

T-Gaia Corporation3738 Tokyo Stock Exchange First
Section

10-Jun.-16

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at the end of this document.FISCO Ltd. Analyst
Yuzuru Sato

■ Aims to Solidify its Top Position in the Industry by Improving the Competitiveness of Sales Bases and Other Business Segment with Strategic Investments in Shops and Human Resources

T-Gaia (3738) is Japan's leading primary mobile phone distributor, with a market share of approximately 13% for domestic mobile phone sales. The company had 2,155 sales bases as of March 31, 2016, including agents' shops operated by its secondary distributors and smartphone accessory shops. In addition, T-Gaia runs solutions business for corporate clients and prepaid settlement service business involving electronic money.

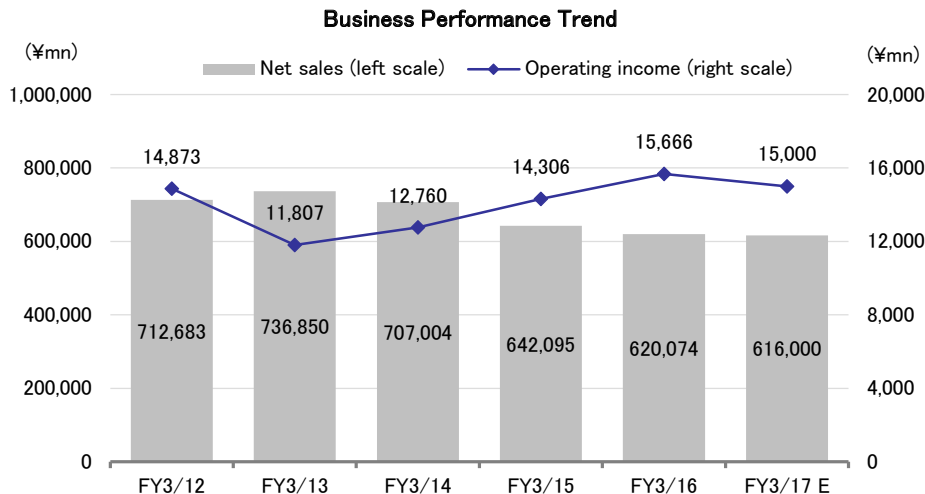
T-Gaia posted consolidated financial results for FY3/16 with a 3.4% decrease year on year in net sales to ¥620,074mn and a 9.5% increase in operating income to ¥15,666mn. Sales fell because of a decline in sales volume of mobile phones and other devices of 430,000 units year on year to 4.69mn units owing to pullback of excessive sales competition and sluggish sales of new models and a change in product composition for the Settlement Services Business. Operating income, meanwhile, exceeded guidance and reached an all-time high thanks to robust sales of accessories and other related merchandise and tablets, increases in gross income per unit and per customer, and efforts to improve companywide business efficiency and productivity.

T-Gaia guides for a 0.7% decrease year on year in net sales to ¥616,000mn and a 4.3% decrease in operating income to ¥15,000mn in FY3/17. It expects a decline in sales volume of mobile phones and other devices of 150,000 units year on year, but aims to expand sales of tablets and smartphone-related merchandise. T-Gaia intends to broaden the product line-up, including audio accessories, MVNO items, and IoT devices and other peripheral devices at accessory shops, which continue to perform well, and increase the shop network from 13 shops at the end of FY3/16. We forecast tougher competition in the sales' agent industry amid dramatic changes that taking place in the business environment for the communications industry, including the mobile phone market, but T-Gaia plans to strengthen the competitiveness of its sales bases and other sites and solidify its top position in the industry by aggressively making strategic investments in sales bases and people. It also aims to improve profitability by reinforcing corporate solutions services in the Solutions Business and to raise sales for the Settlement Services Business by developing new gift-card sales channels and merchandise.

T-Gaia adheres to a policy of returning profits to shareholders based on a dividend payout ratio target of 30% or more. Accordingly, for FY3/17 the company plans to increase its dividend for a third conservative year to ¥52.0 per share, up ¥9.0 year on year (for a payout ratio of 30.1%). It also added a shareholder benefits program in FY3/16. T-Gaia will issue ¥3,000 gift cards that can be used at its Smart Labo accessory shops to shareholders at the end of March.

