COMPANY RESEARCH AND ANALYSIS REPORT

Syuppin Co., Ltd.

3179

Tokyo Stock Exchange First Section

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Summary

Completed the personal recommendations feature that serves as the core marketing measure
Aims for revenue increase by invigorating its customer base, combined with a sales-expanding platform

Syuppin Co., Ltd. <3179> (hereafter, also "the Company") is an e-commerce (EC) enterprise specializing in "valuable items," such as cameras and luxury watches. Making the most of the different customer needs and product characteristics of used and new goods, it has succeeded in creating a virtuous cycle in which both used and new goods reinforce each other to increase sales of both types of goods. In the process, the Company has been rapidly expanding the scale of its business.

1. Posted an increase in sales, but a decrease in profits in 1H FY3/19, impacted by buyer hesitation for cameras

The Company posted an increase in sales, with ¥16,362mn in net sales (+13.4% YoY), and a decrease in profits, with ¥682mn in operating income (-7.4% YoY) in 1H FY3/19. Comparing with the initial forecast, although net sales proceeded according to planned figures, operating income fell below planned figures by 16.2% (¥131mn). We at FISCO believe these results do not warrant disappointment or concern. The primary factor in operating income falling short of planned figures in 1H FY3/19 was the implementation of various measures to boost sales for used cameras, amid buyer hesitation for cameras in general. This factor caused a decline in the profit margin for used cameras. With clarification and removal of this factor, the margin can be expected to improve. The watches business experienced significant growth in 1H FY3/19, which offset stagnation in the cameras business. We believe this point should be further evaluated.

2. With completion of a platform and personal recommendations function, the system for sales expansion is ready to move forward

The Company has undertaken measures towards one-to-one marketing for a number of years, and completed the final stage of Phase 3.0 (personal recommendations) by FY3/18. A platform that utilizes SNS and blogs to attract and retain customers has been completed; from FY3/19, the Company is placing its focus on achieving higher sales and invigorating its customer base on the platform by fully utilizing personal recommendations. The Company is also undertaking merchandising reforms as its Phase 4.0 strategy in FY3/19, aiming for business efficiency and improving profit margins. Through these policies, the Company is able to sufficiently address net sales with a scale of up to ¥50bn. The Company has posted targets for net sales of ¥47,053mn, an operating income of ¥2,860mn in FY3/21 in the current medium-term business plan, but the above achievements were taken into consideration.

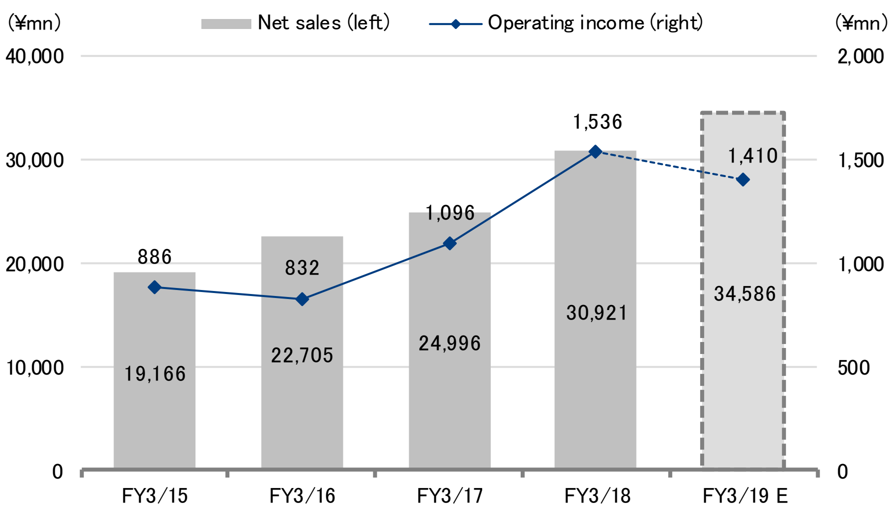
3. The forecast has been downwardly revised. The primary cause is temporary; purchase of new camera models was delayed due to buyer concerns about interchangeable lenses

The Company downwardly revised the FY3/19 forecast. The new forecast calls for an increase in sales and a decrease in profits, with ¥34,586mn (+11.9% YoY) in net sales and ¥1,410mn (-8.3% YoY) in operating income. The reason for the downward revision is that sales for new camera products did not recover in the 3Q main demand period (October – December) as anticipated. Two major camera manufacturers launched sales for new full-frame mirrorless camera models in October and November; as 2Q experienced buyer hesitation, it was expected that consumers would buy these new models in 3Q. However, the interchangeable lens lineup was lacking for the new models, which made camera enthusiasts hesitant in buying the new cameras in that period. As this particular factor will be resolved going forward, we believe that purchase of the new models will steadily proceed. This is due to the spread on SNS and other venues of remedies such as using a mount adaptor for existing lenses or the benefits of downsizing and minimizing. Once buyer concerns regarding interchangeable lenses are dispelled, we expect the purchase of the new models to follow past patterns. Under the above conditions, we take the view that this downward revision is due to a temporary factor and not an issue with the Company's structure, and therefore does not warrant too much concern.

Key Points

- Concluded Phase 3.0 with completion of a platform for the purpose of expanding sales
- Undertaking automation of sales prices for the buying and selling of used products as the strategy for Phase 4.0 in FY3/19
- Aiming for around 15% growth in net sales, and 20% annual growth in ordinary income with the completion of a sales-expanding platform

Results trends



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

Results trends

Increase in sales, decrease in profits posted. Cameras business is sluggish due to buyer hesitation ahead of new product launches

1. Overview of 1H FY3/19 results

The Company posted an increase in sales and a decrease in profits in 1H FY3/19, with ¥16,362mn in net sales (+13.4% YoY), ¥682mn in operating income (-7.4%), ¥679mn (-7.0%) in ordinary income, and ¥462mn (-8.1%) in net income.

Net sales proceeded according to initially planned figures, but operating income fell below initial figures by 16.2% (¥131mn).

