COMPANY RESEARCH AND ANALYSIS REPORT

Estore Corporation

4304

TSE JASDAQ

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Index

Summary

The composition of sales is steadily changing, suggesting improvements to the customer mix and to future revenue potential and profitability.

Estore Corporation <4304> (hereafter, also "the Company") is a comprehensive provider of eCommerce (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 further strengthen sales of sales-promotions systems.

1. Working to improve the "quality" of each of stock, flow, and marketing revenue

The Company only has one business segment for EC support. However, net sales are made-up of three main types of revenue; stock (monthly systems usage fees), flow (a fixed percentage of customer net sales), and marketing (fees for sales-promotions consulting and operations management agency services). It is working to strengthen its revenue base by increasing the quality of these types of revenue. Specifically, its policy is to raise the revenue potential of each of these three business by acquiring larger-scale companies as customers.

2. FY3/17 results were basically as expected. Changes to the revenue structure suggest changes to the customer mix.

The Company's FY3/17 results were as expected, of higher sales but lower profits, with net sales of ¥4,775mn (up 2.5% YoY) and operating profit of ¥407mn (down 35.2%). For the percentages of sales by type of revenue that the Company prioritizes, it is aiming to expand marketing revenue as its focus business. In FY3/17, the percentage of net sales provided by marketing revenue rose to approximately 17%, while flow net sales also continued to steadily increase. This change to composition of net sales by revenue type is just as the Company is aiming for, and at the same time, it suggests that the customer mix is also steadily changing as intended.

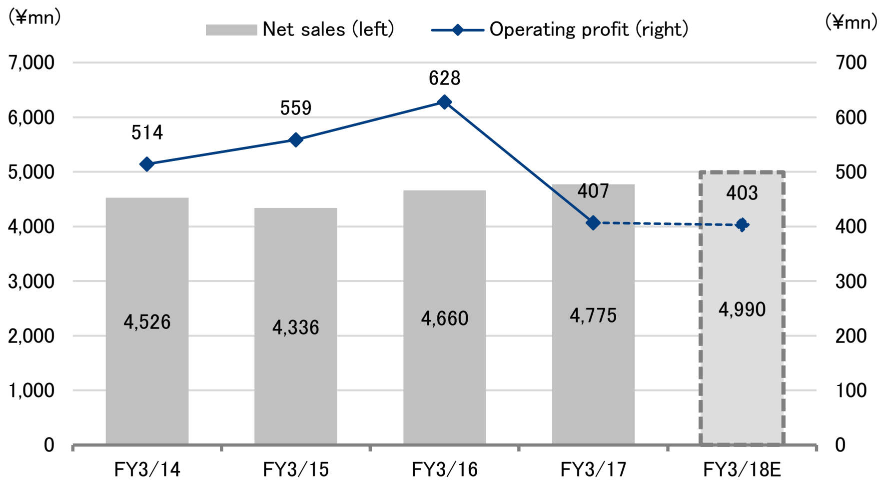
3. It is highly likely to achieve the FY3/18 forecasts. It is focusing on sales-promotions systems for new products.

For FY3/18, the Company is forecasting higher sales and basically unchanged profits, with net sales of ¥4,990mn (up 4.5% YoY) and operating profit of ¥403mn (down 1.0%). At FISCO, we think that the Company is highly likely to achieve these forecasts. We estimate that if the decline in stock revenue is kept down to 4% YoY, flow revenue increases 6%, and marketing revenue reaches the ¥1,000mn level, net sales will exceed ¥5,000mn. In terms of profits, as previously mentioned, the customer mix is changing in the direction of larger customers, and it is expected that this will lead to improved profitability.

Key Points

- Flow revenue continues to steadily increase from the ongoing improvement in net sales per store
- Marketing is supplementing its human resources and its revenue has reached a stage of accelerating growth. Large-scale orders are also trending upward.
- The first version of the Estore Compare sales-promotions systems was released in July 2017. There are also expectations for the second version and onwards.

Results trends (standalone basis)



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. It is currently focusing on increasing marketing revenue.

1. Company history and shifts to the focus business

Since the Company was established in 1999, it has shifted its focus business roughly every seven years. In the first seven years after it was established, it built EC support systems and focused on expanding its customer business and establishing a business foundation from stock revenue. In the next seven years, targeting the existing customers to which it was providing ASP services, it focused on providing them with support for sales promotion and for growing sales, and thereby adding flow revenue in accordance with this sales growth. From around 2012 up to the present day, it has been developing its sales-promotions support into a sales promotions consulting and operations management agency business and working to acquire new customers. Each stage is described in more detail below.

