

MIGALO HOLDINGS | 5535 TSE Prime

3Q Follow-up

Expanding Facial Recognition Platform to Achieve Smart City Goals

• 3Q FY2024/3 Results Summary

On February 7, 2024, MIGALO HOLDINGS, Inc. (hereafter referred to as the Company) announced its financial results for 3Q FY2024/3. This report marks the first financial results since the company became a holding company and changed its name. For the cumulative period from April to December 2023 (9 months), the company achieved a 25.6% YoY sales increase to ¥32,512 mn, and a 7.8% YoY increase in operating profit to ¥2,443 mn. Overall, progress appears favorable compared to the full-year plan of a 12.7% YoY sales increase (¥42,000 mn) and a 14.4% YoY decrease in operating profit (¥2,500 mn). For the October-December period of 2023, 5.8% YoY sales increase (to ¥8,182 mn) and 50.2% YoY operating profit drop (to ¥151 mn) appear slightly weaker than 1H results. This is because that there were fewer deliveries of newly constructed properties during this quarter, as most of them were delivered in the first quarter of this fiscal year, while the total transaction volume of pre-owned properties with low margins increased and its proportion of total sales increased, resulting in operating profit halved YoY within flat sales in the DX Real Estate business. However, the company's performance progress remains broadly in line with its initial plan.

• Full-Year Outlook for FY2024/3

The company's full-year earnings forecast for FY2024/3 remains unchanged from the initial plan for both sales and operating profit, along with an annual dividend of ¥45. The reason for this is that "in the January-March 2024, we will continue to focus on the purchase and resale of pre-owned properties with relatively low margins, and plan to implement upfront investments and M&As in the DX Promotion business, a growth driver." The company expresses that it is currently in a growth stage of sales and volume in the DX Promotion business rather than immediate profits increase.

• Share Price Insights

The company's ROE stands at approximately 18% with consecutive dividend increases. The share price has been gaining momentum since late November of last year, reaching new highs, and the lag behind peers is finally being resolved. However, it remains substantially undervalued with a P/B ratio of 1.32x and the estimated P/E ratio of 9.5x. As highlighted in [our initiation report in February 2024](#), 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. Among these factors, 1) the uncertainty surrounding the monetization potential of a patented facial recognition platform service "FreeID" within the DX promotion business may gradually diminish as more KPIs are disclosed. 2) Although its "conservative disclosure policy" unchanged, some progress has been made in disclosure style with an awareness of the broadening of the potential investors, such as the timely disclosure of the English version of IR materials. 3) It seems that the company is continuing to

Y mn, %	Net 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.



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 (3/8)	1,800
YH (24/3/8)	1,845
YL (24/1/15)	1,362
10YH* (21/9/13)	3,460
10YL* (21/1/21)	328
Shrs out. (mn shrs)	7.316
Mkt cap (¥mn)	13,168
Equity ratio (23/9)	24.4%
FY23/3 P/B* (act)	1.32x
FY24/3 P/E (CE)	9.5x
FY23/3 ROE* (act)	17.9%
FY24/3 DY (CE)	2.62%

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

Daily Stock Price Chart Since Oct.2023



Source: Trading view

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(continued)

consider various options to meet the criteria for maintaining the TSE Prime market, the market capitalization of the tradable shares of over ¥10 bn. We look forward to seeing improvements in the substantial information asymmetry tying into a share price rerating.

■ 3Q FY2024/3 Results Overview: Progress as Planned

By the business segments, the DX Promotion Business generated an operating profit of ¥15 mn during the October-December period. The company has been strategically investing in the increased adoption of its facial recognition platform service (FreeID) and DX support (such as cloud integration) to promote the digitization of its client companies. As a result, the DX Promotion Business posted an operating loss in the April-September 2023, in October-December period, however, its sales steadily grew as anticipated with continued upfront investment, and surpassed the breakeven point.

The DX Real Estate Business saw a 2.4% increase in sales to ¥7,493 mn during the October-December period. However, operating profit decreased significantly by a 57.1% to ¥285 mn, resulting in a lower operating profit margin of 3.8%—the lowest level in recent years. The company explained, "While there were many deliveries of new properties in 2H of the previous fiscal year and a small number of deliveries of new properties in the October-December quarter, an increase in the total volume and sales ratio of pre-owned properties resulted in sales flat, but operating profit did not increase due to low margin on pre-owned properties," adding, "However, this is also broadly in line with the initial plan."

