Estore Corporation

4304

TSE JASDAQ

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Index

Summary

On the fully-fledged launch of sales promotion systems, has in place a service structure for the three businesses and four domains. In FY3/20, is aiming to grow from the effects of the organizational restructuring and the improvements in sales promotion systems

Estore Corporation <4304> (hereafter, also "the Company") is a comprehensive provider of e-commerce (EC) support services. After starting from the Systems Business for the provision of ASP services as a framework for EC, it is currently focusing on consulting and operations management agency services to support revenue growth at customer companies. Going forward, it plans to strengthen sales promotion systems.

1. Conducts three EC support businesses, of sales systems, marketing services, and sales promotion systems

Since its foundation, the Company's business domain has consistently been providing EC support to companies. It started by providing shopping cart services, but responding to the development of and changes to technologies and the EC market, the Company itself has achieved growth by changing the focus of the mainstay business that serves as the earning pillar on a cycle of around seven years. From this fiscal period, it has made a fully-fledged start to the sales promotion systems business (sales of software for the automation and mechanization of marketing activities toward sales growth). Following this, together with the sales systems business and the marketing services business, it now has in place a structure that covers all four business domains to provide EC support, and the extent of its growth strategies can be expected to widen.

2. The core growth strategies are growing sales of marketing services to external, major companies and increasing the number of sales promotion systems customers

The type and nature of the Company's revenue differs greatly for each of the previously mentioned business domains. In the sales systems business, revenue from companies contracting to Shopserve, an ASP service, is divided into stock revenue (monthly fixed-fee revenue) and flow revenue (revenue from fees linked to sales scale). Also, revenue in the marketing services business consists of the total of revenue relating to consulting, survey analysis, and agency services (including advertising and creation), and sales promotion systems business revenue, which is from system fixed usage fees and pay-for-use fees. Among the businesses, the two that are expected to drive the Company's growth in the future are marketing services and sales promotion systems. For marketing services, which has been developed in advance, the Company is conducting fully fledged sales activities for external customers, in addition to for existing customers, and it is focusing on acquiring projects from major companies and improving their productivity. On the other hand, sales promotion systems business is a business in a new domain in which it made a fully-fledged start in FY3/19. Although the current situation is one of trial and error specific to a launch period, the Company has a major opportunity to become the first runner in this industry, and it is considered to be a business with great potential.

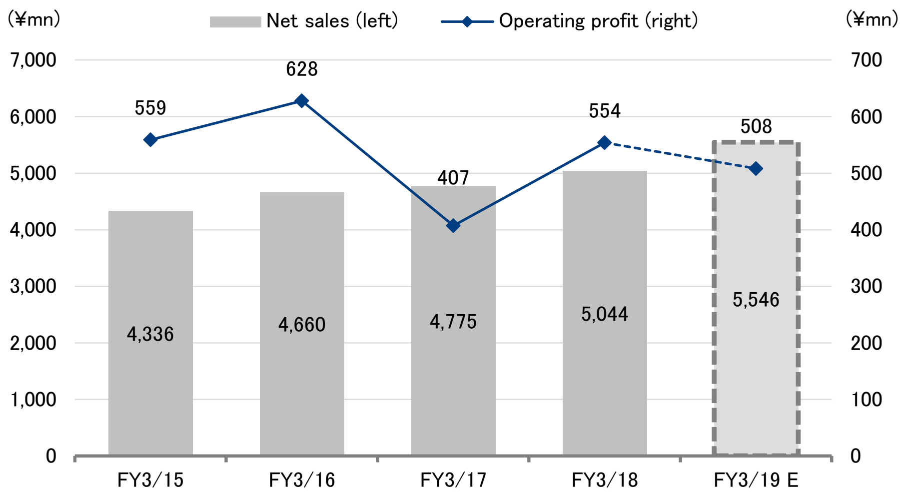
3. Struggled in FY3/19 3Q as a transition period, but is aiming to grow earnings in FY3/20 from the effects of the organizational restructuring and the improvements in sales promotion systems

Although it implemented this growth strategy in FY3/19, in the 3Q results, net sales were below the in-Company forecast. Results are being impacted by the decline in flow revenue, which is the revenue with the largest scale at this point. One of the direct reasons is the decrease in the number of customers, which itself is trending as expected, while another reason is that the increase in the commercial distribution amount per store has been unable to cover for this fall in customer numbers. Currently, the Company is focusing on growing sales of marketing services to external, large customers and increasing the number of customers in sales promotion systems. If these growth strategies produce a certain level of results, it is expected that this will be reflected in flow revenue also, in the form of its growth. For marketing services, the large-scale organizational restructuring has started to move in a positive direction. For sales promotion systems also, going forward the Company intends to improve the systems and software and accelerate the pace of customer acquisition. It is aiming to steadily increase sales and profits in FY3/20 as a result of these measures.

Key Points

- Steadily strengthening the revenue base and customer base by shifting the focus business every seven years
- With the launch of the sales promotion systems business, can offer services in all four domains for EC support
- The core growth strategies are growing sales of marketing services to external, major companies and increasing the number of sales promotion systems customers

Results trends



Note: transitioned to consolidated results from FY3/19
Source: Prepared by FISCO from the Company's financial results

Business overview

Steadily strengthening the revenue base and customer base by shifting the focus business every seven years

Since its foundation in 1999, the Company has consistently developed EC support-related businesses. However, in this process, it has grown while shifting its business focus roughly every seven years to reflect the changes in the business environment and the growth of the Company itself. As each business hit its stride and reached the stage of establishing an earnings base, the Company would use these earnings to expand into creating a new business to contribute to earnings in a repeated cycle. The current year, of 2019, is in the period to shift from the third to the fourth cycle.

