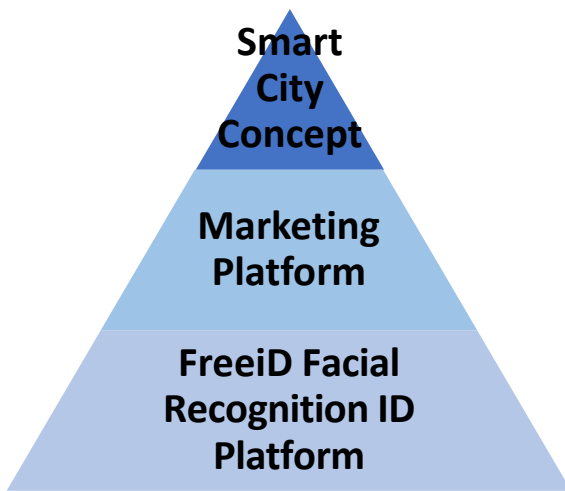
Source: Compiled by SIR

Source: The company IR material.

Another larger framework is to create a smart society in which people do not carry keys, wallets, or smartphones, as shown at the top of the figure on the left. For example, passengers will be able to pick up their baggage at Itami Airport with facial recognition, pass through a facial recognition gate, board a Shinkansen train with facial recognition, exit Tokyo Station with facial recognition, and enter an office in Tokyo with facial recognition. The ultimate vision is to provide solutions that contribute to the creation of a smart city in a broader sense, such as being able to check into a hotel in the Marunouchi area with facial recognition and purchase a beverage from a nearby vending machine using facial recognition.

The company is currently creating "dots" of properties and facilities where FreeiD will be installed as seen in the bottom layer of the triangle of the figure above. By adding more dots, the company will be able to connect them with a line and have more places where FreeiD can be used. It will need to make upfront investments in system development for each industry and business category to create a marketing platform that connects the dots. Once the customization is completed for each business category and the system is generalized for other uses, additional development costs for subsequent deployments will not come at a substantial cost.

■ How does FreeiD differ from others?

Currently, many electronics manufacturers in Japan are developing their own facial recognition engines. NEC is one of the aggressive players, and it has developed its own facial recognition engine and has an ID platform concept that incorporates the engine. However, the NEC's focus appears to be on engine development. Other companies that do not have a facial recognition engine, for example, have introduced facial recognition systems using NEC's engine, but have not gone so far as to develop an ID platform concept. In addition, the aforementioned Osaka Metro and Fuji-Q Highland have introduced Panasonic Connect's facial recognition access system. Since these facial recognition services have different applications and systems, users must register their faces for each service and each location. This state of "rivalry of local warlords" is thought to be one of the reasons why facial recognition services have not become more widespread.

According to the company, FreeiD differs from its competitors in that it does not develop facial recognition engines. Instead, FreeiD is a "multi-platform" system designed to work with a wide variety of facial recognition engines without being tied to a specific engine vendor. **This enables it to manage separate facial recognition IDs on a single platform and connect various engines and services with a single facial registration*.** This makes it a so-called "multi-platform" system that can manage fragmented facial recognition IDs on a single platform and connect various engines and services with a single facial registration*. Besides MIGALO HOLDINGS Inc., there is no other company providing a service that enables the use of facial recognition IDs on a single platform, according to the company.

<div style="float:left; width:25%;">

*Support for various facial recognition engines with a single facial information Registration Patent No. 6839313

An introduction to the MIGALO's IP strategy: https://www.propertyagent.co.jp/company/intellectual-property
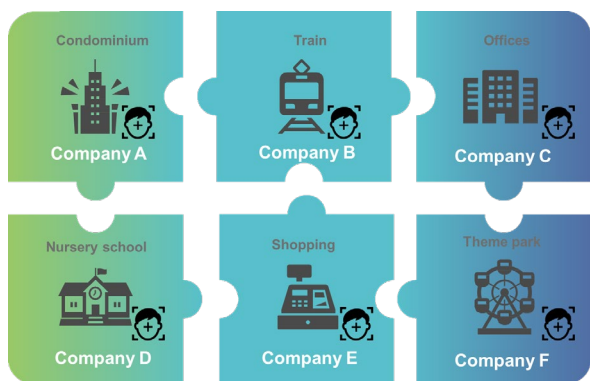
The MIGALO Group's IP strategy in this business is not to earn income from other companies, but to acquire IP to protect the Group's business from easily being copied, and therefore the Group does not earn patent licensing royalties.