Estore's history and the shifts in its business development

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

Source: Prepared by FISCO from Company materials

(1) 1999-2006

The Company's business first started from shopping cart services. After that, it sequentially added the services necessary to conduct EC, including the provision of rental services that are needed in order to establish a website. In 2006, it began providing "Shopserve" for comprehensive EC support, which completed its current system of services as an EC support system. 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, because revenue increases as the customer base grows larger. The Company has concluded business partnerships with various companies and has been working to acquire subscriptions for its EC support system.

(2) 2006-2012

The EC support systems business (Company segment name, "Systems Business") supported the Company's Growth in the first few years after its establishment through providing this ASP service, and today also, it remains an important business for building a customer base. But at the same time, because there are many participating companies in this business and competition is fierce, it has been expected to become a red ocean market. From a business perspective too, there have been cases where the balance between the expenses required to invest in the systems and the revenue from the customer was poor. This applies to the customers obtained from business partnerships (called OEM subscriptions within the Company). The Company responded quickly to this problem in the Systems Business and ended its construction of systems, after which it has been supporting the growth in sales at customer companies and expanding revenue by collecting a fixed percentage of net sales from customers as payment agency commissions (via store websites on Estore's Shopserve). This is the same as the revenue from customers in the Systems Business, but it is different on the point of being a stock-type system of monthly fees. The Company focuses on the nature of these differences according to net sales and distinguishes and manages this flow revenue from stock revenue.

(3) From 2012 to the present day

Sales from existing customers are smoothly increasing, and the percentage of the Company's total net sales provided by flow revenue is also steadily growing. In this situation, it is aiming to further increase revenue and has newly launched the Marketing Business in order to sell its expertise in sales-promotion support, which grows sales for customer, to an even wider range of customers. There are two points for the Marketing Business; 1) "Commoditizing" its sales-promotions 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. The Marketing Business consists of two businesses, "a sales promotions business," which provides consulting and operations management agency services, and "a media business," which manages the PARK EC shopping mall. Within them, the business area that the Company is focusing on the most is the sales promotions business, and it is currently changing its name to the marketing business (narrowly defined). On the other hand, it has positioned the media business as a non-focus business, because it has powerful rivals, like Amazon, and it fulfills a certain purpose.

Based on the single EC business segment, it manages its business by four revenue types

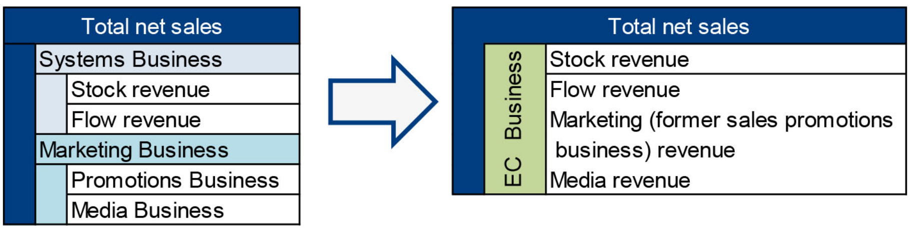
2. The shift of the business segments and the current revenue structure

As previously explained, the Company has changed its business segments and its methods of disclosing information, reflecting the shift in the business field that it is focusing on.

In FY3/17, the Company stopped classifying its business into the Systems Business and Marketing Business segments, and shifted instead to a single EC Business segment. The reason for this change was that the objectives of these two previous businesses were the same, of supporting the growth in sales at customers, so the significance of distinguishing between them had diminished.

Even in the former two-segment system, in the Systems Business the Company separately managed and disclosed stock revenue, which was mainly monthly systems usage fees, and flow revenue, of a fixed percentage of net sales. In the Marketing Business, it separates the sales promotion business, which is mainly consulting and operations management agency services, and the media business, which manages the PARK EC shopping mall. Even since it shifted to a single segment, it discloses net sales according to revenue type, of the four fields of "stock," "flow," "marketing," and "media." "Marketing" corresponds to the "sales promotion business" in the former categories, and its name was also changed from the "sales promotions business."