Estore's history and the shifts in its business development

Date	Event	Business segment
February 1999	Founded Estore	
July 1999	Started providing the shopping cart service storetool	Systems Business
September 1999	Started providing the web hosting service Siteserve	Systems Business
March 2000	Sales partnership with Osaka Yusen Broadcasting Co., Ltd. (currently, USEN Corporation)	Systems Business / OEM subscriptions
June 2000	Sales partnership with Sony Communication Network Corporation (currently, So-net Entertainment Corporation)	Systems Business / OEM subscriptions
July 2004	Business and capital partnership with TELEWAVE, INC. (currently, iFLAG Co., Ltd.)	Systems Business / OEM subscriptions
November 2005	Established a business alliance with Yahoo Japan Corp. <4689>	Systems Business / OEM subscriptions
November 2005	Established a business alliance with Kakaku.com, Inc. <2371>	Systems Business / OEM subscriptions
January 2006	Started providing the Shopserve comprehensive eCommerce support service under its proprietary domain	Systems Business
November 2006	Launched the product search site Shoppingfeed	Systems Business
June 2011	Converted Precision Marketing, Inc. into a consolidated subsidiary	Marketing Business
July 2012	Established the Sapporo Marketing Factory	Marketing Business
October 2012	Established the shopping site PARK, featuring shopping recommendations issued by "curators" in 34 genres	Marketing Business
October 2013	Started providing the Single Hand simple customer acquisition service	Marketing Business
January 2016	Removed Precision Marketing from the scope of consolidation	Marketing Business
April 2016	Strengthened the Promotions Business sales force	EC Business
August 2016	Shopserve is compliant with Amazon Pay	EC Business
March 2017	Shopserve includes bitcoin payments as standard (provided to 12,500 stores)	EC Business
July 2017	Started providing Estore Compare sales promotion system	Marketing Systems
September 2017	Started providing Estore Query sales promotion system	Marketing Systems

Source: Prepared by FISCO from Company materials

(1) 1999-around 2006

The Company's business first started from shopping cart services. After that, it started the provision of rental servers that are needed in order to establish a website, and the rental server business became the main support for the Company's early days. While retaining the rental server business as its core operation, the Company rolled out a series of services needed for conducting EC in addition to its shopping cart services. These paved the way for the Shopserve ASP service providing comprehensive EC support, launched in 2006.

(2) 2006-2012

Over the seven years from 2006, the EC systems business in the form of the Shopserve ASP service providing comprehensive EC support became an earnings source for the Company. Shopserve is an ASP service that provides, as a single service, management of elements such as the store's website, domain, email, payments, ordering, and customers. In terms of its revenue model, the Company collects monthly fees for the usage of the ASP service from customers, so it can be said to be a so-called stock-type model. Stock revenue is very effective for stabilizing the management foundation. The Shopserve customer base has steadily expanded and contributed significantly to the Company's growth and management stabilization.

Once the EC systems business hit its stride, the Company began a parallel project of supporting the growth in sales at customer companies and expanding revenue by collecting a fixed percentage of net sales from customers (revenue linked to the sales scale) as payment agency commissions (via store websites on Estore's Shopserve). This type of revenue is described as flow-type revenue and is distinguished from the monthly fees from Shopserve (stock revenue) in revenue management, even though the revenue comes from the same customers.

(3) 2012-2018

The net sales from existing customers (EC system customers) expanded steadily, with a good compositional balance between stock revenue and flow revenue. Meanwhile, the Company began strengthening the Marketing Business with an eye to developing it as the core business for contributing to earnings. This involved commercializing the Company's sales promotion support expertise for effectively expanding customers' net sales. The two main points were 1) "commoditizing" its sales promotion support expertise and policies and acquiring fees from consulting and operations management agency services, and 2) selling these services to customers other than existing customers (EC system customers).

The Marketing Business initially consisted of two businesses, the "sales promotions business," which provided consulting and operations management agency services, and the "media business," which managed the PARK EC shopping mall. The Company has positioned the sales promotions business as the business domain it should focus on the most. It distinguishes it from the marketing systems business described below and it currently calls it the marketing services business. On the other hand, it has positioned the media business as a non-focus business, because it has powerful rivals, like Amazon, and it has fulfilled a certain purpose. As a result, the Company ended the media business on September 30, 2018.

(4) From 2018 to the present day

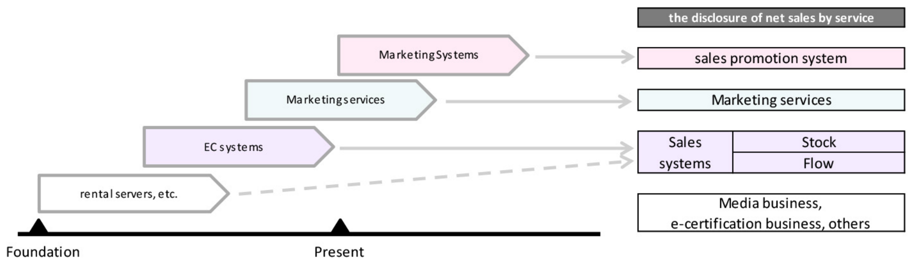
In the marketing services business, it is people who provide the services, or in other words, they are services from a work force. Therefore, the Company has been working on developments to provide sales promotion support services from systems for the growth of the next earnings business, and in the autumn of 2017, it began to provide two software packages, Estore Compare and Estore Query (in some cases, they are collectively called the Back Store Group). This sales promotion systems business is called the marketing systems business, and although it is the same as the sales promotion business, it is distinguished from the marketing services business in that it is conducted by a work force. From 2018, the Company's strategy has been to work toward the fully-fledged expansion of sales in marketing systems, which is expected to lead to profit growth.

(5) Summary

After passing through the above-described transition, currently the Company has only one business segment, the EC business. But net sales are disclosed by dividing them into four categories according to the target of the service provision ("sales" or "sales promotions") and the provider and the method of provision ("machinery and software" or "work-force services"). These four categories are sales promotion services (marketing services), sales promotion systems, sales systems, and the media business and others.

Sales systems is further divided into two according to the type of revenue; stock revenue (system usage fee revenue) and flow revenue (revenue of a fixed percentage of net sales). Also, services in the media business were stopped at the end of September 2018, while the Company has consolidated the subsidiary that conducts the e-certification business. Therefore, the outlook going forward is that this category will change to the e-certification business and others.

The business transition and the correspondence relationships for the disclosure of net sales by service



Source: Prepared by FISCO from Company materials and interviews

Results trends

Sales and profits declined in 3Q. Trial and error is continuing during the transition period for the earnings business

1. Summary of the FY3/19 3Q results

In the Company's FY3/19 3Q results, sales and operating profit declined, with net sales of ¥3,706mn (down 2.9% year-on-year (YoY)), operating profit of ¥393mn (down 6.3%), recurring profit of ¥466mn (up 4.3%), and net profit attributable to owners of parent of ¥332mn (up 8.6%). The Company transitioned to consolidated results from FY3/19 2Q, so the above YoY growth rates are reference values.