</div>

Having to register facial information for each facial recognition service has hindered the spread between services

Transiting to a multi-platform makes it possible not only to enter and leave buildings, confirm identity, and make payments but also to earn points, issue coupons, etc.
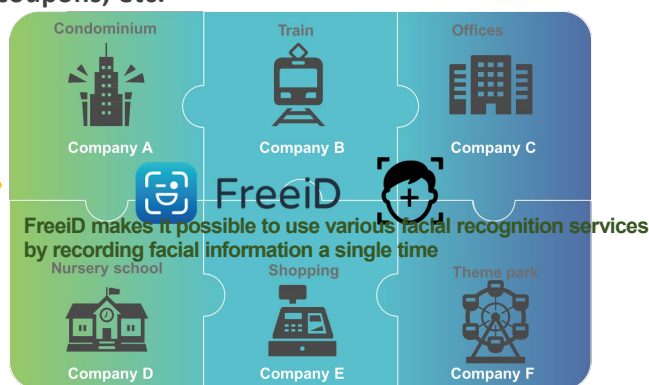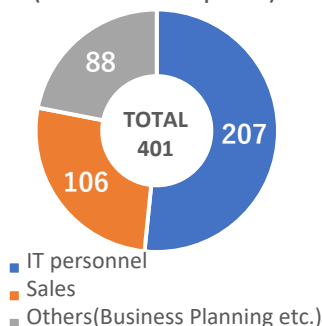

Source: The company IR material.

However, the company is also aware that Bitkey Inc. (unlisted) also describes a similar concept. On its website, Bitkey reported that "Hankyu Hanshin Properties Corp., ForC Company, and Bitkey will jointly establish the Saito Smart City Consortium in December 2020 with the Saito (International Cultural Park City) Construction Promotion Council, which is comprised of Osaka Prefecture, Ibaraki City, and Minoh City. The consortium will play a central role in the establishment of the necessary lifestyle platform for creating a smart city in Saito, a new town in the northern part of Osaka Prefecture. As a first step, in December 2020, the consortium will launch a demonstration experiment of a facial recognition system that enables contactless unlocking of automatic doors using Bitkey's technology in condominiums sold by Hankyu Hanshin Properties Corp."

In any case, SIR believes that the company needs to establish its position as the leading facial recognition platform provider before it can integrate the various ID, authentication methods, and fragmented services through its facial recognition ID platform to create a smart city where people can gain access, make payments, confirm their identity, use transportation services, and redeem loyalty points completely hands-free.

DX Promotion Business Model

Number of IT personnel supporting DX
(person)
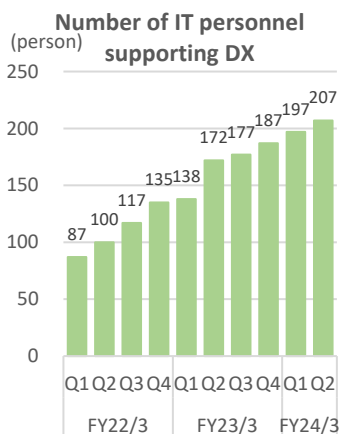
Group-wide job composition
(as of the end of Sep. 2023)

TOTAL 401
- 207
- 106
- 88

- ■ IT personnel
- ■ Sales
- ■ Others(Business Planning etc.)

■ Profitability is only a matter of time with more projects coming online

In addition to DXYZ Co., Ltd., which operates a facial recognition ID platform business, the MIGALO's DX Promotion business includes a group of subsidiaries engaged in cloud integration and system development. These companies provide completely tailor-made services from consulting to system requirement definition and system development for companies in a wide variety of industries, focusing mainly on Salesforce implementation services and AWS system construction.