1H FY3/19 results summary

(¥mn)

	FY3/18			FY3/19			
	1H result	2H result	Full-year result	1H forecast	1H result	YoY	Vs initial forecast
Net sales	14,435	16,486	30,921	16,366	16,362	13.4%	-0.0%
Gross profit	2,418	2,686	5,105	-	2,674	10.6%	-
SG&A expenses	1,681	1,886	3,568	-	1,992	18.5%	-
Operating income	736	800	1,536	814	682	-7.4%	-16.2%
Operating margin	5.1%	4.9%	5.0%	5.0%	4.2%	-	-
Ordinary income	730	790	1,521	809	679	-7.0%	-16.1%
Net income	503	574	1,077	549	462	-8.1%	-15.8%

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

Net sales grew 13.4% YoY (¥1,927mn). Sales growth was suspended at 9.6% (¥976mn) in mainstay cameras, but watches rose 25.3% (¥965mn), achieving close to 15% growth. Gross profit increased 10.6% to ¥256mn. Gross margin slightly decreased YoY from 16.8% to 16.3% in 1H FY3/19. The decline can be attributed to a change in product mix from sluggish sales in the high-margin cameras business and higher sales in watches, which has a much lower margin than cameras. Meanwhile, an increase in products in the Company's lineup and sales campaigns in order to attract new customers also contributed as primary factors.

SG&A expenses increased 18.5% YoY (¥310mn), and the ratio of SG&A expenses to net sales rose from 11.7% YoY to 12.2% in 1H FY3/19. This was due to expanded promotions as part of measures to increase sales of cameras, such as actively distributing point rewards and discount coupons. As a result, operating income was ¥682mn, a decrease of 7.4% by ¥54mn YoY.

Breakdown of SG&A expenses

(¥mn)

	FY3/18					FY3/19		
	1H	2H	Full year	YoY	Ratio to net sales	1H	YoY	Ratio to net sales
Personnel expenses	532	616	1,148	66	3.7%	550	18	3.4%
Advertising expenses	26	27	53	-9	0.2%	26	0	0.2%
Sales promotion expenses	270	275	545	144	1.8%	360	90	2.2%
Outsourcing expenses	76	91	167	36	0.5%	97	20	0.6%
Commissions paid	352	395	747	120	2.4%	410	58	2.5%
Depreciation and amortization	94	101	195	-1	0.6%	106	11	0.6%
Land rent	105	113	218	7	0.7%	131	25	0.8%
Other	224	268	492	99	1.6%	309	84	1.9%
SG&A expenses	1,681	1,887	3,568	462	11.5%	1,992	310	12.2%

Source: Prepared by FISCO from the Company's results briefing materials

In 2Q (July to September), Nikon <7731> and Canon <7751>, the companies which split the single-lens reflex camera (SLR) market, announced launch of sales for new mirrorless lens camera models in autumn 2018. The announcement caused buyer restraint for SLR cameras, and net sales stagnated for newer products. The Company focused on securing sales volumes for used cameras, and conducted sales for used cameras according to plan. Consequently, although sales in the overall cameras business secured an increase year on year, it trended downward in terms of planned figures. The shortfall was compensated by increased sales in watches, and the Company reported company-wide net sales were still in line with the initial forecast.

In terms of profits, the Company conducted active sales promotion measures so that used camera sales would compensate for the impact of buyer hesitation for new camera products. More specifically, the Company actively implemented distribution of point rewards and redeemable coupons that can be used when making a purchase. As a result, operating income declined in the cameras business and fell short of planned figures, despite securing higher profits year on year. On the other hand, watch sales exceeded planned figures and covered the shortfall amount in cameras, allowing the Company to report as proceeding in line with the plan. As with cameras, sales promotion expenses suppressed the profit growth. Subsequently, the shortfall amount in cameras remained on the basis of a company-wide shortfall.

Key indicators such as sales channel distribution ratio, used products ratio, and used camera purchase value progressed steadily

2. KPI trends

(1) Trends in net sales by sales channel, by new products and used products

By sales channel, e-commerce sales for 1H FY3/19 rose 15.6% YoY to ¥10,264mn. Steady increases in sales for mainstay cameras and watches contributed to these results. The ratio of EC net sales to company-wide sales, rose from 61.5% YoY to 62.7%.

In e-commerce sales, cross-border e-commerce was ¥160mn for 1H FY3/19. Cross-border e-commerce was launched in 2H FY3/18, with a store opened on the eBay e-commerce mall site in the United States, selling products geared towards North America. At present, the eBay store sells only cameras, and as of September 2018, it is firmly expanding with monthly sales exceeding ¥30mn.

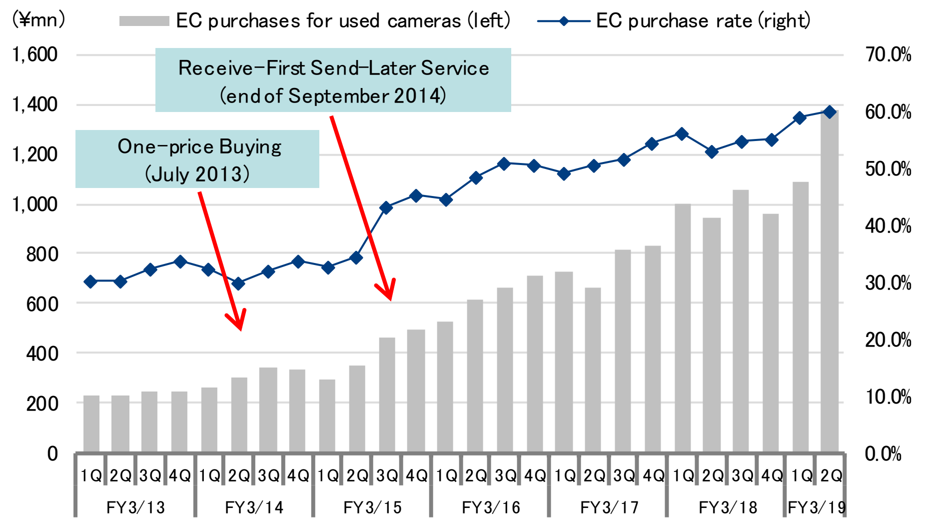
As for new products and used products, the used product ratio rose in 1H FY3/19 compared to the previous period. 1Q was 46.4%, and 2Q (July to September) was 48.2%, higher than the year prior. The reason was that sales of new products did not increase due to buyer hesitation in the cameras business, and the Company focused on used products to compensate for that shortfall. Normally, the used product profit margin is higher than new products, however the profit margin is seen to have declined further than usual in 1H FY3/19 due to intentional expansion of used products given the above circumstances.