■ Check Point

- Mobile Telecommunications Business is its core business, selling mobile phones and other related products to consumers and conducting sales agency business operations
- Slightly lower net sales but all-time high profits in FY3/16, profitability rose and operating income in the Mobile Telecommunications Business increased for a third straight period
- Significant improvements in the equity ratio and interest-bearing debt ratio



*Consolidated results since FY3/12

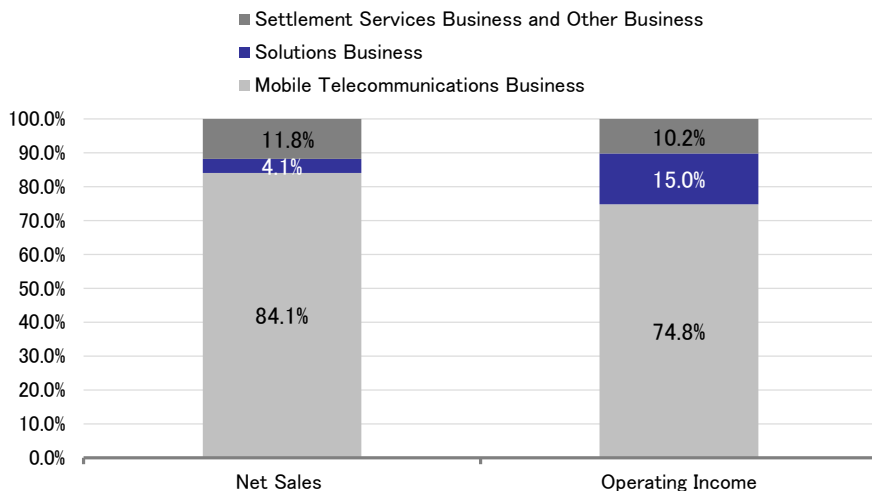
■ Business Overview

Mobile Telecommunications Business is its core business, selling mobile phones and other related products to consumers and conducting sales agency business operations

T-Gaia has three business segments. The first is the Mobile Telecommunications Business, which mainly conducts sales of mobile phones and other related products to consumers, along with agency operations. The second is the Solutions Business, which serves corporate clients through the sale of mobile phones and other related products, the provision of solutions services, and contract agency operations for optical fiber and other fixed-line services. The third is the Settlement Services Business and Other Business, covering the sale of electronic-money based merchandise, comprising online payment methods such as PINs* and gift cards, as well as overseas business. Below we review these businesses.

* PIN (Personal Identification Number) sales system: An electronic payment system enabling online purchases without using a credit card simply by entering a PIN.

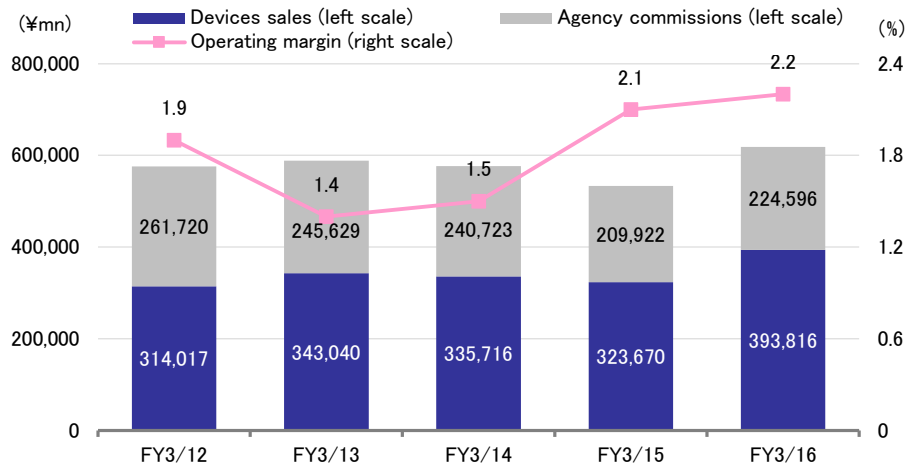
Net Sales and Operating Income by Business Segment (FY3/16)



(1) Mobile Telecommunications Business

Net sales of this business encompass such telecommunication devices as consumer mobile phones and tablets, accessories and other merchandise, as well as received commission for services based on agency agreements with telecommunications carriers. In FY3/16, device and commission accounted for just over 60% and just under 40% of net sales respectively. Device has accounted for a gradually rising proportion of sales in recent years. This is likely because the company has expanded sales of such new merchandise as tablets and accessories. Operating margin has risen since FY3/14 as a result of successful sales channel normalization and business efficiency efforts.

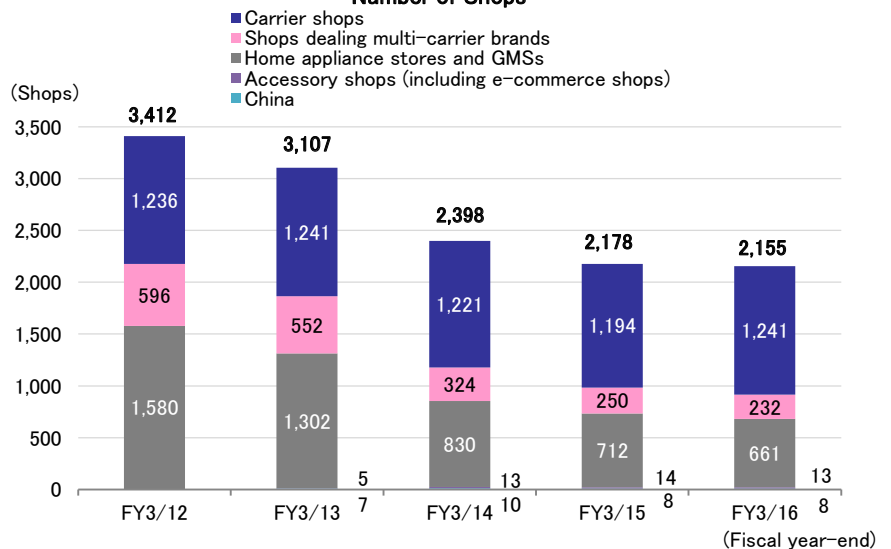
Mobile Telecommunications Net Sales and Operating Margin