The reason for the increase in recurring profit was that in non-operating income, a gain on the sale of investment securities (¥50mn) and investment income from the equity method affiliate (¥42mn) were recorded.

Summary of the FY3/19 3Q results

(¥mn)

	FY3/18		FY3/19				
	3Q cumulative	Full year	3Q cumulative	YoY	vs. forecast	full-year forecast	YoY
Net sales	3,815	5,044	3,706	-2.9%	66.8%	5,546	9.9%
Operating profit	419	554	393	-6.3%	77.4%	508	-8.4%
Operating profit margin	11.0%	11.0%	10.6%	-	-	9.2%	-
Recurring profit	446	582	466	4.3%	83.2%	560	-3.8%
Profit attributable to owners of parent	305	411	332	8.6%	84.6%	393	-4.5%

Note: the Company transitioned to consolidated results from FY3/19 2Q, so the above YoY growth rates for the cumulative 3Q and full-fiscal-year periods are reference values.
Source: Prepared by FISCO from the Company's financial results

In the 3Q results, it seems that net sales were greatly below the Company's own forecast. This is a continuation of the situation from the time of the 1Q results, which was touched upon in the previous report (October 9, 2018). As can be seen from the Company's initial, full fiscal year forecasts of higher sales but lower profits, in FY3/19 it planned to actively conduct upfront investment, including in expanding recruitment of human resources and developing products, with the goal of steadily achieving topline growth, even if it had to accept a decline in profits. However, the situation up to 3Q is that net sales have declined YoY and it is not achieving its goal of realizing topline growth.

There are multiple factors existing across each of the businesses behind sales being below forecast and declining YoY. Flow revenue (revenue linked to the sales scale) in sales systems, which is Company's largest revenue block, declined YoY. Sales were also less than expected in marketing services and sales promotion systems. Each of these businesses have parts that move linked to the other businesses, so if there is slump in one, it impacts the others. Although it is difficult to precisely trace the causes due to these mutual relations, if we had to say, at FISCO we have analyzed that the main factor is that the Company is struggling during a transition period, of transitioning the focal point for the earnings businesses to the marketing services business and the sales promotion systems business.

On the other hand, for profits, it seems that the results exceeded the forecasts because the Company did not progress upfront investment as planned, such as to acquire human resources, and also because advertising expenses temporarily decreased as sales did not grow as expected. As previously stated, operating profit was ¥393mn (down 6.3% YoY) and recurring profit was ¥466mn (up 4.3%), which were rates of progress toward achieving the full fiscal year forecasts of 77.4% and 83.2%, respectively.

2. Breakdown of net sales by business

In marketing services, net sales increased 1.1% YoY to ¥850mn. The main content of this business is the provision of services, including survey analysis and consulting, and webpage production and advertising outsourcing. On entering this fiscal period, on the one hand some major projects cancelled their contracts, while on the other hand it is taking some time to acquire new customers, and this kept down the growth in sales.

Sales systems revenue is from sales from Shopserve, an ASP service. Within this amount, stock revenue, comprised of monthly usage fees, declined 7.1% YoY to ¥1,304mn. To acquire Shopserve contracts, the Company is adopting a strategy of shifting to mainly targeting large customers, and therefore sales declined due to the net decrease in the number of contracting customers. However, it can be said that this trend is in line with the Company's expectations. Conversely, flow revenue, which is comprised of a certain percentage of the sales obtained via Shopserve, declined 1.4% to ¥1,522mn. The distribution amount per store increased 9% due to the shift toward larger stores that is being progressed by the Company and the effects of the services to grow sales at stores. However, sales still declined slightly due to the impact of the decrease in the number of contracting customers.

In sales promotion systems, net sales were ¥10mn. This business started from FY3/18 4Q, so there are no figures for a YoY comparison. In FY3/19, which was effectively its first fiscal year, the Company worked on sales of Estore Compare and Estore Query, which are the two software packages for which a sales structure is already in place. But it seems that the number of customers acquired was significantly less than was initially expected. The details are given below, but in FY3/19, it is limiting the sales promotion systems target customers to those customers who already have a Shopserve contract and aiming to increase flow revenue from the growth in the distribution amount per store, in addition to from sales growth as the sales promotion systems business. As previously explained, one of the reasons for the sluggish growth of flow revenue can be said to be that sales growth in sales promotion systems is behind schedule.

Breakdown of net sales by business

(¥mn)

	FY3/18					FY3/18			FY3/18	FY3/18	
	1Q results	2Q results	3Q results	4Q results	Full fiscal-year results	1Q results	2Q results	3Q results	3Q cumulative	3Q cumulative	vs. FY3/18 3Q
Marketing services	238	276	326	291	1,131	267	268	315	841	850	1.1%
Sales systems											
Stock	476	467	460	452	1,855	442	434	427	1,404	1,304	-7.1%
Flow	494	481	567	482	2,024	486	468	567	1,543	1,522	-1.4%
Sales promotion systems	-	-	-	2	2	2	3	4	-	10	-
e-certification, media, others	8	8	9	5	31	8	7	1	26	18	-28.8%

Source: Prepared by FISCO from the Company's financial results

Medium-term growth strategy and progress

On the launch of the sales promotion systems business, has services for all the EC support domains. Aiming for growth through increasing sales in marketing services and sales promotion systems

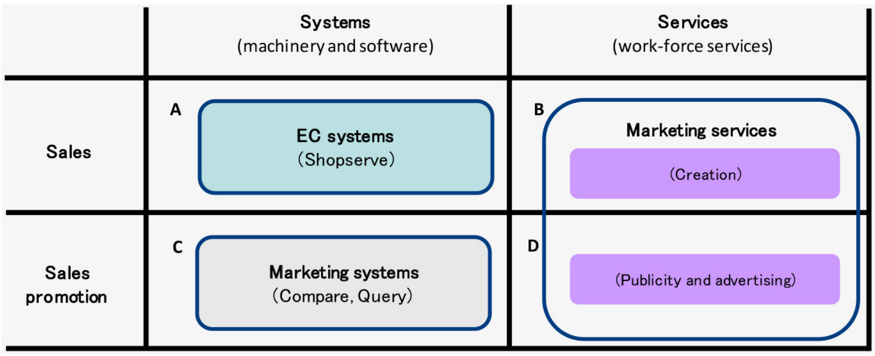
1. Overall image of the growth strategy

Since its foundation, the Company has consistently developed EC support-related businesses. During this time, reflecting the changes in the market environment and the changing times, it has expanded the scope of its business while repeatedly shifting the business that drives earnings on a roughly seven-year cycle. Currently, under the banner of "Responding to the shift to digital and marketing societies," it is working to achieve growth in a new seven-year period.