Tax-exempt net sales, which represent inbound demand, significantly increased 35.4% YoY to ¥1,747mn in 1H FY3/19. The Company cautiously estimated around ¥100-150mn in monthly inbound sales in its earnings forecast, however these sales are gradually returning from a bottom in 1H FY3/17. By product, watches are forecast to account for more than half of inbound sales.

(2) Status of used camera purchases

The purchase of used cameras continued to firmly expand, rising 26.8% YoY to ¥2,462mn in 1H FY3/19. Purchases greatly increased as a result of the Company enlarging its own distribution space, the effect of buyer hesitation for new cameras, and the active purchase of used cameras. On the purchase route, the Company's promotion of EC purchases steadily raised the distribution ratio, reaching 60.2% in 2Q FY3/19 (July to September).

Trends in used product EC purchases for cameras business



Source: Prepared by FISCO from the Company's results briefing materials

Sluggish sales in the cameras business covered by substantial growth in the watches business

3. Trends by business segment

Sales and operating income by business segment

(¥mn)

		FY3/17		FY3/18		FY3/19	
		1H	YoY	1H	YoY	1H	YoY
Cameras	EC	5,660	23.7%	7,140	26.2%	8,276	15.9%
	Stores	2,523	-25.9%	2,998	18.8%	2,838	-5.3%
	Total net sales	8,184	2.5%	10,138	23.9%	11,114	9.6%
	Segment operating income	640	7.8%	821	28.3%	855	4.1%
	Operating margin	7.8%	-	8.1%	-	7.7%	-
Watches	EC	1,093	34.1%	1,397	27.8%	1,645	17.7%
	Stores	1,475	-15.5%	2,422	64.2%	3,140	29.6%
	Total net sales	2,569	0.3%	3,820	48.7%	4,785	25.3%
	Segment operating income	104	-15.7%	228	118.9%	250	9.5%
	Operating margin	4.1%	-	6.0%	-	5.2%	-
Stationery	EC	163	17.7%	195	19.5%	165	-15.4%
	Stores	77	2.7%	85	10.9%	70	-17.5%
	Total net sales	240	12.4%	281	16.7%	236	-16.0%
	Segment operating income	24	0.1%	22	-10.0%	1	-94.5%
	Operating margin	10.3%	-	7.9%	-	0.5%	-
Bicycles	EC	124	-1.6%	144	15.9%	177	23.1%
	Stores	42	-43.2%	50	17.6%	48	-3.9%
	Total net sales	167	-17.2%	194	16.4%	225	16.1%
	Segment operating income	-5	-	-0	-	-5	-
	Operating margin	-3.1%	-	-0.4%	-	-2.4%	-
Company-wide	EC	7,041	24.5%	8,877	26.1%	10,264	15.6%
	Stores	4,119	-22.3%	5,557	34.9%	6,098	9.7%
	Total net sales	11,161	1.8%	14,435	29.3%	16,362	13.4%
	Operating income	472	9.1%	736	55.8%	682	-7.4%
	Operating margin	4.2%	-	5.1%	-	4.2%	-

Source: Prepared by FISCO from the Company's results briefing materials

(1) Cameras business

The cameras business posted higher sales and profits, with net sales at ¥11,114mn (+9.6% YoY) and operating income at ¥855mn (+4.1%) in 1H FY3/19. Operating margin fell from 8.1% a year ago to 7.7%. Nikon and Canon, the companies which split the single-lens reflex camera (SLR) market, announced during 1H FY3/19 they would launch sales for new mirrorless lens camera models in autumn 2018, thus sales for new cameras decelerated in this period due to buyer hesitation. Both companies changed the lens mount for the new models, which impacted not only the camera itself, but lens assets as well and caused concern among buyers. Thus the Company concentrated on increasing sales for used cameras due to the need to turn over inventory and maintain its top position in the used camera market. As a result, the Company achieved its sales volume target for used cameras. However, the Company was unable to fill out the deceleration for new camera sales and the growth rate stagnated at single-digit growth, along with the profit margin declining due to the impact of activities such as sales campaign.

(2) Watches business

The watches business posted higher sales and profits, with net sales at ¥4,785mn (+25.3% YoY) and operating income at ¥250mn (+9.5%) in 1H FY3/19. Operating margin was 5.2%, a decline from 6.0% in the previous year. The Company focused on expanding the quantity of its watch inventory and building a competitive lineup with successful results, which linked to an increase in sales. Inbound sales from stores also progressed favorably, as watches account for three-fourths of inbound sales. In July 2018, videos explaining design and product movement were posted on each details page for all used products on the website. Videos were also posted on YouTube, which enabled customers to more accurately understand product quality and tied in to increased EC sales. In earnings, profit margin fell due to the impact from sales campaigns to increase market share, attracting new customers, and bolstering e-commerce, and the growth rate stagnated a single-digit level. Despite the profit margin decline, net sales exceeded 25% YoY, which can be evaluated as achieving the expected targets.

(3) Stationery business

The stationary business posted lower sales and profits, with net sales at ¥236mn (-16.0% YoY) and operating income at ¥1mn (-94.5%) in 1H FY3/19. In net sales, the Company implemented measures to strengthen the EC site's features, created products in collaborations with manufacturers, and strengthened warranties, but did not experience a recovery in customer numbers or transactions per customer. Sales were also affected by a reduction in used products. In earnings, the Company incurred temporary costs for store renovations in September 2018 in addition to lower sales, leading to the substantial decline in profits.

(4) Bicycles business

The bicycles business posted sales growth but also a large operating loss, with net sales at ¥225mn (+16.1% YoY) and operating loss at ¥5mn (¥0.7mn a year ago). Store sales leveled off, while EC sales steadily expanded due to the effects of strengthening the EC website and setting up a Yahoo! store. Sales were slow for used high-end complete bicycle units. In earnings, the business could not cater to preceding costs for boosting sales, thus the operating loss widened.