10-Jun.-16

The Mobile Telecommunications Business had 2,155 sales bases at the end of March 2016 (including agencies operated by its secondary distributors and overseas sites), a decline of 23 sites from a year earlier. This network included 1,241 carrier shops, 232 shops dealing multicarrier brands, 661 home appliance stores and GMSs, and 13 accessory shops (of which one on an e-commerce site). The company has the largest number of sales bases in Japan. It has the top market share, accounting for around 13% of the total mobile phone unit sales in Japan. It is worth noting that the company has well-balanced inner share among NTT DoCoMo <9437>, au (KDDI) <9433>, and the SoftBank Group <9984> in terms of its mobile phone unit sales.

Number of Shops

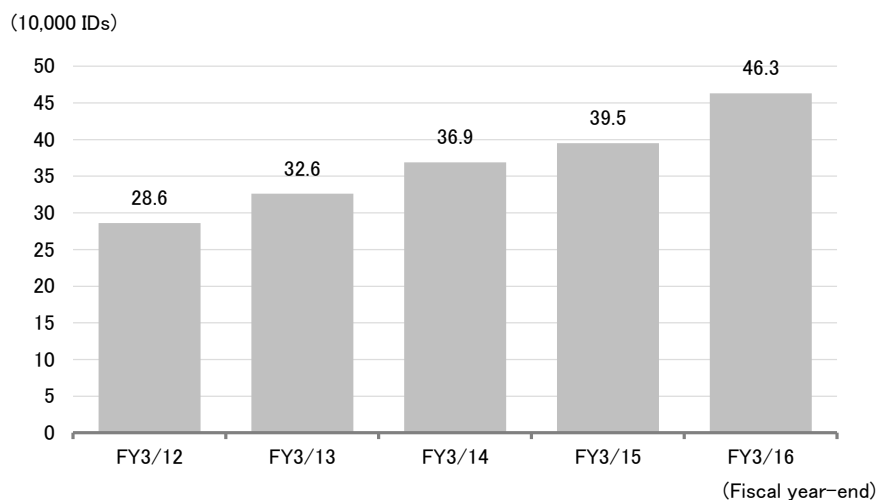


(2) Solutions Business

The Solutions Business includes solution services for corporate clients that sells mobile phones and makes optimal proposals to resolve issues at these clients, such as terminal and device management services; optical fiber agency services, such as FTTH for both corporations and consumers; and high volume data transmission services utilizing the cloud infrastructure of WAMINET Japan, which became its subsidiary in March 2014.

Among these services, the sales of mobile phones follow more or less the same business model as the consumer-oriented Mobile Telecommunications Business. The terminal and ID management services provide usage management, charge settlement, simulations of an ideal pricing plan, payment agency and other services related to various telecommunication devices and IDs used by corporate clients, such as mobile phones, smartphones, tablets and fixed lines. These solution services are bundled into the “movino star” application service provider (ASP) managed service provided by the company, which is a service that enhances operational efficiency at its corporate clients and cuts their costs. The number of movino star subscriber IDs has steadily expanded, reaching 493,000 as of the end of March 2016.

Number of movino star subscriber IDs



(3) Settlement Services Business and Other Business

The Settlement Services Business involves sales of electronic money-based merchandise and gift cards using PIN sales systems through major convenience stores and other retail outlets throughout Japan. As of the end of March 2016, the business has just over 55,000 sales bases. The merchandise handled includes Amazon, iTunes, Google Play, and gift cards, as well as WebMoney and BitCash in PIN merchandise.

The method of calculating net sales differs for gift cards and PIN merchandise. For gift cards, the company records only the commission received from the operators as net sales, while for PIN merchandise the total transaction amount (face value amount) is recorded as net sales. Sales are nominally trending downward, as demand has recently shifted from PINs to gift cards, but the company is sustaining double-digit annual growth in gift card transactions, and gross transaction value is steadily expanding. Transaction composition on a face-value basis is about 40% in PINs and about 60% in gift cards.

Overseas, the company runs seven China Unicom shops in Shanghai through an agency agreement with that carrier. Also in China, the company sells mobile phones and solutions services to the local units of Japanese companies. In Singapore, the company sells gift cards through convenience and electronics stores and is sustaining healthy business.