Berners Inc., CloudTechPlus Co., Ltd. and resolver inc.'s main business is Salesforce implementation services. Berners Inc. focuses on Salesforce services for SMEs such as CRB and SB, and also handles EBU enterprise projects for large companies. CloudTechPlus Co., Ltd. mainly undertakes custom development as it has many engineers with excellent technical skills. resolver inc. was founded by a former Salesforce employee, and adds value in terms of Salesforce operations and additional applications. This group of subsidiaries do not compete with one another, since projects emerge as sales of Salesforce progresses, and each company demonstrates its strengths in its respective area. Avant Corporation. and CB Lab Inc. are engaged in system construction in AWS and Java-centered development.

These are manpower intensive businesses, and the business model consists of adding accounts by adding more people to generate more sales.

The number of active system integration (SI) projects has been steadily rising, reaching 203 projects in the July-September 2023 period, up 18% from 172 projects a year earlier. The number of client companies that the company provided cloud integration services to reached 129 companies in the July-September 2023 period, up 24 companies from the previous quarter.

Since the cloud integration business can ensure an operating profit margin of over 10% for sales above a certain scale without making aggressive growth investments, the company expects to grow sales to ¥5 bn and operating profit to over ¥500 mn for a 10% operating profit margin within the next three years. When sales surpasses ¥5 bn, the company plans to invest about 10% of sales for the next stage of growth, while maintaining at least a 10% profit margin.

In FY24/3, the company projects sales of over ¥2.5 bn from cloud integration alone. The key to this business is securing personnel, and the company plans to do this by acquiring companies with personnel through M&A deals and by hiring new graduates and training them internally to boost its workforce.

Number of Active System Integration Projects
(cases)

Quarterly Sales of DX Promotion Business
(¥mn)
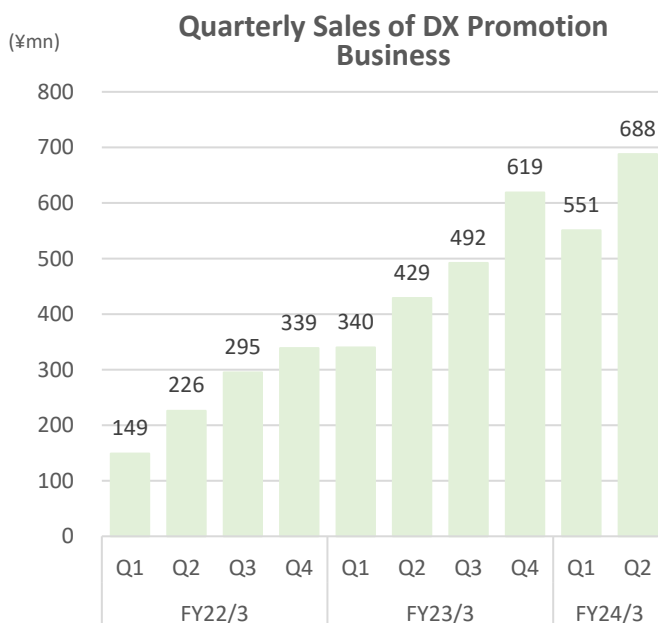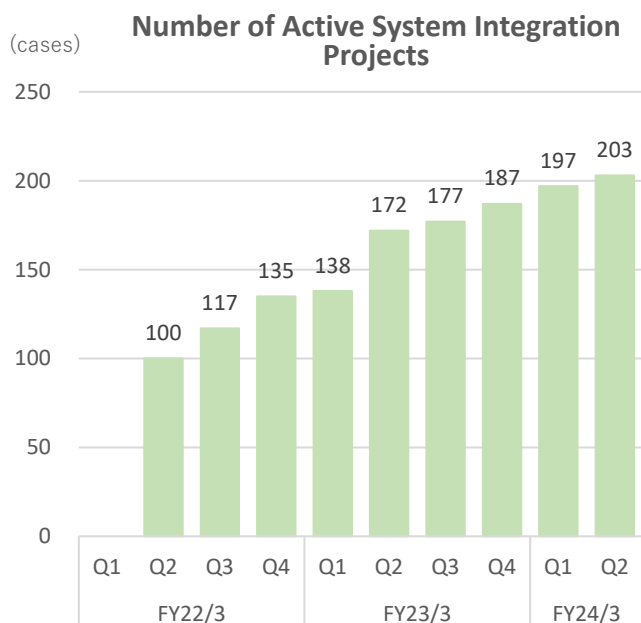
Source: Compiled by SIR from the company IR material.