Measures for medium- to long-term growth and updates

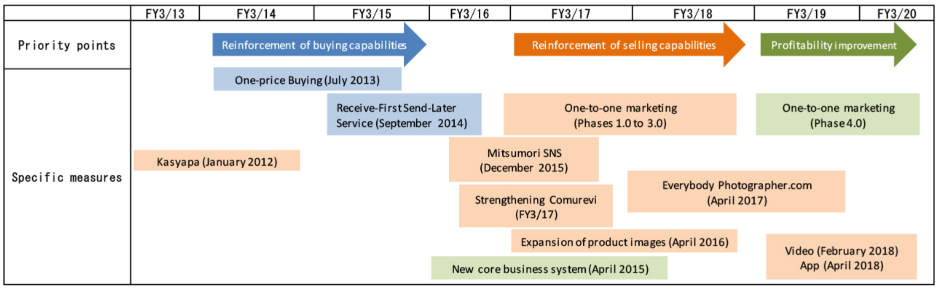
The Company continuously implements effective measures to leverage the business model of specialization in e-commerce; it completed the framework for income expansion through FY3/18

1. Trends in growth initiatives

We see the following three features and strengths in Syuppin's business model; as a reuse business operator, the Company narrows down its scope to products considered as having value, it limits real stores to the utmost extent by utilizing an e-commerce model, and it seeks growth through expanding its sales of both used products and new products. We also evaluate the Company as carefully selecting products and having a business model that has been refined logically and with high precision, taking into account the shift from brick-and-mortar retail to e-commerce.

In addition, the Company undertook creation of a mechanism to achieve medium- to long-term growth that utilizes the strengths of its business model to the utmost extent; it has been steadily and systematically implementing this mechanism over a number of years. We at FISCO believe this demonstrates the high quality of the management capabilities of the administrative team, and that this point serves as a fourth feature of the Company.

Trends in initiatives aimed at driving Syuppin growth



Source: Prepared by FISCO from the Company's materials

The Company began with reinforcement of one-price buying and receive-first, send-later service. When referring to this in terms of utilizing used products as a catalyst for new product sales in the Company model, it is an incredibly reasonable and important measure. Unlike new products, purchasing for used products is unstable; in order to maintaining the Company's business model, it must first establish a mechanism to stabilize purchasing for used products.

The Company then changed course to increasing sales and quickly rolling out a variety of measures. It focused on and leveraged consumer generated media (CGM) marketing at an early stage, which fit well with the e-commerce business model. Some examples are its launches of Mitsumori SNS and Comurevi. It also adopted high-resolution images and significantly expanded the number of product images, a vital component of e-commerce. It revamped the core system to enhance business efficiency as well as a behind-the-scenes initiative. Since FY3/17, the Company has worked on reinforcement of marketing to individuals and built operations that involve it in all aspects of the consumption behavior cycle of its customers.

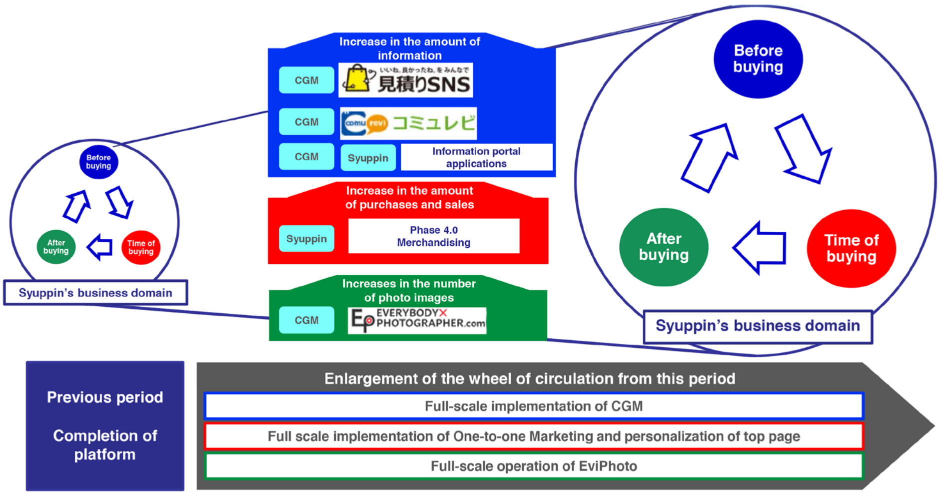
Phase 3.0 for one-to-one marketing concluded; sales-expanding platform completed

2. Creation of a mechanism for expanding sales

In both FY3/17 and FY3/18, the Company focused on creating a mechanism to expand sales. The mechanism was created with a platform to attract and immerse customers, and one-to-one marketing to boost the activity of customers. It was completed by FY3/18, and the Company is ready to proceed further with profit expansion.

The Company's platform as a whole and its intentions are encompassed in the diagram. The diagram was created with the cameras business in mind as the business with the highest sales composition ratio, however the basic approach is the same for watches and other assets.