Financial Results Trends

Slightly Lower Net Sales but All-Time High Profits in FY3/16, Profitability Rose and Operating Income in the Mobile Telecommunications Business Increased for a Third Straight Period

(1) Overview of FY3/16 Results

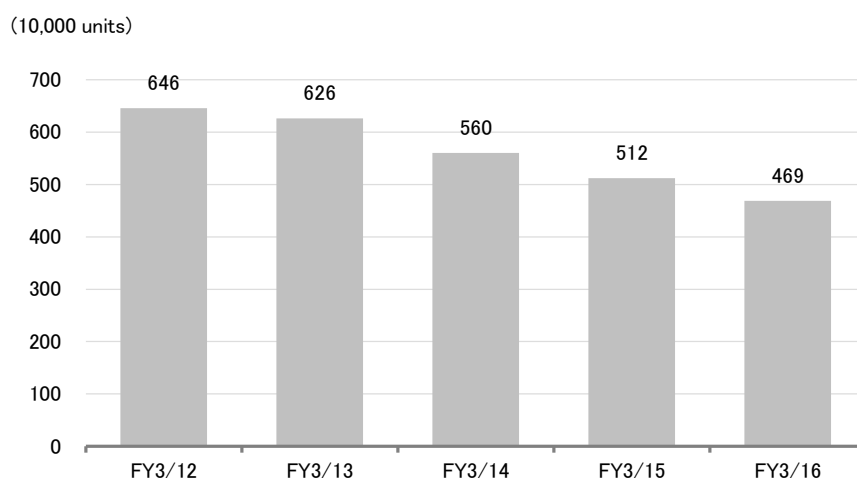
In FY3/16 consolidated results, net sales declined 3.4% year on year to ¥620,074mn, operating income rose 9.5% to ¥15,666mn, ordinary income climbed 10.0% to ¥15,621mn, and net income attributable to owners of the parent rose 22.6% to ¥9,498mn. Sales fell because of a decline in sales volume of mobile phones and other devices and a change in product composition for the Settlement Services Business. Income, meanwhile, reached an all-time high on a rise in Mobile Telecommunications Business profit thanks to robust sales of tablets and accessories and other related merchandise and increases in average prices per unit and per customer and a large profit advance for Settlement Services Business and Other Business. Compared to guidance, although net sales missed by 5.3% on the decline in mobile phone sales and other factors, operating income overshot by 4.4% mainly due to improvements in companywide business efficiency and productivity and Settlement Services Business and Other Business upside.

Consolidated Financial Results in FY3/16

	FY3/15		FY3/16				(¥mn)
	Actual	Ratio to net sales	Full-year forecasts	Actual	Ratio to net sales	YoY	Compared with full-year forecasts
Net sales	642,095	-	655,000	620,074	-	-3.4%	-5.3%
Gross margin	61,984	9.7%	63,500	63,381	10.2%	2.3%	-0.2%
Selling, general and administrative expenses	47,677	7.4%	48,500	47,714	7.7%	0.1%	-1.6%
Operating income	14,306	2.2%	15,000	15,666	2.5%	9.5%	4.4%
Ordinary income	14,194	2.2%	14,900	15,621	2.5%	10.0%	4.8%
Net income attributable to owners of the parent	7,748	1.2%	9,000	9,498	1.5%	22.6%	5.5%

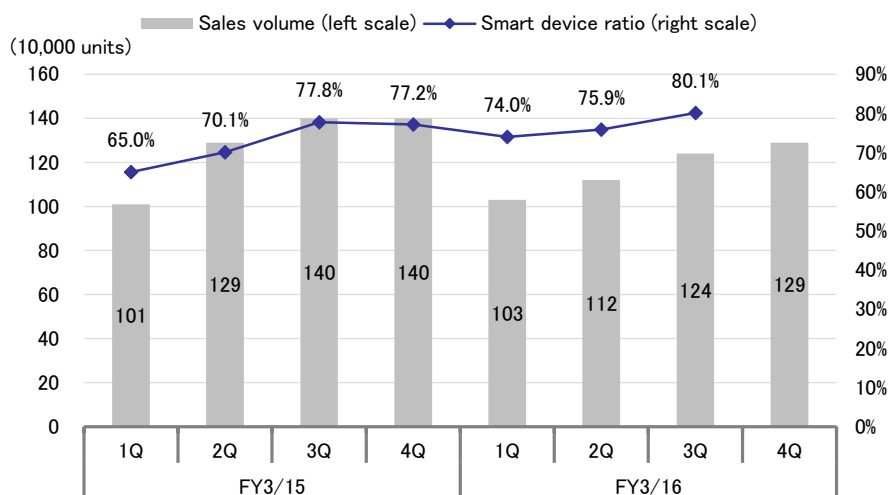
Sales volume for mobile phones and other devices dropped by 430,000 units year on year to 4.69mn units owing to pullback of excessive sales competition and slower sales of new models than anticipated. Sales were steadily lower than the previous year from 2Q at the quarterly level. While observers were concerned about the impact in 4Q of curtailing sales of "zero-cost handsets" to comply with the Ministry of Internal Affairs and Communications' policy, we think the actual impact was minor because the decline margin narrowed from 2Q and 3Q levels. Furthermore, the ratio of smart devices (smartphones and tablets) climbed to about 77%.