The number of DX Real Estate members (DX Real Estate’s customer base), which is positioned as the “business core” reached 164,345 members by the end of December.

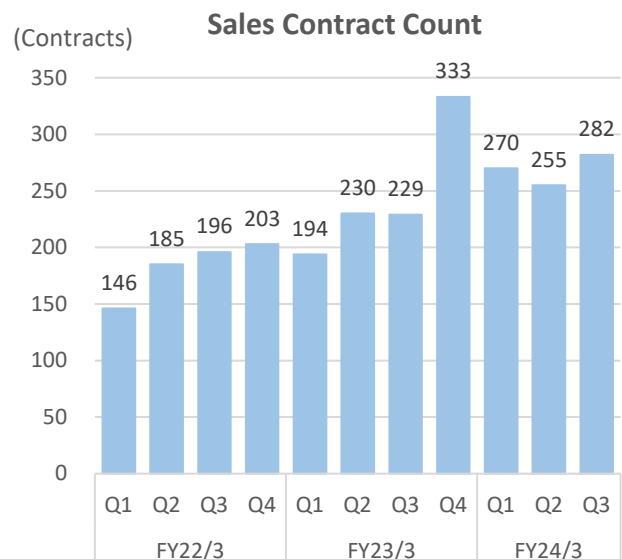
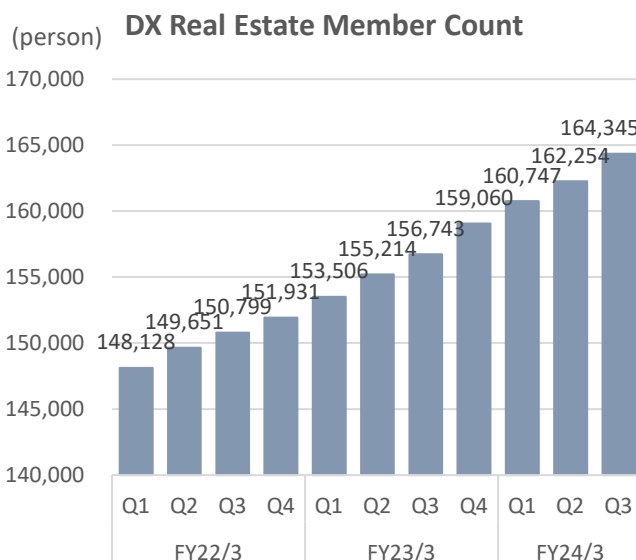
FY2024/3
3Q Results

Segment Information

Segment	(¥mn)	2022/3	2023/3	2024/3	2023/3	2024/3	Change (%)	2023/3	2024/3	Change (%)
					3Q C	3Q C		Oct-Dec	Oct-Dec	
DX Promotion	Net Sales	833	1,799		1,207	1,872	55.1	464	712	53.4
	Operating Profit	(9)	51		25	(49)	Turn Red	-20	15	Turn Black
	OP Margin	(1.1%)	2.8%		2.1%	(2.6%)		(4.3%)	2.1%	
DX Real Estate	Net Sales	34,462	35,639		24,812	30,702	23.7	7,320	7,493	2.4
	Operating Profit	3,600	4,302		3,206	3,351	4.5	665	285	(57.1)
	OP Margin	10.4%	12.1%		12.9%	10.9%		9.1%	3.8%	
Total	Net Sales	35,186	37,259	42,000	25,884	32,512	25.6	7,735	8,182	5.8
	Operating Profit	2,208	2,919	2,500	2,266	2,443	7.8	303	151	(50.2)
	OP Margin	6.3%	7.8%	6.0%	8.8%	7.5%		3.9%	1.8%	

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.