Changes in business segments



Source: Prepared by FISCO from Company materials

AT FISCO, we think this decision is extremely rational. The objective of the Company's business is to realize sales growth at its customer companies. Both from the perspective of building a business strategy to realize this business objective, and also for investors to understand its business strategy, we think an approach of dividing its business into four revenue types is more rational than the former approach of dividing it into two business segments. In addition, the categorization into four fields by revenue type is still consistent with the former approach and therefore the relatedness of the numerical values is preserved, and it absolutely does not cause information disclosure to regress.

Results trends

Sales increased and profits decreased in FY3/17, which is as the Company expected. The composition of sales is also changing as intended.

● Summary of the FY3/17 results

Estore reported lower profits on an increase in sales in FY3/17 with ¥4,775mn in net sales (up 2.5% YoY), ¥407mn in operating profit (down 35.2%), ¥401mn in recurring profit (down 36.1%), and ¥285mn in net profit (down 32.1%).

Compared to the forecasts, net sales were 5.1% (¥256mn) below forecast, but each item from operating profit down greatly exceeded their forecasts.

Summary of the FY3/17 results

(¥mn)

	FY3/16 full fiscal year	FY3/17			
		Full year forecast	Full year	YoY	vs. forecast
Net sales	4,660	5,032	4,775	2.5%	-5.1%
Operating profit	628	331	407	-35.2%	23.1%
Operating profit margin	13.5%	6.6%	8.5%	-	-
Recurring profit	628	331	401	-36.1%	21.4%
Net profit	420	229	285	-32.1%	24.7%

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

At FISCO, we evaluate that the Company's FY3/17 results have both positive and negative aspects, but that as a whole they are positive, as their content is in line with the direction that its management is aiming to take.

Looking at the breakdown of net sales by revenue type, while sales from flow and marketing, which the Company is aiming to grow, steadily expanded, sales from stock and media declined, which was as expected. In this way, the composition of sales is changing just the way the Company intended (the details are described in the Growth Strategy section). Conversely, the fact that actual net sales were below the forecast can be said to be a negative point. However, this has the aspect of being closely related to the fact that the items from operating profit down exceeded their forecasts.

Breakdown of net sales by revenue type

(¥mn)

	FY3/15 full year result	FY3/16 full year result	FY3/17			
			Full year result	Change	YoY growth rate	Ratio to net sales
Total net sales	4,336	4,660	4,775	115	2.5%	100.0%
Stock	2,112	2,060	1,967	-80	-3.9%	41.2%
Flow	1,737	1,915	1,967	52	2.7%	41.2%
Marketing	350	582	787	192	32.3%	16.5%
Media	136	103	53	-49	-47.6%	1.1%

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

The Company forecast a decline in profits at the start of the period. This was because it is actively investing in human resources to expand its Marketing Business. Initially, it conducted upfront investment as personnel expenses were generated in advance and it could not avoid a time lag in the recovery of this investment in the form of higher sales, so this investment was the obvious choice as it could not make progress without accepting it.

It seems that the recruitment of human resources was less than planned in FY3/17. As a result, expenses, which are primarily personnel expenses, were also less than anticipated, and so profits exceeded their forecasts. On the other hand, for net sales, we estimate that the Company captured less marketing demand than expected due to the shortage of human resources and was therefore unable to achieve its net sales target. As mentioned above, marketing net sales grew steadily, up 32.3% YoY to ¥787mn, and we think that the real intention of the Company is to increase them rapidly to around ¥1,000mn. As there is potential demand, it can realistically expect to achieve this.

Growth strategy

Working to improve the "quality" of each of stock, flow, and marketing revenue

1. Overall image of the growth strategy

As described above, currently the Company's revenue is comprised of four types; stock, flow, marketing and media. For the three types other than media, which is not a field that the Company is focusing on, as is described below it is pursuing medium- to long-term growth by expanding revenue for the next-generation focus businesses.

The keyword for the Company's growth strategy is improving "quality." First of all, quality is customer quality, or more specifically, aiming to shift to customers that will lead to an improvement in the Company's revenue potential from the viewpoints of customer scale, type, and attributes. This approach was first introduced with the aim of qualitatively improving stock revenue and flow revenue, but currently, in order to expand marketing revenue also, it is also prioritizing this viewpoint of "quality" on the surface, in terms of the numerical values of the number of subscriptions and net sales.

Already around three years have passed since the Company started conducting "upfront investment," mainly to acquire human resources. This upfront investment is recovered in the form of higher sales, but even so, the amount that sales have grown during this time has not been that dramatic. At FISCO, we think that this clearly reflects the Company's stance of aiming to improve the quality of customers, and thereby the quality of its revenue and so solidify its revenue foundations, rather than superficially trying to improve results.