Specifically, in the autumn of 2017, it newly launched the sales promotion systems business. This refers to digital marketing measures, and it had previously launched two newly developed software packages. As a result, it currently has a three-business structure, of the sales systems (EC systems) business, the marketing services business, and the sales promotion systems (marketing systems) business.

The services provided by the Company (or its business domains) can be divided into four quadrants created from two axes; sales and sales promotion (marketing), and systems (machinery and software) and services provided by people. As described in the Company summary section, on its foundation, it conducted the sales systems business (below, quadrant A), and then subsequently expanded the scope of its business to marketing services (quadrants B and D), while transitioning the domains in which it conducted activities and the sources of earnings. Following the launch of the marketing systems business (quadrant C), it can provide services for all four quadrants.

Business domain



Source: Prepared by FISCO from Company materials and interviews

The Company's growth strategy is, of course, to aim to grow earnings in each of the A to D businesses. But the key point is that it is not the case that A to D exist separately (independently) from each other on the same plane, but rather that they are related to each other in various ways, such as having causal, substitution, and complementary relations, and they have a three-dimensional and multilayered existence according to their respective relations. Therefore, in order for the Company to grow earnings, of course the various businesses must work together to pursue synergies, but it is also necessary to combine them to reflect changes in the market environment and the changing times, while modifying their contextual relations. In other words, there will be times when trial and error is required, and it can be said that the Company is currently in such a period.

Above, we discussed the processes the Company is progressing toward realizing earnings growth. But on the point of the actual ways it will grow earnings, at FISCO, we think that in the future, the Company's growth will be driven by two businesses; marketing services and sales promotion systems. Marketing services is the next mainstay business after sales systems, and it has a comparatively long history among the Company's businesses. Initially, sales were started to sales systems' existing customers, but currently, it has completely shifted the main target customer group to external customers (here, the companies that already have a sales systems contract are defined as "existing customers," "in-Company customers" or "internal customers," and those who do not have a sales systems contract are called "external"). It is conducting sales with a focus on large, corporate customers in order to improve business efficiency, and the current situation is that the earnings potential per company is steadily rising. On the other hand, sales promotion systems, which from now on is expected to grow to become a core business, is the newest business domain within the Company. Sales promotion systems are "services from machinery and software," so even if the scale of earnings per project is small, it is possible to grow earnings by acquiring customers with large-volume projects or a large number of customers. Sales promotion systems is a new field as a service domain, so it is also attractive on the point that the Company has the potential to become the first runner in this industry.

As previously mentioned, the Company's basic policy when developing a new business or service is first to provide it to existing sales systems customers. Therefore, if marketing services and sales promotion systems grown in line with the Company's scenarios, this can be said to signify that, for the sales systems existing customers also, marketing services and sales promotion systems are in a fully functioning state. It is considered that this will appear in the form of the growth of flow revenue in sales systems, so in this sense, flow revenue is an item to focus on for the future also.

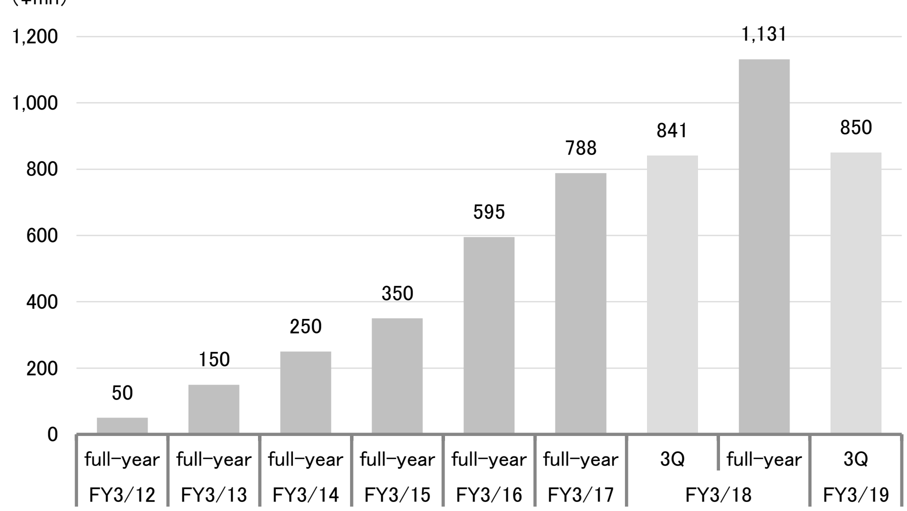
The effect of the organizational restructuring is becoming gradually apparent and is currently rapidly catching-up to the forecasts. Aiming for business expansion through improving production efficiency alongside acquiring human resources

2. The marketing services business growth strategy and the progress made

The marketing services business consists of services provided by a human work force, and it straddles the sales domain (webpage production, etc.) and the sales promotions domain (advertising, etc.). It also includes the provision of services such as survey analysis and consulting.

This business was initially developed with existing Shopserve customers as the target customers. Subsequently, sales to external customers were also begun and the scope of the business expanded. Due to the nature of marketing services, of being provided by a human work force, it is difficult to achieve growth by increasing the number of customers. Therefore, the Company's strategy is to grow this business as a whole by increasing earnings per customer through targeting large-scale, corporate customers.