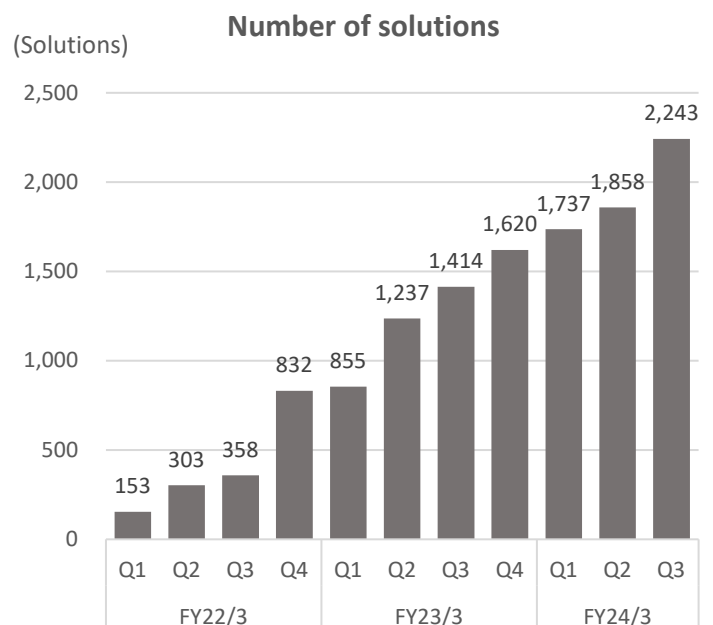
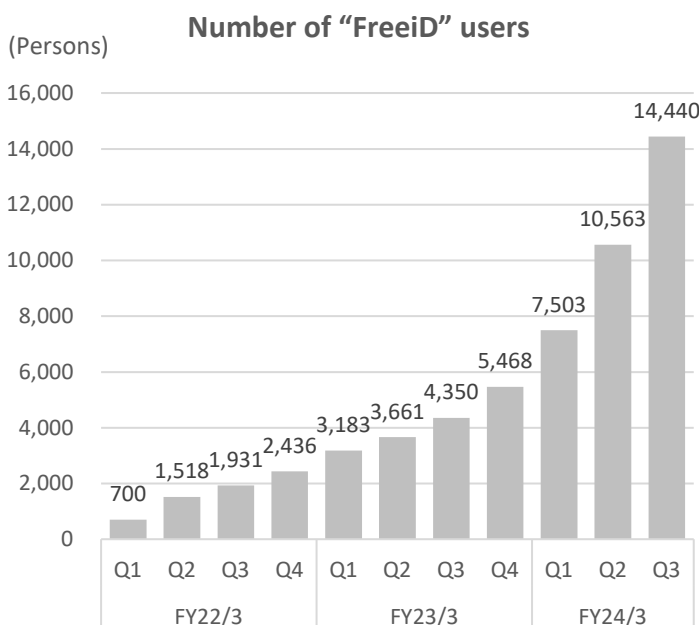
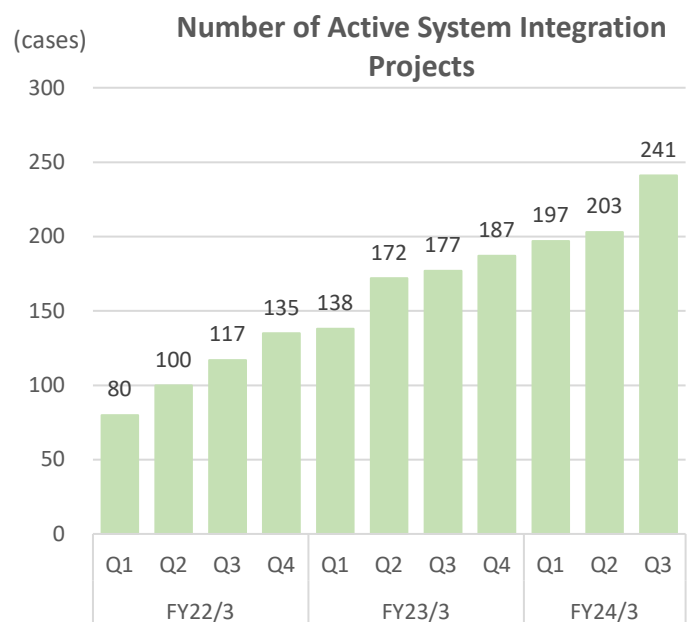
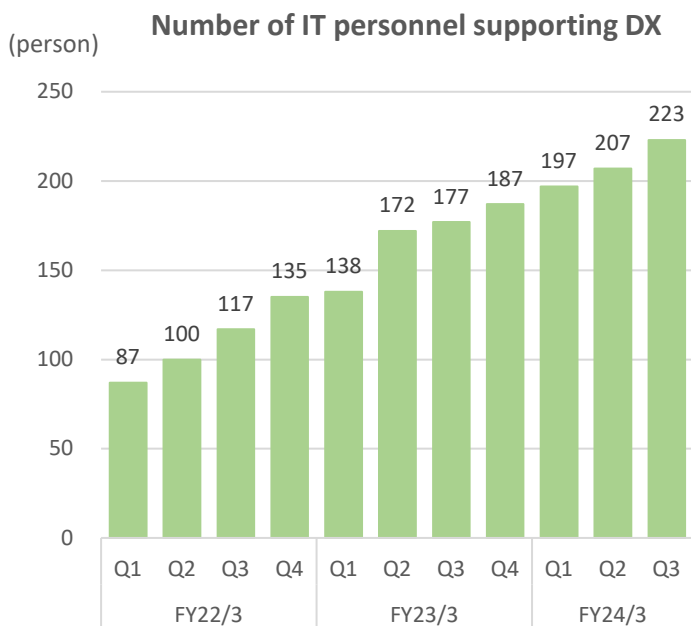