FY24/3 Earnings Perspectives

■ FY2024/3 target: Sales of ¥42.0 bn, operating profit of ¥2.5 bn

Since its establishment, the company has consecutively grown sales and profits through FY2023/3. However, in its FY2024/3 earnings forecast announced on May 10, 2023, the company projected sales to increase 12.7% YoY to ¥42.0 bn and operating profit to fall 14.4% YoY to ¥2.5 bn.

The company explained that although it expects sales to grow steadily, the forecast for lower operating profit reflects soaring construction costs in the DX Real Estate business stemming from high material costs and labor shortages, as well as a planned increase in upfront investment for accelerating growth in the DX Promotion business.

■ Sales and profit rose in 1H FY2024/3 but expected to fall in 2H

In its 1H earnings results announced on November 8, 2023, the company reported substantial growth, with sales up 34.1% YoY to ¥24,330 mn and operating profit up 16.8% YoY to ¥2,292 mn. The factors driving the growth in earnings include the increase on account of large number of new property deliveries and higher sales of pre-owned properties in the DX Real Estate business, as well as the increased adoption of the facial recognition platform by other companies and the expansion of new orders in the DX Promotion business. However, the DX Promotion Business posted a segment operating loss owing to increased upfront investments.

1H progress against full-year forecasts came to 58% for sales and 92% for operating profit, but the company maintained its initial projections. Regarding the 2H forecast calling for lower sales and profit YoY, the company explained that it expects deliveries to be centered on relatively low-margin pre-owned properties and that it plans to proceed with upfront investments and M&A deals in the growth driver DX Promotion business in 2H.

■ Facial recognition platforms nearing a transition from inception to growth phase

The company has set a medium- to long-term sales target of ¥100 bn, but has maintained a policy of not disclosing its medium-term management plan since its IPO. The figure below is an illustration of the company's growth stages and drivers for reaching ¥100 bn in sales, as shown in its IR materials.

The president and CEO, Mr. Nakanishi believes that facial recognition platforms are currently in between the inception and growth stages, and that if facial recognition spreads and becomes the norm nationwide by 2025, when all Osaka Metro stations begin using facial recognition gates, the shift from the inception to the growth stage will be a matter of time, and we will soon witness a groundbreaking change through DX.
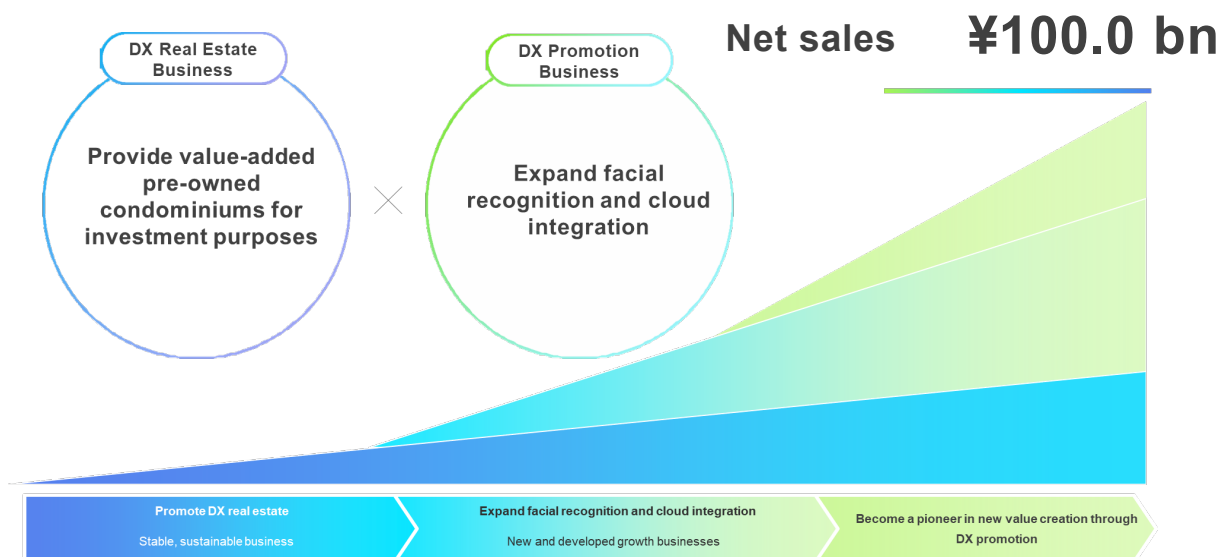
Source: Compiled by SIR from the company IR material.