Trend in marketing services net sales



Source: Prepared by FISCO from the Company's financial results

In marketing services, net sales grew extremely well up to FY3/18, but the sales-increase rate in the FY3/19 3Q cumulative period slowed down significantly, to 1.1% YoY. This was mainly because, while on the one hand some large-scale projects cancelled their contract, on the other hand hardly any progress was made in acquiring new customers up to the second half of 3Q. Since the basis of marketing services contracts are automatic renewals on a half-year basis, it can be said that a certain number of cancelling the contract is to be expected.

Conversely, the lack of progress made in acquiring new contracts would seem to be an effect of the large-scale organizational restructuring conducted in August 2017. This restructuring is intended to rejuvenate management positions on a Company-wide basis. In FY/18 2H, it worked to execute the business plan created under the previous managers, so problems did not appear. But in FY3/19, it worked on the business plan created under the new managers, and it would seem that some negative aspects of the rejuvenation come to the fore, and therefore results have trended below the forecasts. But on this point, it seems that from the second half of 3Q, the trial-and-errors measures conducted up to that time started to bear fruit and it made rapid progress in acquiring customers. This trend continued on entering 4Q also, and based on the current situation, it seems fully possible that the initial, full fiscal year forecasts will be achieved.

The marketing services business is gradually getting on track, but an issue going forward will be acquiring human resources. This business involves services provided by a human work force, so recruiting human resources signifies increasing the capacity of this business. This has been a consistent point since the start of this business, and the Company itself positions it to be the most important investment target. However, the reality is that it has not made progress in acquiring human resources as planned due to the labor shortage in society as a whole. In the marketing services business also, it is focusing on increasing the sizes of projects and working to improve efficiency. In addition, it is aiming to achieve earnings growth at a pace exceeding the pace of human-resources recruitment, including by 1) improving the skills of its existing human resources 2) introducing Robot Process Automation (RPA) and Marketing Automation (MA), and 3) improving productivity through increasing the contract-retention rate of customers. If it can expand the capacity of its human work force, we can expect earnings growth in marketing services to rapidly accelerate from the growth in earnings per customer, as a result of the previously described expansion in customer scale and the synergies with the growth in earnings per customer.

In the sales promotion systems business, is aiming to increase the number of contracting customers through improving Compare and Query

3. The sales promotion systems business growth strategy and the progress made

The sales promotion systems business refers to the development and sales of sales promotion support systems, which is to say promotion software. The objective of the business is to expand customers' sales, which overlaps with that of the marketing business; however, the revenue model is made up of fixed basic monthly fees and a pay-for-use charge according to the number of times the services is used.

By autumn of 2017, the Company launched two MA tools: Estore Compare ("Compare") and Estore Query ("Query"). Compare is a tool that helps to increase EC website sales by using A/B comparison testing for an EC website to determine in real-time which has the higher conversion ratio (CVR), number of conversions, and life time value (LTV). On the other hand, Query is an email marketing tool for business operators who already have an existing customer base of a certain size. The main feature of the tool is that it can distribute personalized email through refined customer characteristics.

In the sales promotion systems business, fully fledged sales activities only began from FY3/19. The target customers are existing Shopserve customers, and currently the Company does not sell to external customers. Its strategy is to first grow sales to existing customers, which will lead to the expansion of flow revenue. But although the sales promotion systems business has made a fully-fledged start in this way, it seems that the number of contracting customers is significantly below the Company's initial forecast. It is thought that there are various reasons for this, including that the market is underdeveloped, the lack of sales activities, and that needs have cooled alongside deflation, but the truth is that the real reason is not fully understood.

There are considered to be several options for the development of the sales promotion systems business from FY3/20 onwards. The first is to launch a third software package. But on this point, it seems that the Company's policy, even if it speeds-up the launch of a third software package, is first to prioritize improvements to Compare and Query. As the effects up to the present time have been confirmed, it seems that it expects the number of contracting customers to increase from improvements to the user interface (such as the ease of use) and accuracy.

One more option is to start sales to external customers. It is thought highly possible that external sales will begin in FY3/20. But in the Company's new business development, the presence of existing customers, for who it can easily utilize its expertise and data from the past, is considered to be extremely significant. As previously explained, the Company is currently at the stage of searching for the decisive ways to increase the number of sales promotion systems contracts, and in this situation, it is thought that making steady progress with existing customers as the partners (including by improving the software) while turning the PDCA cycle may ultimately prove to be a shortcut for this.

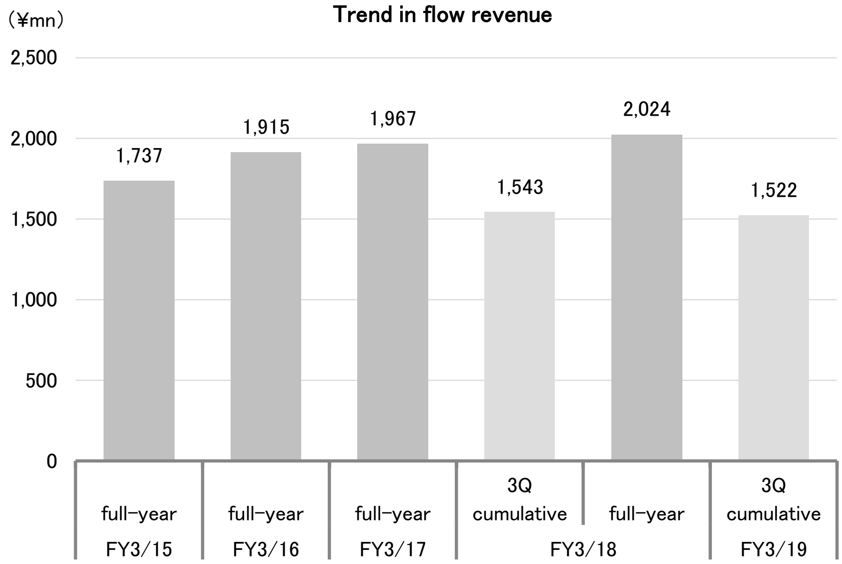
The collaboration with the sales promotion systems business will increase net sales per customer store, leading to the recovery of flow revenue growth

4. The sales systems business growth strategy and the progress made

(1) The flow revenue

Although the pursuit of flow revenue itself can be a growth strategy, currently the Company has established a service structure for all four domains, and among them, it has positioned two, marketing services and sales promotion systems, as its core growth strategies. If they function as expected, it is thought that the effects of this will be expressed in the form of flow revenue growth. Therefore, flow revenue can also be viewed as a barometer of the progress made by the Company for its growth strategies.