Image of expanding income through completion of the platform

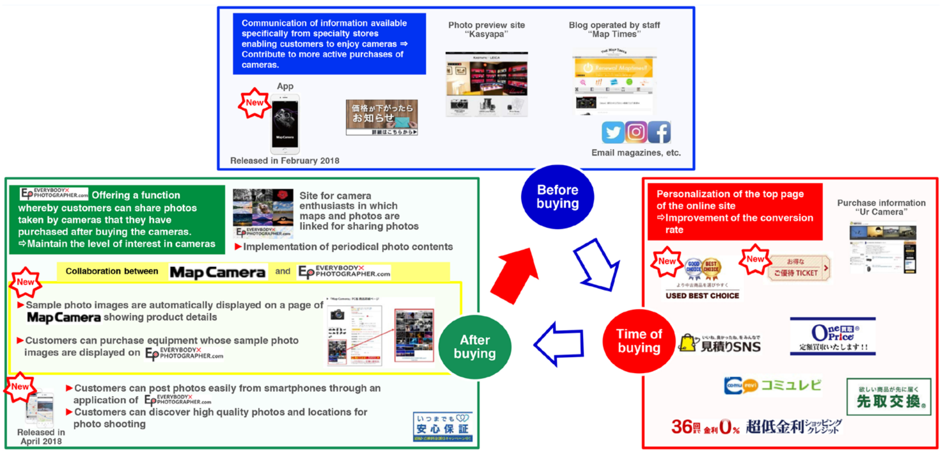


Source: From the Company's results briefing materials

(1) The platform

The Company separates customer actions into three stages: before purchase, during purchase, and after purchase. The Company undertook efforts to figure out what to do at each stage to attract and immerse customers. For the "before purchase" stage, the Company introduced blogs that are useful for customers when choosing a product model, such as the Map Times staff blog and the Kasyapa photo preview site. For the "during purchase" stage, it introduced high-quality review information, such as Comurevi, Mitsumori SNS, trade-ins, and the receive-first send-later service. For the "after purchase" stage, the Company launched EVERYBODY x PHOTOGRAPHER.com (shortened as "EveryPhoto") as a place for users to upload and enjoy photos they took with their cameras. With EveryPhoto, users can also become motivated by other users and receive new information, which stimulates their desire to purchase new cameras or interchangeable lenses and ties in to the next transaction. The point of the platform is to create a continuous consumer action cycle that begins and ends with "before purchase," instead of a linear line ending after the purchase. The platform also generates a "Syuppin trade area" with these cyclical actions in order to retain customers.

Platform related to the camera purchase cycle



Source: From the Company's results briefing materials

(2) One-to-one marketing

It is difficult to simply tie profit increase to a platform with the launch of EveryPhoto. Thus the Company also introduced a personal recommendations feature to boost the activity of customers who have been drawn in and immersed in the platform. The feature reads into what customers want through their actions when interacting on the platform, and recommends products and auxiliary products matched to what the customer wants. The Company calls this "one-to-one marketing," focusing on implementing recommendations that directly address the customer's needs. The ultimate goal was the personal recommendations feature, but the Company believed it would not be possible to realize it in one single leap. Thus it gradually introduced measures as "group targets" as Phase 1.0 (customer grouping that uses past transaction data as a base), "personal requests" as Phase 2.0 (providing price change and inventory information for products added to a customer's wish list), and finally "personal recommendations" as Phase 3.0, which was completed in FY3/18. These phases give a clear account of the Company's previously mentioned management accuracy and carefulness in how it would proceed. The initiatives going forward for Phase 4.0 are described below.

Overview of one-to-one marketing

FY03/17		FY03/18	FY03/19
Phase 1.0 Groupings of targets	Phase 2.0 Personal requests	Phase 3.0 Personal recommendations	Phase 4.0 Merchandising
Customers are grouped based on big data related to transaction histories. Information on events is sent by e-mail to the groups in accordance with their needs.	Syuppin responds to customers' obvious needs. Syuppin sends them information on products on their wish list, including changes in prices and product arrivals.	Syuppin will respond to customers' potential needs. Syuppin will send information on related products and will recommend popular products to help customers find what they want more easily.	**Syuppin checks the balance between supply and demand, and automates operations for timely purchase and sale price settings. If any item is out of stock, it facilitates purchases by sending a notice of purchase to customers who have such an item.**
Syuppin can send information that customers need instead of e-mailing, without any specific reasons, information in which customers are not very interested. Syuppin can **negotiate with manufacturers and strengthen purchases effectively.**	Syuppin do not need to conduct excessive sales. When Syuppin purchase products, Syuppin can **set fair transaction prices**, taking supply and demand relationships into consideration.	Syuppin will display products in accordance with each customer's priority to **raise the "conversion ratio."**	**Syuppin will be able to create transaction opportunities and increase the amount of transactions because prices can be automatically controlled to generate appropriate margins.**

Source: The Company's results briefing materials

(3) Effects of the sales-expanding platform

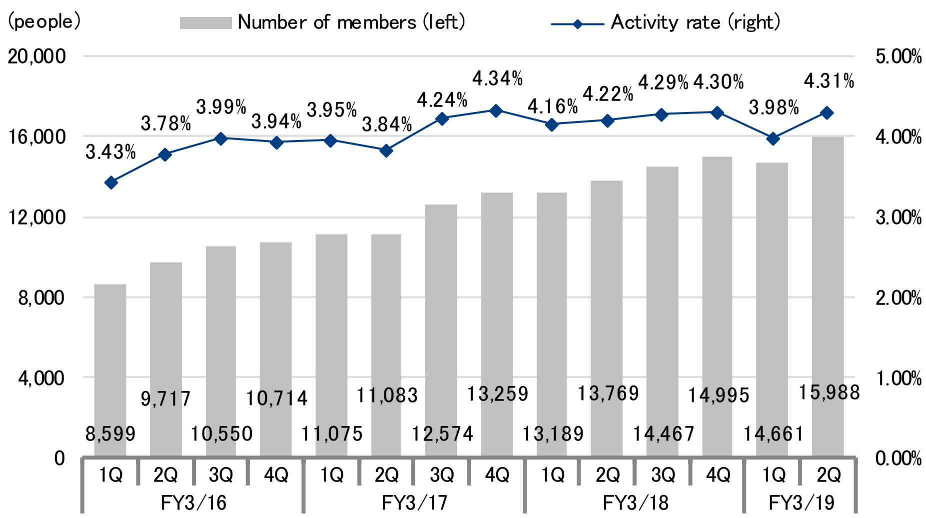
The Company's KPI is changing with completion of the sales-expanding platform (including one-to-one marketing in a broader sense). The details for each KPI are listed below, with the important points being that each KPI is progressing as expected, and the connotations they have as leading indicators suggest many future trends.

a) Member numbers and activity rate

Customers who complete registration on the Company's websites are designated as "members," and once registered as members, they fundamentally maintain that status. Therefore "an increase in member numbers" means the added portion of new members who made purchases on the websites (new members). The level of importance for increasing new members has not changed, but the Company is currently undertaking initiatives to enable existing site members to become more active. The aforementioned sales-expanding platform is the mechanism that serves that purpose. The reason for the Company's focus on active existing members is higher efficiency. As of the end of September 2018, there are 382,760 members. Members are increasing at a pace of 3,000 per month, but the actual increase is less than 10% per year. On the other hand, if existing and active members increased their purchases by one, the Company could record a 30% increase in sales.