Share Price Insite

■ Share price highlighting substantial information asymmetry

MIGALO's shares have recently traded at a P/B ratio of 1.08x and a forecasted P/E ratio of 7.8x, both lower than the TSE real estate sector average of 1.41x and 13.7x, respectively. This is despite the company boasting an ROE of 17.9%, which is higher than the sector average of 11.1%. This level of undervaluation is extreme, even considering the small-cap discount.

When asked which companies it views as competitors from a strategic standpoint, the company cited SRE Holdings Corporation. for its overall business, GA technologies for areas similar to DX real estate, and TerraSky, Sharing Innovation, and Flect for cloud integration and system development. The forward P/E ratios of these five companies are in the double-digits, suggesting that they are viewed as small-cap growth stocks. Meanwhile, the company has recorded sales and profit consecutive growth since its establishment, and should be viewed as a growth stock. In fact, the company has been proactive in returning profits to its shareholders, as evidenced by its plan to boost its annual dividend to ¥45 per share, including a commemorative dividend of ¥5 per share for its 20th anniversary this fiscal year. The company should be also viewed as a dividend-growth stock, unlike the above five companies that have not paid dividends.

So what factors are driving the discount on MIGALO's shares? SIR believes that there are three main factors at play: (1) a lack of sufficient information on technology and systems to dispel uncertainty over the monetization strategy and business environment for the facial recognition platform, which is a pillar of the company's growth strategy, (2) the lack of support stemming from lack of disclosure of the company's medium-term management plan, and (3) investor concerns about the worst-case scenario in the event that the company fails to execute its plan for meeting the TSE Prime continued listing criteria. In any case, we look forward to seeing improvements in the substantial information asymmetry tying into a share price rerating.