Number of Mobile Phones Sold



Note: Including Wi-Fi tablets

Number of Mobile Phones Sold and Smart Device Ratio

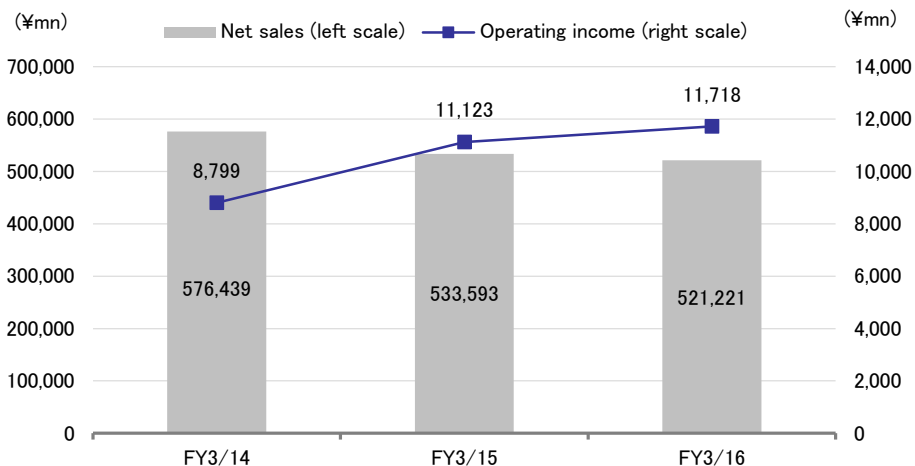


(2) Business Segment Trends

○ Mobile Telecommunications Business

Net sales fell 2.3% year on year to ¥521,221mn, while operating income advanced 5.3% to ¥11,718mn. Although sales of mobile phones and other devices declined by 440,000 units year on year to 4,500,000 units, sales of tablets rose at a double-digit pace and accessories, contents, and other related merchandise remained upbeat with a 25% gain. Gross income increased at unit and customer levels. Additionally, segment operating income expanded for a third straight fiscal year thanks to continued efforts to improve efficiency and raise productivity in sales base operations.

Mobile Telecommunications Business Results



Differences in sales staff skills are directly impacting the customer draw and profitability of sales bases more than in the past because of changes in the sales measures used by telecom carriers, adoption of new rate plans, and addition of a wider range of products and services, such as optical fiber lines, and we think T-Gaia's aggressive investments in personnel training over the past few years are contributing to higher profitability.

Sales at Smart Labo smartphone accessory shops expanded by a robust 24% year on year. We attribute this trend to recent additions of fashionable headphones, earphones, and other audio devices to the product line-up that are driving a related steady upward trend in average spending per customer, in contrast to past emphasis on protective films and cases and covers as the main products. Income improved in 4Q with most of the company's 13 shops reaching profitability.



T-Gaia Corporation

3738 Tokyo Stock Exchange First Section

10-Jun.-16

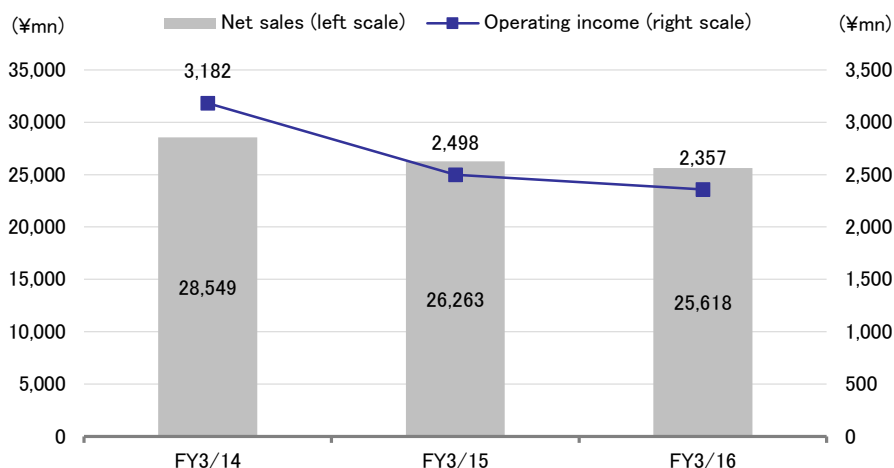
○Solutions Business

Net sales dropped 2.4% year on year to ¥25,618mn and operating income fell 5.6% to ¥2,357mn in the Solutions Business, which handles mobile and fixed-line network businesses for corporate clients. Sales of mobile phones and other devices rose by 2,000 units year on year to 186,000 units. Kitting service, help desk service, and other support services and “movino star” corporate communication line and devices management service performed well too. These trends drove a rise in corporate mobile business sales. The main source of the decline in segment sales, meanwhile, was the drop in sales of conventional FTTH and other optical line services accompanying changes in the business model for fixed-line products.