This flow revenue is currently in a leveling-off phase. In the FY3/18 full year, net sales increased 2.9% to ¥2,024mn and growth was sluggish, but subsequently in FY3/19, as previously explained, they declined 1.4% YoY in the 3Q cumulative period. It is thought that the decline in the number of customers in sales systems is the direct reason why flow revenue has stopped growing.

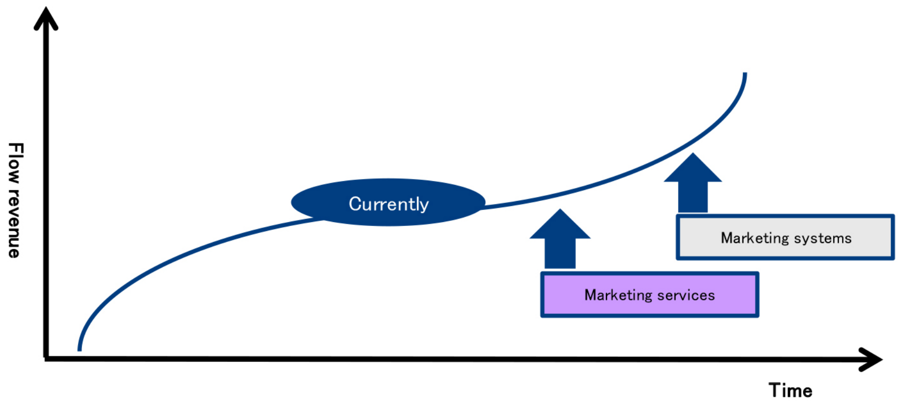


Source: Prepared by FISCO from the Company's financial results

In this situation, the Company is adopting a strategy of once again recovering growth through increasing sales from existing customers (the distribution amount per store). This is because of the nature of flow revenue, of being fees linked to the sales scale. Toward realizing this, the Company is utilizing its essence, of being an "EC support company," to actively conduct sales to existing Shopserve customers in its businesses, including in marketing services by providing survey analysis, consulting and agency services (advertising, webpage production, etc.), and in the new business of sales promotion systems.

In FY3/19, the Company aimed to increase flow revenue through synergies with the sales promotion systems business, but it seems that it did not achieve results as expected. The reason for this is thought to be the same as for the above-described slump in flow revenue growth, of the problem of customer numbers. As described in the sales promotion systems section, in a situation in which there are few competitors for the Company's products (Compare and Query), the expected effects for sales growth have been confirmed. However, the number of sales promotion systems customers has not increased as expected, so the synergies with the sales promotion systems business have been buried within the overall slump in sales growth. The Company is working to improve the two products in sales promotion systems in FY3/20, and it intends to increase flow revenue from the launches of their improved versions. We will be paying attention to how this progresses.

Image of the re-acceleration of the growth of flow revenue



Source: Prepared by FISCO from Company materials and interviews

(2) The stock revenue

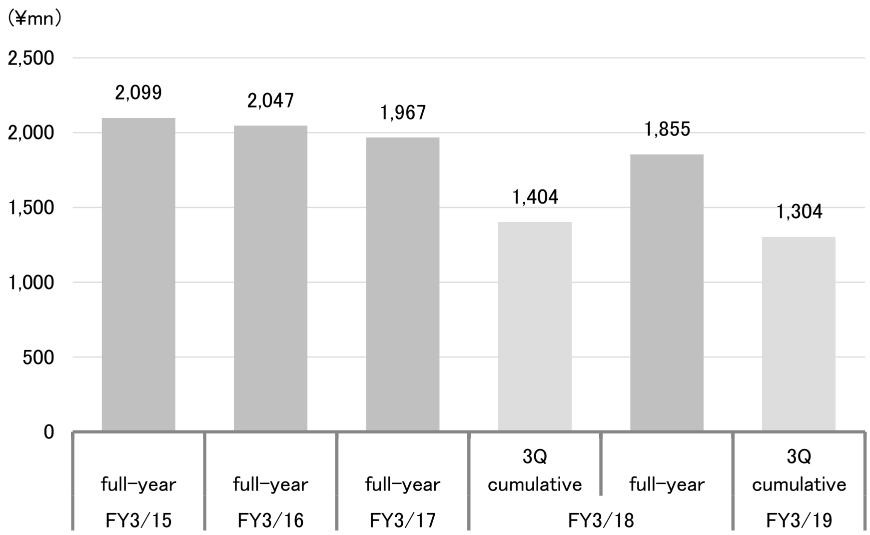
Stock revenue is collected as monthly fixed-fee revenue and sales are calculated as the product of the number of the Shopserve ASP service contracted customers and the average spend per customer. Within these two, the Company has stated that it does not focus on the number of contracted customers and that rather, it focuses on raising up the average spend per customer.

There are two conceivable ways to raise the average spend by customer–raising it for the same customers without changing their composition, and raising it by changing the customer composition–and the Company is currently focusing on the latter. Under the slogan of “shift to good products, good stores,” it is progressing the shift to large customers for the acquisition of new contracts.

These measures are gradually producing results and the average spend per customer is steadily rising. But because the number of customers cancelling contracts is higher than the number of new large customers, stock revenue is trending downward. On this point, the Company itself has stated that its strategy is to cover for the decrease in stock revenue through the growth in flow revenue from the measures to “shift to good products, good stores,” and it is not at all a cause for concern.

But the current situation is that, even if net sales per store (commercial distribution amount) are growing, as was previously explained, due to the decline in the number of contracting customers, flow revenue is falling. It seems that the strategy of “not pursuing contracting customer numbers” and instead advancing the “shift to good products, good stores” will be maintained in the future. But as it is expected that the decrease in customer numbers will continue due to a certain number of customers, mainly medium- and small-sized customers, cancelling their contracts each year, it can be said that it will be necessary to increase the pace of increase of net sales per store.

Trend in stock revenue



Source: Prepared by FISCO from the Company's financial results

The e-certification business to make a fully-fledged start as an earnings business from FY3/20

5. The e-certification business growth strategy and the progress made

On August 6, 2018, the Company newly established CrossTrust, Inc., and launched an e-certification business. The Company's e-certification business entails issuing SSL/TLS server certificates with a function to verify the identity of the website management company (for further details, please refer to the report of October 9, 2018).