From this perspective, the Company is featuring member numbers and the activity rate as indicators. Member numbers refer to those who made a purchase on the Company's own websites in each quarter excluding new members, and those members who actively make purchases within the existing member group. The activity rate is the ratio of active members in that quarter against the number of members at the start of each quarter. When looking at these trends, the number of members on the websites is is clearly growing. While a denominator of member numbers themselves increasing is not as clear as member numbers, it can still be read that the number of members along the trend line is slowly growing.

Trends in m and active rate

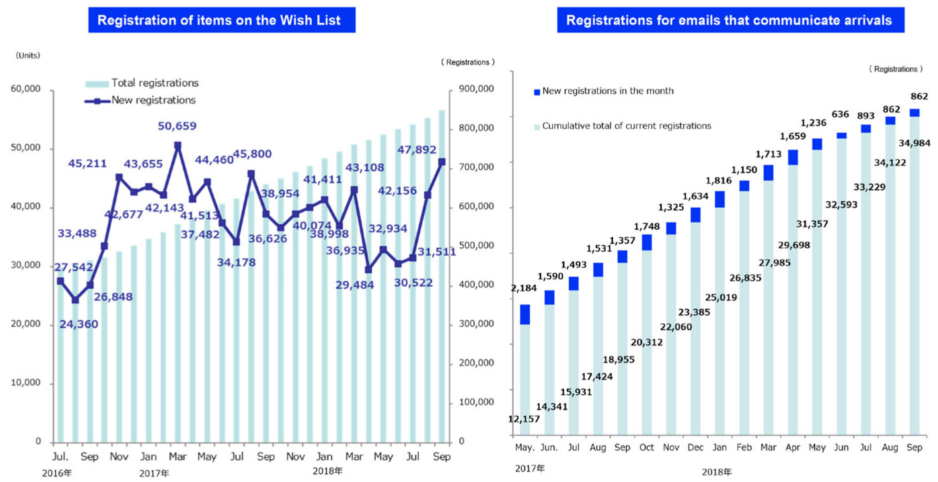


Note 1: "Number of members" = number of members who made a purchase on the Company's websites each quarter, excluding newly registered members
Note 2: "Activity rate" = number of active members ÷ number of members at the start of each quarter
Source: Prepared by FISCO from the Company's results briefing materials

b) Number of subscribers for wish list and now-in-stock notification emails

Main contributors to lifting the activity rate are product registrations to the "wish list" and registrations for a "now-in-stock notification email." While the wish list fluctuates because of removals from the list when purchases are made, it stably holds at about 40,000 people. The number of registrants for now-in-stock notification email is steadily climbing by about 1,500 people per month. Both the wish list and now-in-stock notification email are indicators of interest in buying by existing members. Provision of relevant final-push information (price changes, etc.) helps raise the conversion rate.

Wish list and now-in-stock notification email registrations



Source: The Company's results briefing materials

Undertaking initiatives to reinforce buying capabilities as part of one-to-one marketing in Phase 4.0

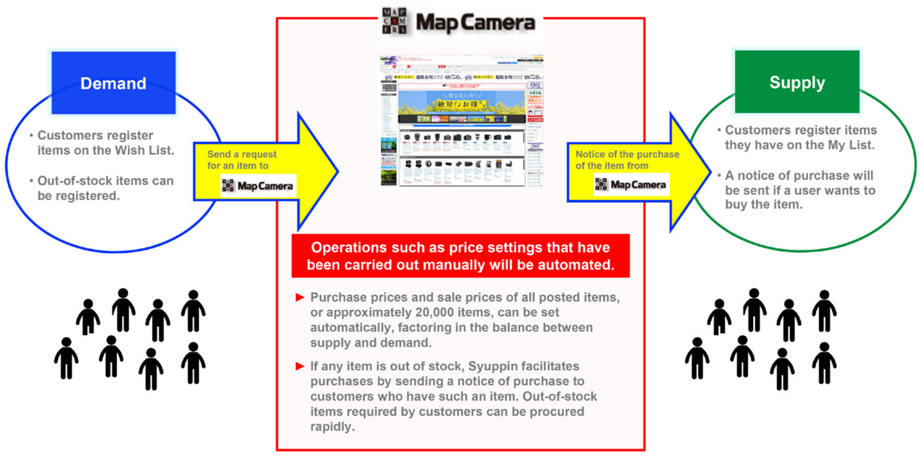
3. Strengthen merchandising as an initiative going forward

In FY3/19, the Company is undertaking initiatives to strengthen its merchandising. As stated previously, it is proceeding with one-to-one marketing and has completed up to Phase 3.0. The initiative for Phase 1.0 to Phase 3.0 was to expand sales, but 4.0 as the final phase seeks to strengthen both merchandising and buying capabilities.

As for buying, the Company is currently realizing the strengthening of the introduced "trade-ins" and "receive-first, send-later" measures. However, what it wants to accomplish with the strengthening of merchandising is automation of duties that will change buying and selling prices while monitoring the supply-demand balance--a task that was performed by human staff until now. The Company handles around 20,000 items, so it cannot be said to be efficient to have such tasks constantly maintained by human employees. We at FISCO believe this is one big turning point in undertaking operations to improve these tasks.

Phase 4.0 consists of background measures designed to improve business efficiency. The reason why it is included in one-to-one marketing is because it utilizes information gained from measures in Phase 1.0 to 3.0 in order to achieve results in Phase 4.0. For instance, in striving for appropriate pricing to achieve results for Phase 4.0 there is need of a mechanism that not only utilizes the flow of logistics on the Company's system, but also uses the status of registrations for customer wish lists and now-in-stock notification emails. Because the Company has information on potential buyers and sellers, and has accumulated data for market price and transaction results, that information can be fully utilized as buying capability that matches both sellers and buyers. The mechanism to put that into practice is Phase 4.0 itself. We at FISCO believe the Company can seize upon its high quality management capabilities in designing the method to build such a mechanism, as well as strengthening the balance between the front and back ends of its business operations.