Although sales climbed for various solution services in the corporate mobile business and optical collaboration and other new fixed-line products, income slipped due to ramp up of system development related to upgrading movino star and investments in human resources to strengthen proposal-type sales.

For movino star, the company added a new feature from fall 2015 to manage customers' Wi-Fi-based devices and other assets are not outfitted to connect to telecom lines. It also provides a management screen and other features that enhance usability and significantly improve operability. The major upgrade helped to acquire new contracts and boosted additional contracts at existing customers. T-Gaia increased the number of subscriber IDs by 98,000 from the end of the previous year to 493,000 at the end of March 2016. Additionally, T-Gaia started wholesale business to electrical installation firms and others from January 2016 for resale of the TG Hikari optical access service to corporate clients. Wholesale customers benefit from the ability to sell optical lines under their own brand and quick ramp-up of Hikari Collaboration business thanks to provision of the TG Optical Support Package that packages a variety of support services (such as start-up support, system-related support, and billing-related support) at the time of business ramp-up. T-Gaia has already recruited about 100 resellers and is targeting 200 companies by March 2017.

Solutions Business Financial Results

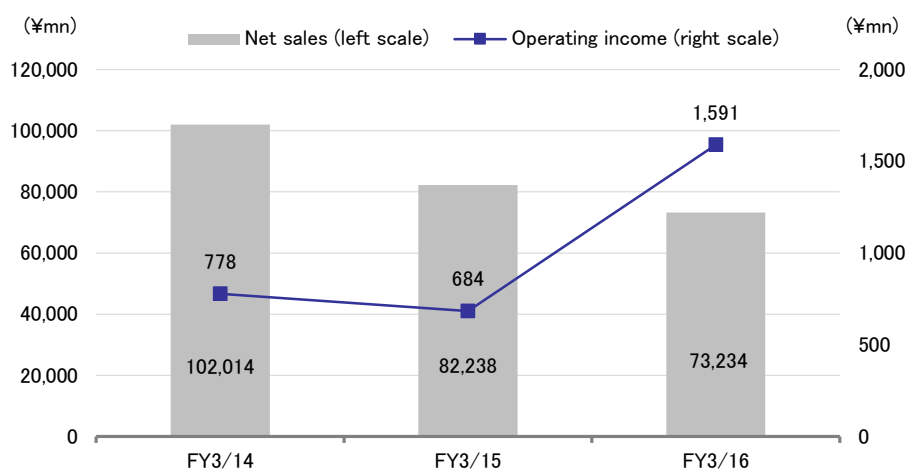


○Settlement Services Business and Other Business

Net sales fell 10.9% year on year to ¥73,234mn, while operating income climbed 132.6% to ¥1,591mn. The decline in net sales was mainly caused by a shift in demand from PIN merchandise, where the face value amount of all transactions is recorded as net sales, to gift cards where only the received commission is recorded as net sales. Earnings, meanwhile, rose sharply owing to healthy growth in transaction value and recognition of one-time income in 4Q.

In overseas business, T-Gaia received profit boosts from improved income in its mobile phone sales operations in China by streamlining efficiency and enhancing productivity to lower administrative costs and a rapid roughly five-fold year on year rise in gift card sales for the settlement services business in Singapore.

Settlement Services Business and Other Business Financial Results



■ Outlook

Continuing to Focus on Sales of Smartphone-Related Products and Tablets, though Actively Enhancing Strategic Investments for Its Future Growth

(1) Financial forecasts for FY3/17

For FY3/17, T-Gaia expects a 0.7% decline year on year in net sales to ¥616,000mn, a 4.3% drop in operating income to ¥15,000mn, a 4.3% decline in ordinary income to ¥14,950mn, and a 2.1% rise in net income attributable to owners of the parent to ¥9,700mn. It projects a decline in mobile phone sales volume of 150,000 units year on year to 4.54mn units. While T-Gaia still aims to increase gross profit per unit and customer by focusing on sales of accessories and other related products, just as in FY3/16, it anticipates lower operating income because of aggressive promotion of strategic investments to bolster competitiveness, improve customer satisfaction at sales bases with moves, renovations, and expansions, and train staff. It expects an increase in net income because of a lower effective tax rate and other factors. Below we review segment outlook trends.