Valuation comparison of peers

TSE Code			5535	2980	3491	3915	4178	4414
Listing classification			Prime	Prime	Growth	Prime	Growth	Growth
Company Name			MIGALO HOLDINGS Inc.	SRE Holdings	GA Technologies	TerraSky	Sharing Innovations	FLECT
Latest act. FY			2023/03	2023/03	2023/10	2023/02	2022/12	2023/03
Share Price	¥	2024/1/18 cp	1,401	2,435	1,174	1,450	802	4,200
Shrs out.	1,000 shrs	Latest FY	7,316	16,186	36,754	12,866	3,793	3,005
Mkt Cap.	¥ mn	Latest FY	10,249	39,413	43,149	18,656	3,042	12,621
EV	¥ mn	Latest FY	32,227	44,468	56,063	14,388	2,249	12,098
PER	X	Latest FY	6.5	34.2	42.6	53.4	30.9	55.6
		CE (current period)	7.8	27.5	25.6	75.6	27.7	32.4
		Consensus forecast (next period)	--	21.8	17.1	14.6	--	24.0
PBR	X	Latest FY	1.08	3.58	2.10	1.94	2.12	8.17
PSR	X	Latest FY	0.28	2.13	0.29	1.21	0.59	2.38
		CE (current period)	0.24	1.77	0.24	1.00	0.52	1.97
EV/EBITDA	X	Latest FY	10.7	22.2	7.5	15.7	8.7	35.3
		CE (current period)	12.4	17.8	N.A.	16.6	7.9	18.7
		Consensus forecast (next period)	N.A.	14.2	5.3	N.A.	N.A.	N.A.
EBITDA	¥ mn	Latest FY	3,019	2,004	7,468	918	260	343
		CE (current period)	2,600	2,495	--	869	283	647
		Consensus forecast (next period)	--	3,142	10,482	--	--	--
ROE	%	Latest FY	17.9	11.0	5.1	3.8	6.7	15.8
Div. Yield	%	CE (current period)	3.21	0.00	0.00	0.00	0.00	0.00
Shere Price Change Rate	%	from 1 year ago	(6.0)	(34.3)	(5.8)	(25.1)	(21.4)	88.3
	%	from 3 years ago	(0.9)	(38.2)	(56.6)	(59.3)	--	--
Ownership % by investor type (Data from Japan Company Handbook 2023 Ⅳ)	%	foreigners	1.7	12.1	21.2	9.0	1.1	8.1
		floating stock	18.9	13.8	8.8	24.9	15.4	15.8
		investment trusts etc.	--	10.9	1.0	1.5	0.0	3.0
		specific stocks	72.0	76.3	67.9	61.9	79.9	81.6

Source: Compiled by SIR from SPEEDA data.

■ **Discount Factor 1: Can FreeiD really be monetized?**

The FreeiD service, which integrates with and supports a wide variety of facial recognition engines and enables the management of fragmented facial recognition IDs on a single platform, could be a game-changer for the facial recognition-related business in this age of rivalry between the best and the brightest. The chances of a share price rerating will grow if these expectations persist.

However, if FreeiD's smart city concept, which is expected to be the company's biggest value-added catalyst, does not progress as fast as the company plans or expects, and the possibility of monetizing the service diminishes, there will be little room for a rerating. Currently, the obstacles for adoption of facial recognition that may bring about this scenario include: a) the emergence of authentication methods that are better than facial recognition, b) the use of this technology for surveillance purposes in other countries, which may cause users to react negatively to it, or c) frequent system incidents such as personal information leaks involving the facial recognition systems of other companies. In addition, if FreeiD's advantages are not well understood, and potential new partners are lost to competitors, the company may be seen as "a maverick" in the facial recognition business, which will make it difficult for the company's shares to be rerated higher.

■ **Discount Factor 2: Disclosure under development**

As mentioned earlier, MIGALO HOLDINGS Inc. has a policy of not disclosing the details of its medium-term management plan. While the policy may be justified, the fact that the company discloses very little IR information in English also appears to be impelling to the information asymmetry. According to the most recent Toyo Keizai Kaisha Shikiho *(Japan Company Handbook)*, the foreign shareholding ratio of the company is 1.7%. The second company with the lowest valuation, Sharing Innovations, also has very little IR information disclosure in English and a 1.1% foreign shareholding ratio. In contrast, SRE Holdings and GA Technologies provide relatively extensive IR information in English, while TerraSky and Flect disclose IR information in English on a regular basis, though not quite extensive.

Presumably, the high valuation of SRE Holdings and GA Technologies shares is likely related to their relatively high name recognition, as indicated by the foreign shareholding ratios of 12% and 21%, respectively. While enhanced English-language IR information disclosure is not a cure-all for discounted share prices, it may at least provide an opportunity to rectify the information asymmetry.