Source: Compiled by SIR from the company IR material.

■ The DX Promotion business

During the October-December period, the DX Promotion business achieved profitability. When questioned about the sustainability of this profitability, the management team emphasized “Our focus extends beyond mere profit, but we are at the stage of increasing the top line (sales), so we will continue active upfront investment in the development of facial recognition systems and the recruitment of system development personnel.”

In January 2024, the company announced the acquisition of a newly split-off company of OmniScience Co., Ltd and made it a subsidiary. This M&A targets engineers and their customer networks. An estimated sales scale of ¥200-300 mn and operating profit of ¥20-30 mn is expected to fully contribute to the company’s consolidated earnings for FY2025/3. Although the acquisition amount remains undisclosed, it appears that once synergies can be realized, it would be repaid in approximately 3 years.



Source: Compiled by SIR from the company IR material.

*"Major 7" refers to the below seven major developers in Japan: Sumitomo Realty & Development Co., Ltd., DAIKYO INCORPORATED, TOKYU LAND CORPORATION, Tokyo Tatemono Co., Ltd., Nomura Real Estate Development Co., Ltd., Mitsui Fudosan Residential Co., Ltd., and MITSUBISHI ESTATE RESIDENCE CO., LTD. <https://www.major7.net/>

■ The Progress on the FreeiD Implementation Plan

This plan involves the implementation of FreeiD, a facial recognition ID platform, across various locations such as apartments, offices, nurseries, and construction sites. The plan also facilitates payments using FreeiD and collaboration with local governments.

Regarding the implementation of FreeiD into real estate properties, multiple real estate developers are willing to introduce FreeiD beyond the company's assumptions. Many major players (often called "Major Seven"*) have almost decided to implement FreeiD and some mid-sized developers have made it a standard practice to adapt FreeiD. The management team recognizes that the progress is good, as indicated in the table below.

The facial recognition ID platform is currently undergoing practical testing in Kameoka City in Kyoto Prefecture. Its synergy with other systems, such as linking with My Number (a Japanese national identification system) and payment systems, contributes to its viability. As more people register their faces, especially in apartment complexes, FreeiD becomes a robust multi-platform solution. Simultaneously, the ID platform continues to progress smoothly in terms of system functionality and number of memberships.

Additionally, various local governments are exploring the integration of IDs based on My Number cards system. The company maintains frequent communication with the Digital Agency. Following Kameoka City, negotiations are underway with other municipalities, according to the management team.