One-to-one marketing



Source: The Company's results briefing materials

The automation of tasks as the focus of Phase 4.0 is being implemented for price setting (both purchase price and selling price). As the Company's business operations expand, commercialization of used products is a key component. The process for commercializing used items starts with the purchase price setting. In addition to inspecting the product after purchasing (checking the condition, accessories, etc.), an item is graded and priced, then cleaned and photographed before being lined up in an online store. Within this process, the most important aspect is price setting. By automating this part, even if the number of items increases in the future, it will be possible to prevent opportunity loss. Effects can be expected in each stage of the profit and loss statement. The reduction of opportunity loss means expansion of sales, and speeding up the price setting stage can be expected to lead to results, such as raising the turnover rate, as well as the gross margin through appropriate price setting.

Outlook

With the sales slump for new cameras, the outlook for FY3/19 was downwardly revised
The issue revolving around interchangeable lenses as the reason for the slump is temporary, and thus no cause for concern

The Company announced it has downwardly revised its performance forecast for FY3/19 on January 8, 2019. Instead of higher sales and profits, it now forecasts a decrease in profits, with net sales at ¥34,586mn (+11.9% YoY), operating income at ¥1,410mn (-8.3%), ordinary income at ¥1,400mn (-8.0%), and net income at ¥955mn (-11.4%).

Outlook for FY3/19

(¥mn)

	FY3/18			FY3/19						
	1H result	2H result	Full-year result	1H result	2H forecast	YoY	Initial full-year forecast	Revised full-year forecast	YoY	Vs. initial forecast
Net sales	14,435	16,486	30,921	16,363	18,223	10.5%	35,381	34,586	11.9%	-2.2%
Operating income	736	800	1,536	682	727	-9.0%	1,842	1,410	-8.2%	-23.5%
Operating margin	5.1%	4.9%	5.0%	4.2%	4.0%		5.2%	4.1%		
Ordinary income	730	790	1,521	679	720	-8.8%	1,833	1,400	-8.0%	-23.6%
Net income	503	574	1,077	462	492	-14.2%	1,251	955	-11.4%	-23.7%

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

As for the reason for the downward revision, the Company states the sales slump for new cameras as the primary cause. As stated previously, the mainstay cameras business fell short of planned targets for 1H FY3/19, the main factor being buyer hesitation that pulled down sales ahead of the launches of new camera models scheduled for October to November. Sales for the new models were launched as planned, with all models present at the end of November. Given these circumstances, the Company anticipated that it could recover from the delay in sales in 2Q, and that it could still achieve initial targets. However, due to insufficiencies in the interchangeable lens lineup for the new full-frame mirrorless camera models, purchase of the newer models did not accelerate as expected, and sales figures had to be downwardly revised.

We at FISCO believe there is no need for concern for this downward revision as it falls within the range of expectations. First of all, as clearly stated in the press release for the Company's downward revision, the watches business and used camera sales in the cameras business continued to experience favorable conditions. This suggests there are no changes in terms of the Company's business model or competitive environment.

The miscalculation was in the sales trends for new cameras, but we believe this was within the realm of expectation. The emerging risk factor involved with the announcement of launch of sales for new full-frame mirrorless cameras was that the standard lens mount for both Nikon and Canon had changed from existing SLR cameras. For instance, even if a Nikon SLR camera user bought the company's new full-frame mirrorless camera model, they could not use their own SLR lenses as they are. It is still possible to use the lenses with a mount adaptor, however as they are not "genuine lenses" for the new mirrorless camera models, there were concerns about the potential of functional limitations. Therefore, camera users perceived a risk in purchasing the new models, which became a reality in this case. As a camera specialist company, someone must have been aware of this point. On the other hand, the high functionality, shift to mirrorless, and minimization aspects of the new models meant that sales could be judged as proceeding at the same pace as other upgrade purchases, but this ended up becoming a miscalculation.

Even so, we believe there is a high possibility that purchases of the full-frame mirrorless cameras will gradually proceed. When looking at various websites and message board information for camera enthusiasts, there are daily postings about how using a mount adaptor with existing SLR lenses does not limit the functionality of the camera, and demonstrations of performance as expected. The cameras are also generally receiving high praise as an effect of anyone being able to personally experience minimizing and weight-saving aspects with the shift to mirrorless. Thus we do not see a cause for concern, as the primary factor of this downward revision was that the buyer hesitation seen in 1H 2Q (July to September) was drawn out longer than anticipated, and it appears to be a time issue, not a structural issue.

In earnings, revisions were made to operating income, which was reduced 23.5% (¥432mn) from initial forecasts, or down 8.2% YoY (¥126mn). The primary factors were the aforementioned slowdown in new camera sales and encouragement of new purchases that should have covered the slowdown, strengthening of buying and selling used cameras through implementation of sale campaigns, and an increase in costs to encourage sales such as discount tickets and point rewards, all of which suppressed the profit margin. This composition was the same in 1H FY3/19, and there was no change in the Company's business model or competitiveness. The change to a profit decline year on year was no doubt an unwelcome surprise, but the Company has previously experienced profit decline due to temporary factors, such as increased costs from investment. Significant factors for the profit decline include the fact that FY3/18 results substantially increased 40.1% YoY and that there were greater hurdles for increasing profits in FY3/19.

Although results have been downwardly revised, there are still many points that can be evaluated positively. One is that the Company is posting higher sales. Furthermore, favorable expansion of the watches business continues, steadily solidifying its place as the Company's second pillar of business after the cameras business. When looking at the monthly sales disclosure report for December, there was an increase of 4,251 new site members, exceeding numbers for that month in the previous fiscal year. We believe this indicates that the Company's marketing measures are functioning. In regards to earnings, we believe that securing an operating margin of 4.1% with a 4% base also demonstrates that the Company maintains its low-cost structure and timely and high quality cost control capabilities.

At present, the issue directly facing the Company is quite clear; it is difficult to anticipate when exactly new camera purchases will accelerate. However, that can be seen as an issue that time will resolve. Once the Company begins selling new cameras, excess stocking of used cameras will become unnecessary. Furthermore, this is consistent with FISCO's view that improvements will be made through the promotion of Phase 4.0. We would like to watch these trends going forward.