■ **Discount Factor 3: Concerns over meeting continued listing criteria**

PROPERTY AGENT, Inc., the company's predecessor, selected the Prime Market in connection with the April 2022 reorganization of the Tokyo Stock Exchange's market classification, but did not meet the continued listing criteria for the Prime Market. Accordingly, it submitted a "Plan for Compliance with the Continued Listing Criteria for the New Market Classification" in December 2021. When the company listed its shares on the Prime Market in October 2023 as MIGALO HOLDINGS Inc., it was subject to transitional measures as part of the reverse IPO examination, but out of the five criteria for continued listing, the company did not meet the minimum listing threshold of ¥10 bn in market capitalization of the tradable shares. If the company cannot maintain its market capitalization of the tradable shares above ¥10 bn by the end of March 2027, it will be forced to move out of the Prime Market.

The company's basic policy is (1) to increase its market capitalization by expanding its corporate scale and profits, and (2) to positively consider a request to its controlling shareholder, President and CEO, Mr. Sei Nakanishi, to gradually reduce his shareholding ratio while taking into account the balance of supply and demand in the market and the company's capital policy.

The first part of the policy may be feasible as a result of if the company's growth strategy in terms of fundamentals and its disclosure information are properly evaluated, and this leads to a rerating. As for the second part of the policy, it may be important for the methods and timing of increasing the tradable share ratio to be well aligned with the change in the company's fundamentals. The company has stated that it does not plan to issue new shares.

Income Statement

¥mn, %	FY2020/3 NC	FY2021/3 C	FY2022/3 C	FY2023/3 C	FY2024/3 CE
Total Revenue	**22,675**	**27,524**	**35,186**	**37,260**	**42,000**
Cost of Sales	18,164	22,183	29,555	30,259	
Gross Profit	4,511	5,341	5,631	7,001	
Gross Margin	*19.9*	*19.4*	*16.0*	*18.8*	
Selling, General and Administrative Expenses	2,607	3,248	3,422	4,081	
Operating Profit	**1,904**	**2,093**	**2,209**	**2,920**	**2,500**
Operating Profit Margin	*8.4*	*7.6*	*6.3*	*7.8*	*6.0*
Non-Operating Income	9	4	57	32	
Interest and Dividends Income	2	2	3	4	
Non-Operating Expenses	368	307	347	434	
Interest Expenses	212	219	234	280	
Ordinary Profit	**1,545**	**1,791**	**1,919**	**2,519**	**2,120**
Ordinary Profit Margin	*6.8*	*6.5*	*5.5*	*6.8*	*5.0*
Extraordinary Gains/Losses	-2		16		
Extraordinary Gain			16		
Extraordinary Loss	2				
Pretax Profit	**1,543**	**1,791**	**1,935**	**2,519**	
Pretax Profit Margin	*6.8*	*6.5*	*5.5*	*6.8*	
Income Taxes	589	621	710	926	
Income Taxes - Current	674	557	757	1,006	
Income Taxes - Deferred	-85	63	-47	-80	
Net Profit Attribute to parent company shareholders	**955**	**1,170**	**1,217**	**1,577**	**1,310**
Net Profit Margin (Attribute to parent company shareholders)	*4.2*	*4.3*	*3.5*	*4.2*	
EBITDA	**1,932**	**2,149**	**2,305**	**3,019**	**2,600**
EBITDA Margin	*8.5*	*7.8*	*6.6*	*8.1*	*6.2*
(Per share information: Yen)					
Dividends per Share	25.00	26.00	27.00	40.00	45.00
EPS	133.87	161.72	166.82	215.92	180.2
Diluted EPS	131.82	160.42	165.7	214.84	
BPS	842.6	982.6	1,113.8	1,302.8	
(liquidity, safety and leverage)					
Current Ratio (%)	223.3	205.6	287.9	185.2	
Cash/Total Assets (%)	19.0	18.6	24.7	15.7	
Shareholders' Equity Ratio (%)	24.5	25.6	25.5	21.8	
Financial Leverage(X)	4.08	3.91	3.93	4.58	
D/E Ratio(X)	2.63	2.37	2.46	3.04	
Net D/E Ratio(X)	1.86	1.64	1.49	2.32	

Source: Compiled by SIR from SPEEDA data. Note: Non-consolidated results until FY2020/3