FreeiD Implementation Status (October 2023 onward)—The progress is viewed positively

Date of disclosure	Disclosures regarding the implementation of FreeiD
2023 Oct. 4	Marimo Co., Ltd. has decided to introduce FreeiD to all future condominiums they develop.
Oct.12	Kameoka City has initiated a demonstration experiment called "Citizen Services with Just Your Face," eliminating the need for presenting physical identification cards during facial recognition check-ins.
Oct. 18	Business partnership with CaNowHOME to introduce FreeiD into single-family homes.
Oct. 26	FreeiD has been successfully implemented in an existing condominium for the first time in Japan. The condominium is called "Oberu Sannou".
Nov. 9	A joint demonstration experiment of "Skybox Facial Recognition Entry" is conducted at Sanga Stadium by KYOCERA.
Dec. 1	FreeiD is introduced into the logistics facility of Mitsubishi Estate "LogiCross Zama".
Dec. 6	System collaboration between FreeiD and Haseko Corporation's condominium living information utilization platform "LIM Cloud". They jointly launch the first "full facial recognition condominiums" project at Haseko Real Estate.
2024 Jan. 9	FreeiD is implemented in the new office "Cross Innovation Center" by Okumura Corporation.
Jan. 15	FreeiD is confirmed for use in Yasuda Real Estate developments, achieving the first "All Facial Recognition Property" for Yasuda Real Estate Co., Ltd.
Jan. 24	FreeiD collaborates with xID and launched demonstration project of Facial Recognition reception service in Kameoka City for "Citizen Services with Just Your Face, cooperation with My Number card.
Jan. 30	FreeiD is introduced in the "Sakura Hills Hakata Kita" rental apartment developed by RAITO KOGYO CO., LTD., marking the first "full facial recognition condominiums" in Kyushu.
Feb. 1	"Shopping with Just Your Face" using FreeiD for a Facial Recognition payment service begins in Kameoka City and Sanga Stadium by KYOCERA.
Feb. 8	FreeiD is first implemented in NITOH's RELIA condominium series.
Feb. 15	FreeiD is introduced in the research lab of Meiho Enterprise Co., Ltd. and the EL FARO YOGA rental housing (22 units).
Feb. 16	FreeiD is implemented in the common areas of Mitsubishi Estate Residence's "The Parkhabio Shin-Sakae".
Feb. 29	DXYZ and Shin-Idemitsu jointly first introduce "FreeiD" to an existing condominium in Kyushu.

Source: Compiled by SIR from the company and DXYZ Inc. of Migalo Group website

FY2024/3
The Company
Full-year forecast

■ **DX Real Estate Business**

While there was a small number of deliveries of new properties and an increase in the total volume and sales ratio of pre-owned properties in the October-December quarter resulted in sales flat, operating profit halved compared to the same period last year and its operating profit margin declined to 3.8%. The company added, "However, this is also broadly in line with the initial plan."

The real estate industry as a whole faces challenges related to rising costs, including construction expenses, material price inflation, and labor shortages. Therefore, not only the company, but other companies are also suffering from a decline in profitability. Despite these challenges, the real estate market remains strong, with robust demand even amid low inventory levels and rising price levels.

There are many bullish views that such a strong sales situation in the real estate industry will continue for the time being, and an optimistic outlook for the industry is propelled by the positive wealth effects from the stock market since last year with low mortgage interest rates. So, we questioned the company management if there is a concern regarding the availability and pricing of suitable new lands despite of soaring land price. The answer from them, "The land is prepared in accordance with the numerical target of the sales plan including inventory and period with adjusting the final completion and sales of the property ,so that we can create a stable sales growth path. Our competitive advantage lies in the' track records of relationship with various vendors and the financial trust it has built up over its 20-year history. We are not very worried about the purchase of land. " In fact, active efforts are underway to procure funding that will bolster the property inventory for the next fiscal year. Very recently, interest payment costs are slightly increased than expected.

■ **No change in FY2024/3 outlook**

The ordinary profit for the first 9 months of FY2024/3 was ¥2,132 mn and exceeded the company's full-year earnings forecast of ¥2,120 mn (a decrease of 15.8% YoY). However, the company has maintained its full-year sales forecast at ¥42 bn (an increase of 12.7%, YoY), and ¥2,500 mn (a decrease of 14.3%, YoY) for operating profit.

Management has provided the following rationale for not changing its guidance: "in the January-March 2024, we will continue to focus on the purchase and resale of pre-owned properties with relatively low margins, and plan to implement upfront investments and M&As in the DX Promotion business, a growth driver."

Therefore, the management expressed their thought that it is currently in a growth stage of sales and volume in the DX Promotion business rather than immediate profits increase. Not limited to this company, in the real estate industry, the timing of sales recognition on the income statement is impacted by the timing of property handovers. The company sometimes carries over the sales recognition of properties to the next fiscal year, and will not be forced to pursue profits too much in this fiscal year.