Consolidated Financial Forecasts for FY3/17

	FY3/16		FY3/17		
	Actual	Ratio to net sales	Full-year forecasts	Ratio to net sales	YoY
Net sales	620,074	-	616,000	-	-0.7%
Operating income	15,666	2.5%	15,000	2.4%	-4.3%
Ordinary income	15,621	2.5%	14,950	2.4%	-4.3%
Net income attributable to owners of the parent	9,498	1.5%	9,700	1.6%	2.1%
Number of mobile phones sold (10,000 units)	469		454		-150,000 units

○ Mobile Telecommunications Business

T-Gaia expects a 1.2% year on year decline in sales to ¥515,000mn and a 2.7% drop in operating income to ¥11,400mn. It projects a decline in mobile phone and other device sales volume of 140,000 units to 436mn units due to a tougher business environment with pullback of excessive sales competition and wider use of low-cost MVNO* smartphones. However, it only expects a slight drop in overall sales because of a continuing sales focus on accessories, contents, and other smartphone-related products and tablets. It guides for a profit decline due to aggressive promotion of strategic investments in sales bases, staff training, and other areas.

* MVNO (Mobile Virtual Network Operator) Operators supplying voice and data communications services over infrastructure leased from other companies without owning their own mobile phone or wireless communications infrastructure.

T-Gaia Corporation

3738 Tokyo Stock Exchange First Section

10-Jun.-16

T-Gaia is adding sales of electricity service and insurance products from FY3/17. It is offering electricity service at au and Softbank shops from April. While the product impact on profitability should be limited, T-Gaia is looking for a rise in store traffic. It started handling various insurance products (contract continuation) at au shops and plans to begin sales of life insurance at NTT docomo shops in fall 2016. It will just start with a few shops handling these products nationwide for the time being and will review the addition of more shops based on results.

T-Gaia aims to boost customer draw and raise profitability and customer satisfaction by expanding the scope of products and services handled by mobile shops beyond mobile phones to optical lines, electricity, insurance, and other life infrastructure and thereby converting these sites into comprehensive shops that propose and provide a wide range of products and services related to customer lives. This evolution requires further improvement of the skills of sales staff. The shift to more sophisticated products and services as well as complex rate plans extends time interacting with customers at shops, and differences in skill levels hence become a major factor influencing efficiency and productivity. T-Gaia was an industry leader with the creation of the TG Academy as an internal education and training entity, and its focus on staff education and training has earned it an excellent reputation for personnel training capabilities. It plans to improve skills throughout the company by recruiting high-quality staff as employees.

T-Gaia expects to keep the number of direct-operation mobile shops at roughly the same level as in FY3/16. However, it intends to boost customer draw, profitability and customer satisfaction at sales bases by continuing to aggressively invest in moves, renovations, and expansions. Smart Labo accessory shops are sustaining upbeat sales, and T-Gaia plans to increase shop volume from 13 sites at the end of FY3/16 to about 20 sites fairly soon. It will be expanding shop sales floors and widening product line-ups to fuel higher sales growth as these shops broaden sales items from protective films and cases and covers to audio devices (headphones and earphones) and others. Osaka-based Smart Labo Namba Ebisubashi started selling handsets without SIM locks in FY3/16, and T-Gaia intends to begin handling these handsets at new shops and other locations too in FY3/17, including Smart Labo Shinjuku Higashiguchi.

○Solutions Business

T-Gaia projects a 2.4% year on year decline in net sales to ¥25,000mn and a 4.8% increase in operating income to ¥2,470mn. While it guides for lower sales because of the impact of an anticipated drop in mobile phone and other device sales volume of 10,000 units to 176,000 units, the company expects higher earnings thanks to solutions services, a rise in movino star contract volume, and promotion of TG Hikari resale business.

○Settlement Services Business and Other Business

T-Gaia expects a 3.8% year on year rise in sales to ¥76,000mn and a 29.0% drop in operating income to ¥1,130mn. It guides for stronger sales thanks to slowdown of the decline pace for PIN merchandise in settlement services and steep gift-card sales advances due to development of new sales channels and products. It projects an earnings decline because of removal of one-time profit booked in FY3/16 and pursuit of investments in sales-related systems and strategic outlays for aggressive sales measures. T-Gaia only has overseas settlement operations in Singapore, but plans to review entries into nearby countries in FY3/17. It also factors in continued improvements for the mobile shop business in China.

Net Sales and Operating Income by Business Segment

	FY3/15	FY3/16	FY3/17 E	YoY
(¥mn)				
Net Sales by Business Segment				
Mobile Telecommunications	533,593	521,221	515,000	-1.2%
Solutions	26,263	25,618	25,000	-2.4%
Settlement Services and Other Business	82,238	73,234	76,000	3.8%
Total	642,095	620,074	616,000	-0.7%
Operating Income by Business Segment				
Mobile Telecommunications	11,123	11,718	11,400	-2.7%
Solutions	2,498	2,357	2,470	4.8%
Settlement Services and Other Business	684	1,591	1,130	-29.0%
Total	14,306	15,666	15,000	-4.3%

■ Financial Status and Shareholder Return Policy

Significant Improvements in the Equity Ratio and Interest-Bearing Debt Ratio

(1) Financial status

Looking at financial conditions at end-March 2016, total asset value dropped by ¥4,150mn year on year to ¥85,930mn. Under current assets, trade receivable were down by ¥3,610mn and merchandise inventory fell by ¥1,670mn due to the decline in period-end sales, but cash and deposits rose by ¥1,229mn and other accounts receivable increased by ¥817mn. Under fixed assets, goodwill declined by ¥1,191mn.