Balance Sheet / Statements of Cash Flows

¥mn	FY2020/3 NC	FY2021/3 C	FY2022/3 C	FY2023/3 C	FY2023/9 C
Total Assets	**24,725**	**27,962**	**31,982**	**43,442**	**43,458**
Current Assets	**24,112**	**26,794**	**30,585**	**41,850**	**41,737**
Cash Equivalents And Short-term Investments	4,710	5,192	7,908	6,819	7,917
Accounts Receivables	3	2	177	329	343
Inventories	19,121	21,133	21,955	33,829	32,953
Non-Current Assets	**613**	**1,168**	**1,397**	**1,592**	**1,721**
Property, Plant & Equipment (PPE)	82	195	186	174	163
Intangible Assets	22	308	353	411	499
Investments and Other Assets	509	665	858	1,007	1,059
Investment Securities	197	304	502	539	
Allowance for Doubtful Accounts - Fixed	-187	-174	-149	-139	-139
Deferred Tax Assets - Non-Current	28	47	31		30
Current Liabilities	**10,798**	**13,030**	**10,623**	**22,596**	**18,750**
Trade Payables	1,376	2,344	1,172	2,179	1,533
Accounts Payable - Other and Accrued Expenses	274	357	448	570	
Short-Term Debt	8,154	9,240	7,031	17,679	13,596
Short-Term Borrowings	*4,110*	*3,758*	*4,272*	*9,834*	*7,330*
Current Portion of Long-term Debt	*4,044*	*5,481*	*2,759*	*7,845*	*6,266*
Advances Received	156	61	84	133	
Non-Current Liabilities	**7,866**	**7,781**	**13,139**	**11,274**	**13,990**
Long-Term Borrowings	*7,408*	*6,642*	*12,257*	*10,325*	*13,058*
Straight Bonds	*400*	*1,058*	*770*	*802*	*768*
Total Shareholders' Equity	**6,060**	**7,150**	**8,145**	**9,478**	**10,615**
Capital Stock	596	609	616	617	619
Capital Surplus	546	559	534	536	537
Retained Earnings	4,908	5,899	6,907	8,286	9,344
Share Warrants	10	9	7	8	6

¥mn	FY2020/3 NC	FY2021/3 C	FY2022/3 C	FY2023/3 C	FY2023/9 C
Cash Flows from Operating Activities	**160**	**237**	**127**	**-9,307**	**-4,048**
Depreciation and Amortization - CF	28	56	96	99	100
Cash Flows from Investing Activities	**-176**	**-578**	**28**	**-286**	**-231**
Payments for Purchases of Securities and Investment Securities	-135	-4	-195	-90	
Payments for Purchases of Stocks of Subsidiaries and Affiliates		-57			
Purchases/Sales of PPE	-19	-149	-15	-22	-37
Purchases/Sales of Intangible Assets	-25	-266	-59	-49	-37
Cash Flows from Financial Activities	**879**	**823**	**2,560**	**8,504**	**4,671**
Proceeds/ Repayments from Short-Term Borrowings	2,144	-352	514	5,561	
Proceeds from Long-Term Borrowings	6,831	7,867	9,287	9,209	11,887
Proceeds from Issuance of Bonds	400	700	200	100	
Repayments of Long-Term Borrowings	-8,304	-7,209	-7,220	-5,655	-9,342
Redemption of Bonds	-130	-29	-48	-468	-468
Proceeds from Issuance of Stock	94	25	17	2	3
Redemption/Retirement of Stock	0	0		-48	
Cash Dividends Paid	-149	-180	-189	-197	-291
Changes in Cash	863	482	2,716	-1,089	392
Cash & Cash Equivalent - Beginning	3,837	4,700	5,182	7,898	7,515
Cash & Cash Equivalent - Ending	4,700	5,182	7,898	6,809	7,907
Free Cash Flow (FCF)	**-16**	**-341**	**155**	**-9,593**	**-4,279**

Source: Compiled by SIR from SPEEDA data. Note: Non-consolidated results until FY2020/3

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