Additionally, the annual dividend guidance has been maintained at ¥45.

Share Price Insights

* Financial Results for the Q3 of the Fiscal Year Ending March 31, 2024

https://ssl4.eir-parts.net/doc/5535/ir_material1/224446/00.pdf

■ Expectation for alleviating “Information Asymmetry”

The share price has been gaining momentum since late November of last year, reaching new highs, and the lag behind peers is finally being resolved. However, it remains substantially undervalued with a P/B ratio of 1.32x and the estimated P/E ratio of 9.5x, which are far below the multiples of peers with no dividend paid, as shown in the table below.

In SIR’s initiation report issued in February 2024, three discount factors related to the company’s share price were highlighted. Among these, the first factor, “Can FreeiD really be monetized?” whose progress seems to be generally going well, as illustrated on page 4 of this report. Monitoring the progress on KPIs related to the DX promotion business, including FreeiD, may alleviate monetization concerns, in SIR’s view.

Regarding as the second factor “Disclosure under development”, while the company’s disclosure policy remains conservative, there have been some positive developments, such as the release of the English version of the financial results presentation for 3Q FY2024/3 on February 20. Additionally, the impact of IR efforts might be reflected in the latest ownership ratio dynamics by investor type, with the foreigners ownership ratio from 1.7% last time to 3.0%, and previously nonexistent investment trusts, etc., now holding 1.7%.

In order to eliminate the third factor “Concerns over meeting continued listing criteria”, i.e.. *the market capitalization of the tradable shares of over ¥10 bn.*, the company is considering various options by March 2027, including measures to gradually reduce the ownership of the company’s controlling shareholder, President and CEO, Mr. Sei Nakanishi and release them to the equity market while taking into account the market supply-demand balance and the company’s capital policy.

In any case, we continue to expect 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	¥	2024/3/4 cp	1,715	3,660	1,473	1,503	787	6,570
Shrs out.	1,000 shrs	Latest FY	7,316	16,189	36,763	12,866	3,793	3,021
Mkt Cap.	¥ mn	Latest FY	12,547	59,250	54,152	19,338	2,985	19,849
EV	¥ mn	Latest FY	33,751	64,305	66,558	15,070	2,361	19,326
PER	X	Latest FY	7.9	51.5	53.5	55.4	86.6	87.0
		CE (current period)	9.5	41.4	32.1	78.4	21.0	43.8
		Consensus forecast (next period)	--	30.6	21.4	35.1	--	24.4
PBR	X	Latest FY	1.32	5.38	2.63	2.01	2.04	12.78
PSR	X	Latest FY	0.34	3.20	0.37	1.25	0.59	3.74
		CE (current period)	0.30	2.66	0.31	1.03	0.58	2.90
EV/EBITDA	X	Latest FY	11.2	32.1	8.9	16.4	10.4	56.3
		CE (current period)	13.0	25.6	N.A.	17.3	6.2	25.1
		Consensus forecast (next period)	N.A.	19.3	6.3	N.A.	N.A.	N.A.
EBITDA	¥ mn	Latest FY	3,019	2,004	7,468	918	226	343
		CE (current period)	2,600	2,508	--	869	382	771
		Consensus forecast (next period)	--	3329	10,482	--	--	--
ROE	%	Latest FY	17.9	11.0	5.1	3.8	2.4	15.8
Div. Yield	%	CE (current period)	2.62	0.00	0.00	0.00	0.00	0.00
Share Price Change Rate	%	from 6 months ago	22.0	7.6	8.6	-29.4	-0.8	70.9
	%	from 1 years ago	-6.0	4.0	34.0	-21.2	--	--
Ownership % by investor type (Data from Japan Company Handbook 2024 I)	%	foreigners	3.0	16.1	21.2	89.0	1.1	8.6
		floating stock	16.8	12.6	8.8	19.9	15.4	12.1
		investment trusts etc.	1.7	10.5	1.0	4.2	0.0	2.9
		specific stocks	73.0	75.8	67.9	64.9	79.9	80.0

Source: Compiled by SIR from SPEEDA data.

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