Liabilities were down by ¥10,883mn year on year to ¥49,911mn, including declines in interest-bearing debt of ¥8,674mn and accounts payables of ¥2,502mn. Net asset value rose by ¥6,732mn year on year to ¥36,018mn. Profit surplus increased by ¥6,714mn due to booking a net profit.

For key business indicators, the equity ratio that reflects stability climbed from FY3/15's 32.3% to 41.7%, and the interest-bearing debt ratio dropped from 111.8% to 66.7%. These changes indicate healthier financial standing. In profitability, T-Gaia sustained ROE at a high level of 29.3% and continued an upturn in operating margin of 0.3ppt to 2.5%. We believe the company is making steady advances in improving its financial standing and profit margin.

T-Gaia conducted a public-offering share buyback for the 1,304,000 shares (16.5% of outstanding share volume) held by Mitsubishi Corporation, its second largest shareholder, in April 2016. It paid ¥12,771mn at a price of ¥979 per share. Although the interest-bearing debt ratio will temporarily rise because T-Gaia used existing credit lines from financial institutions to purchase the shares, we do not see any issues with the company's cash flow and expect a contribution to better capital efficiency in FY3/17.

Consolidated Balance Sheet

	(¥mn)			
	FY3/14	FY3/15	FY3/16	Changes
Current assets	88,227	75,029	72,276	-2,752
(Cash and deposits)	3,490	2,085	3,314	1,229
(Merchandise inventory)	45,146	37,612	35,942	-1,670
Fixed assets	16,364	15,051	13,653	-1,397
Total assets	104,592	90,080	85,930	-4,150
Current liabilities	68,427	54,243	32,955	-21,288
Fixed liabilities	12,450	6,550	16,956	10,405
(Interest-bearing debt)	50,934	32,551	23,877	-8,674
Total liabilities	80,878	60,794	49,911	-10,883
Total net assets	23,713	29,286	36,018	6,732
(Stability ratios)				
Equity ratio	22.6%	32.3%	41.7%	
Interest-bearing debt ratio	215.9%	111.8%	66.7%	
(Profitability ratios)				
ROE (net income / shareholders' equity)	26.4%	29.4%	29.3%	
Operating income to sales ratio	1.8%	2.2%	2.5%	



T-Gaia Corporation

3738 Tokyo Stock Exchange First Section

10-Jun.-16

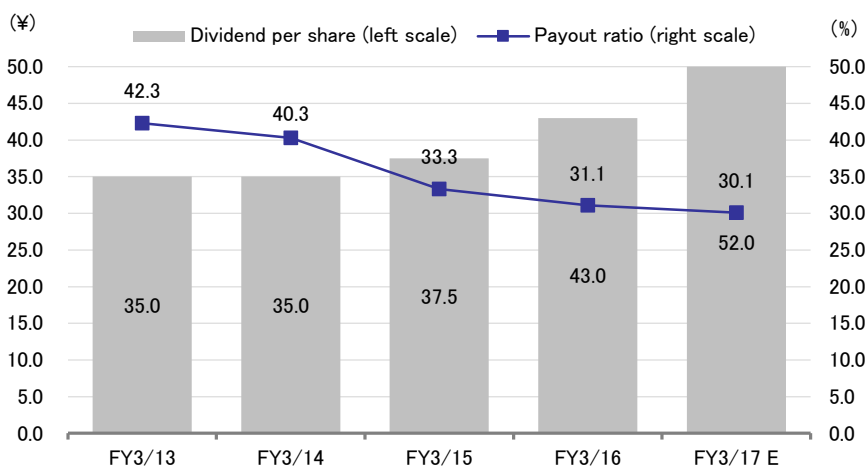
Plans to Increase the Dividend by ¥9.0 to ¥52.0 in FY3/17

(2) Shareholder returns policy

The company's shareholder returns policy is mainly to return profits to shareholders through dividends with a payout ratio goal of at least 30%. In FY3/16, T-Gaia lifted the dividend by ¥2 from the period-start target of ¥41.0 to ¥43.0, including support from earnings beating guidance. It is targeting a ¥9.0 hike year on year to ¥52.0 in FY3/17 (30.1% dividend payout ratio). The steep dividend hike, despite just a 2.1% projected rise in net income, reflects a hefty anticipated increase in EPS from FY3/16's ¥138.1 to ¥172.7 in FY3/17 thanks to share buybacks.

T-Gaia also added a shareholder benefits program in FY3/16. It will issue ¥3,000 gift cards that can be used at its Smart Labo accessory shops (including the online store) to shareholders at the end of March. Those shareholders not interested in using the gift card can donate the funds to Japan Red Cross in exchange for returning the unused gift card.

Dividend Per Share and Dividend Payout Ratio



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