There is a fee for the issue of a SSL/TLS server certificate (generally said to be ¥30,000 a year) and this is the source of earnings. But in FY3/19, the Company is prioritizing issuing SSL/TLS server certificates to existing Shopserve customers free of charge due to concerns that warning popups will appear on the websites of EC stores that do not have an SSL/TLS server certificate, which would have a major impact on EC sales. So in FY3/19, this business was developed while being positioned as an in-Company cost, rather than as an earnings business.

From FY3/20 onwards, the Company plans to start external sales (to charge a fee) of SSL/TLS server certificates and to launch fully-fledged activities as an earnings business. Toward expanding the service lineup, it seems that it also intends to create a business for next-generation certificates (such as transaction certificates and escrow).

Outlook

Net sales may be below forecast, as progress up to 3Q was behind schedule. But it seems fully possible that the profit forecasts will be achieved due to cost reductions.

Estore forecasts for a profit decline on increased sales in FY3/19 with ¥5,546mn in net sales (up 9.9% YoY), ¥508mn in operating profit (down 8.4%), ¥560mn in recurring profit (down 3.8%), and ¥393mn in profit attributable to owners of parent (down 4.5%).

The non-consolidated (stand-alone) results forecasts are for net sales of ¥5,540mn (up 9.8% YoY), operating profit of ¥531mn (down 4.1%), recurring profit of ¥531mn (down 8.7%), and net profit of ¥367mn (down 10.7%), and there have been no changes to the initial forecasts.

Overview of the FY3/19 forecasts

(¥mn)

	FY3/18			FY3/18				
	3Q cumulative	4Q	Full year	3Q cumulative	4Q E	YoY	Full year E	YoY
Net sales	3,815	1,228	5,044	3,706	1,839	49.7%	5,546	9.9%
Operating profit	419	134	554	393	114	-14.9%	508	-8.4%
Operating profit margin	11.0%	11.0%	11.0%	10.6%	6.2%	-	9.2%	-
Recurring profit	446	135	582	466	93	-30.7%	560	-3.8%
Profit attributable to owners of parent	305	105	411	332	60	-42.5%	393	-4.5%

Note: the Company transitioned to consolidated results from FY3/19 2Q, so the YoY growth rates are reference values.
Source: Prepared by FISCO from the Company's financial results

As described in the results trends section, up to the current 3Q, net sales were behind schedule in terms of achieving the full fiscal year forecast. In order to achieve this forecast, net sales of ¥1,839mn (up 49.7% YoY) will be required in 4Q, and the impression is that this will be a high hurdle to clear. But for profits, the rates of progress up to 3Q were high, and the situation is that even if every profit item from operating profit down declines by 15% to 40% YoY in 4Q, it will still be possible to achieve the full fiscal year profit forecasts.

In terms of how to evaluate this contrasting situation for net sales and profits, at FISCO we think that, the same as in the past, for example even if profits exceed the forecasts, this cannot be evaluated positively as it is not what the Company itself intended. It is thought that the Company feels the same on this point.

The Company is focusing on topline growth. It is conducting business management while giving top priority to creating a framework that can continuously realize it, and also to actually realizing it. As stated above, following the launch of the sales promotion systems business, it has in place a structure to conduct businesses covering all four EC support business domains, and on this point it can be positively evaluated. However, the Company's current situation is that the organizational restructuring conducted in the previous period and the new products in the sales promotion systems business have not been fully utilized. Although there are already signs of improvement, such as in the marketing services business, there are also cases in which the response will be delayed until FY3/20, including the software improvements in sales promotion systems. Therefore, it seems that a little more time will be needed for the Company to enter a period in which its results take a fully-fledged leap forward.

The points to focus on in 4Q will be the extent of the recoveries of the marketing services business, for which sales will have to be rapidly caught-up after falling greatly behind schedule up to 3Q, and in the sales promotion systems business, in which the number of contracts was significantly less than forecast. Also, a third point to focus on will be whether, as a result of these efforts, the Company can achieve a YoY increase in flow revenue (revenue collected of a certain percentage of the sales of customer stores) on a full fiscal year basis.

The Company transitioned to consolidated results from FY3/19 2Q. The consolidated results include the results of CrossTrust (consolidated subsidiary), a wholly-owned subsidiary that conducts the e-certification business, and EC Holdings Inc. (an equity method affiliate) that conducts EC sales of health foods. In its first fiscal year of FY3/19, CrossTrust is expected to record a loss for the full fiscal year, as it is focusing on issuing certificates free of charge to existing customers. But its earning situation is expected to improve from FY3/20 onwards, as it will actively conduct its business, including external sales of certificates.

Analysis of differences between consolidated and non-consolidated results on a FY3/19 full year forecasts basis

(¥mn)

	FY3/19		Difference	Remarks
	Non-consolidated forecast	Consolidated forecast		
Net sales	5,540	5,546	6	Consolidated subsidiary CrossTrust's net sales
Operating profit	531	508	-23	Consolidated subsidiary CrossTrust's operating loss
Recurring profit	531	560	29	Equity-method investment income from affiliate EC Holdings (recorded ¥42mn in the 3Q cumulative period)
Profit attributable to owners of parent	367	393	26	

Note: In the consolidated forecasts, "Net profit attributable to owners of parent"
Source: Prepared by FISCO from the Company's financial results

Income statement

(¥mn)

	FY3/15 full year	FY3/16 full year	FY3/17 full year	FY3/18 full year	FY3/19	
					3Q cumulative	Full year (E)
Net sales	4,336	4,660	4,775	5,044	3,706	5,546
YoY	-4.2%	7.5%	2.5%	5.6%	-2.9%	9.9%
Gross profit	1,649	1,769	1,548	1,449	1,115	-
Gross profit margin	38.0%	38.0%	32.4%	28.7%	30.1%	-
SG&A expenses	1,090	1,140	1,141	895	722	-
SG&A margin	25.1%	24.5%	23.9%	17.7%	19.5%	-
Operating profit	559	628	407	554	393	508
YoY	8.7%	12.5%	-35.2%	36.1%	-6.3%	-8.4%
Operating profit margin	12.9%	13.5%	8.5%	11.0%	10.6%	9.2%
Recurring profit	562	628	401	582	466	560
YoY	8.9%	11.9%	-36.1%	44.9%	4.3%	-3.8%
Profit attributable to owners of parent	330	420	285	411	332	393
YoY	5.0%	27.3%	-32.1%	44.1%	8.6%	-4.5%
EPS after adjustment for share split (¥)	55.27	78.66	55.32	79.73	64.38	76.14
BPS after adjustment for share split (¥)	197.18	196.74	227.30	283.36	-	-
Dividend after adjustment for share split (¥)	17.00	24.00	24.00	28.00	-	-