Income statements

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19	
					1H	Full year (E)
Net sales	19,166	22,705	24,996	30,921	16,362	34,586
YoY	22.8%	18.5%	10.1%	23.7%	13.4%	11.9%
Cameras business	13,758	16,572	18,131	21,937	11,114	-
Watches business	4,680	5,301	6,013	7,974	4,785	-
Stationery business	363	470	511	573	236	-
Bicycles business	363	360	339	436	225	-
Gross profit	3,348	3,729	4,202	5,105	2,674	-
Gross margin	17.5%	16.4%	16.8%	16.5%	16.3%	-
SG&A expenses	2,461	2,897	3,105	3,568	1,992	-
Ratio of SG&A expenses to net sales	12.8%	12.8%	12.4%	11.5%	12.2%	-
Operating income	886	832	1,096	1,536	682	1,410
YoY	26.4%	-6.1%	31.8%	40.1%	-7.4%	-8.3%
Operating margin	4.6%	3.7%	4.4%	5.0%	4.2%	4.1%
Ordinary income	870	821	1,078	1,521	679	1,400
YoY	26.2%	-5.6%	31.3%	41.1%	-7.0%	-8.0%
Net income	563	560	741	1,077	462	955
YoY	44.5%	-0.6%	32.3%	45.4%	-8.1%	-11.4%
After adjustment						
EPS (¥)	23.54	23.41	30.96	45.00	19.32	39.39
DPS (¥)	3.50	4.00	6.00	10.00	0.00	14.00
BPS (¥)	94.83	114.74	141.69	180.68	-	-

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

Balance sheets

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19 2Q
Current assets	4,024	4,905	5,727	7,692	8,428
Cash and deposits	492	506	644	1,268	985
Notes and accounts receivable	917	1,327	1,612	1,851	1,751
Inventories	2,222	2,757	3,209	4,194	5,301
Non-current assets	1,085	1,001	949	1,088	1,256
Property, plant and equipment	159	137	123	136	152
Intangible assets	607	530	468	443	433
Investments and other assets	318	333	356	508	670
Total assets	5,110	5,907	6,676	8,780	9,684
Current liabilities	2,260	2,585	2,954	3,353	4,039
Notes and accounts payable	656	940	823	1,045	1,329
Short-term loans payable, etc.	871	1,215	1,428	1,474	1,956
Non-current liabilities	579	568	322	1,095	1,081
Long-term loans payable, bonds payable	577	568	322	1,095	1,081
Shareholders' equity	2,270	2,746	3,392	4,325	4,558
Capital stock	508	508	508	508	513
Capital surplus	408	408	408	408	413
Retained earnings	1,352	1,829	2,474	3,408	3,631
Treasury shares	-	-	-	-0	-0
Subscription rights to shares	-	6	6	5	5
Total net assets	2,270	2,753	3,399	4,331	4,564
Total liabilities and net assets	5,110	5,907	6,676	8,780	9,684

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

Cash flow statements

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19 1H
Cash flows from operating activities	157	90	388	134	-242
Cash flows from investing activities	-262	-333	-122	-184	-268
Cash flows from financing activities	154	257	-128	675	228
Effect of exchange rate change on cash and cash equivalents	-	-	-	-1	-
Change to cash and deposits	50	14	137	624	-283
Balance of cash and deposits at start of period	441	492	506	644	1,268
Balance of cash and deposits at end of period	492	506	644	1,268	985

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

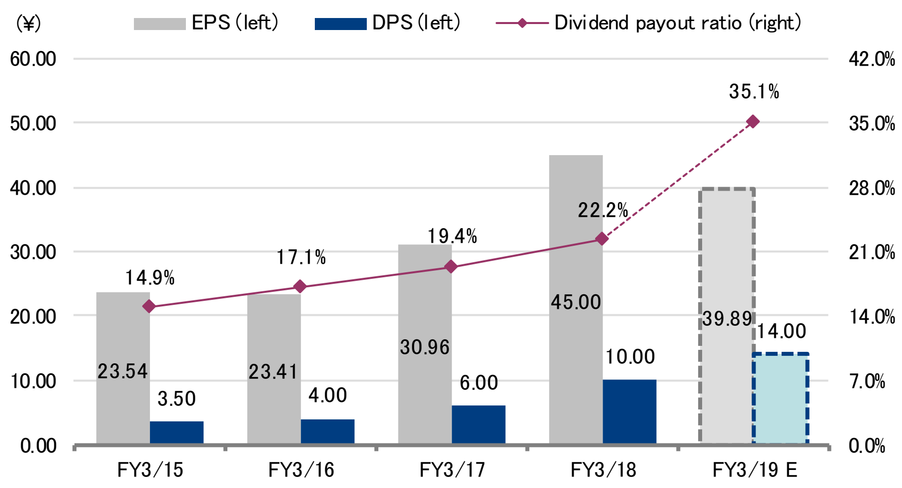
Shareholder returns

Maintains planned dividend of ¥14 (increase of ¥4) for FY3/19

The Company addresses shareholder return as an important management topic and adheres to a core policy of return through dividends. It updated the policy on March 14, 2017. The Company switched from a policy of sustaining stable dividends to setting a target dividend payout ratio and paying dividends accordingly to the ratio from FY3/17. It began with a target ratio range of 20-30% in this change and noted plans to ramp up shareholder returns further in the future.

The Company announced that it is planning for a dividend of ¥14--an increase of ¥4 YoY. As stated previously, the performance forecast was downwardly revised; however there are no changes to the dividend forecast at this point in time. After the revision, it is forecasting an EPS of ¥39.89, and based on this, a payout ratio of 35.1%. The Company may reevaluate dividends at the end of the fiscal period, but as the cause for this performance revision is temporary and not structural in nature, it is possible to maintain the initial forecast as it is.

Income statements



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

Information security

Emphasis on suitable management of security software and maintaining the latest version

The Company is highly sensitive to information security as an EC company that caters to a wide spectrum of individual consumers and with a membership of about 380,000 people. It utilizes an external system to settle transactions using credit card information, the riskiest area, and hence does not possess the data and avoids leak risk. Security software is used to manage general personal information, and the Company focuses on maintaining its security systems in a fresh state through updates and preventing gaps in defenses against new attacks.

Disclaimer