Note: The Company transitioned to consolidated results from FY3/19 2Q, so the YoY growth rates are reference values
Source: Prepared by FISCO from the Company's financial results

Balance sheet

(¥mn)

	As of March 31, 2015	As of March 31, 2016	As of March 31, 2017	As of March 31, 2018	As of December 31, 2018
Current assets	2,797	3,058	3,012	3,568	4,736
Cash and deposits	2,155	2,385	2,312	2,778	3,942
Accounts receivable	528	553	575	604	660
Fixed assets	511	447	480	411	709
Tangible fixed assets	100	82	129	106	119
Intangible fixed assets	116	108	103	74	62
Investments & other	293	256	247	230	526
Total assets	3,308	3,505	3,492	3,979	5,445
Current liabilities	2,098	2,471	2,296	2,490	2,768
Accounts payable	180	173	190	226	245
Short-term borrowings	102	324	-	-	-
Deposits held	1,393	1,559	1,740	1,853	2,314
Fixed liabilities	40	18	22	26	1,025
Long-term borrowings	24	-	-	-	999
Shareholders' equity	1,162	1,012	1,173	1,461	1,649
Paid-in capital	523	523	523	523	523
Capital surplus	539	539	539	539	-
Retained profits	2,439	2,759	2,921	3,209	1,126
Treasury stock	-2,339	-2,810	-2,810	-2,810	-0
Accumulated other comprehensive income	6	3	-0	0	1
Stock subscription rights	1	-	-	-	-
Net assets	1,170	1,015	1,173	1,462	1,650
Total net assets & liabilities	3,308	3,505	3,492	3,979	5,445

Note: transitioned to consolidated results from FY3/19 2Q
Source: Prepared by FISCO from the Company's financial results

Shareholder returns

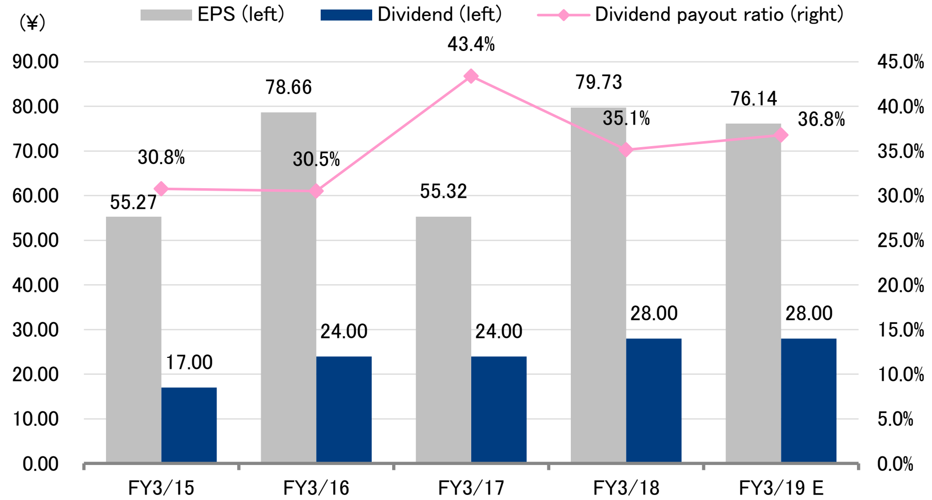
Paid a dividend of ¥28 in FY3/18.
Plans to announce the FY3/19 dividend after the results announcement

The Company basically returns profits to shareholders through dividends. It pays dividends after taking into account a comprehensive range of factors, including business results, financial position, and the need to retain sufficient internal reserves to invest in growth. While it does not formulate an official dividend payout ratio, the foundation of Estore's thinking on the distribution of profits is its basic philosophy of "dividing profits between three groups; shareholders, customers, and staff." In the past also, it has a track record of determining the dividend based on this basic philosophy.

For FY3/18, the Company increased the dividend by ¥4 YoY to ¥28. It would seem that this reflects the high rates of increase, of around 40%, for each of the profit items from operating profit down. The dividend payout ratio was 35.1%. The Company has not decided on a dividend forecast for FY3/19, which is the same as in the past. In a typical year, it decides and announces its dividend forecast at the stage when the full fiscal year results are basically determined, and it would seem it will do the same in this fiscal year also.

Based on the FY3/19 Company forecasts, the consolidated earnings per share is provisionally calculated to be ¥76.14. Assuming that the dividend for this fiscal period will be ¥28, the same as in the previous period, the dividend payout ratio based on this will be 36.8%, and it can be said that the above-mentioned "dividing profits between three groups;" is being sufficiently achieved. As previously explained, it is possible that profits will be above forecast in FY3/19, but it should be noted that this was not the Company's intention.

Trends in EPS, dividend per share, and dividend payout ratio



Note: created assuming that the FY3/19 dividend will be the same as in the previous fiscal year.
Source: Prepared by FISCO from the Company's financial results

Information security

Steadily accumulating a track record of acquiring external certification in order to secure reliability

Based on its in-house development of various systems for EC support, the Company is constantly aware of constructing systems with high levels of security. Meanwhile, it has in place a system of checks by third parties for the level of security of its in-house systems.

The Company also provides a credit card payment service within its EC support ASP service. As it functions as a payment-receipt agency for this service, it holds consumers' credit card information. To ensure the security of this information, it has achieved the "PCI DSS" global security standard, which was jointly established by five international credit card companies and is operated and managed by PCI SSC and acquired the certification for it (the Company is a member of the Japan Card Data Security Consortium, which is the group managing PCI DSS in Japan).

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