On the other hand, as previously explained, the Company has repeatedly grow while changing the field it focuses on roughly every seven years. Currently, it is approaching the end of the period in which it focuses on marketing (consulting and operations management agency services), which started around 2012. Its present goal for revenue from marketing is to achieve a revenue scale of "one quarter of total net sales." This goal is already in sight, so it is expected to gradually shift to the next focus field from around 2018. It is already clear that this next focus field will be sales of "sales-promotions systems."

Below, the existing three fields that comprise the Company's revenue, and the sales-promotion field that will be the focus field in the future, are described in more detail.

The downward trend in stock revenue is bottoming-out and a recovery to an upward trend is in sight.

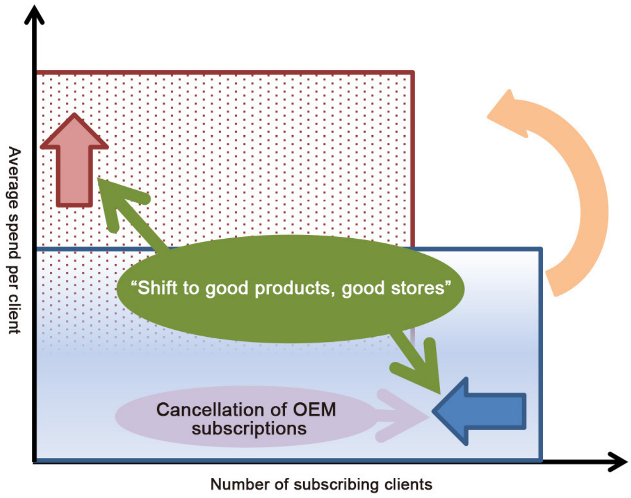
2. The stock revenue growth strategy

As previously mentioned, stock revenue is revenue from the monthly fees for Shopserve, which is EC support ASP service provided by the Company. For several years, the Company has been working on stock revenue structural reforms.

The first was to cancel low-margin OEM subscriptions from among customers with subscriptions to the mainstay Shopserve service. These were customer subscriptions acquired through business partnerships with external companies in the period soon after the Company's establishment. An imbalance existed between the Company's revenue and costs because of the presence of business partners in-between itself and the customers. Estore actively worked to cancel these OEM subscriptions and eliminated all of them during FY3/14.

The second step, which is still taking place, is raising the average spend per customers. This is a positive reform. In acquiring new customers, it has been focusing on stores that handle competitive products, stores with high profit growth potential, and medium-sized companies with prospects of large sales revenue and high monthly average fees under the slogan of shifting to "good products, good stores".

Structural reforms of stock-type revenue in the Systems Business



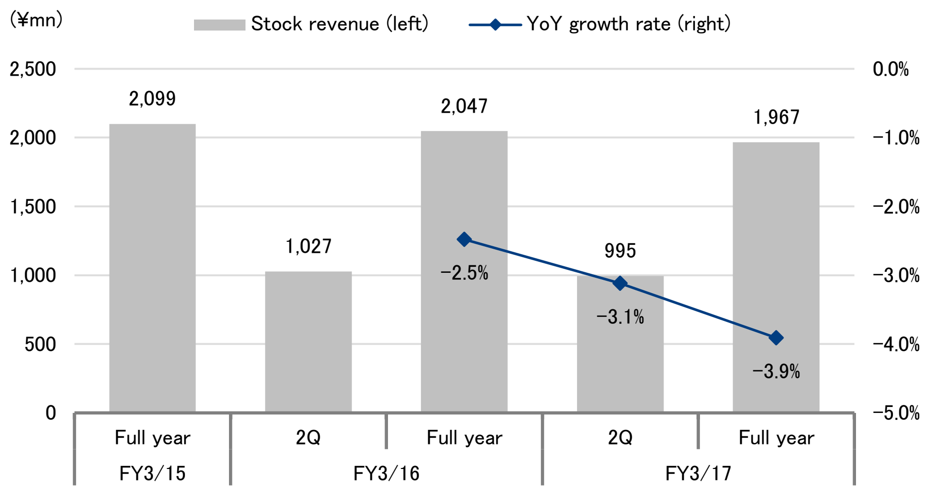
Source: Prepared by FISCO from Company materials

As a result of these structural reforms, the number of subscribing stores has been trending downward. The total number of subscribers has fallen by 41.0% in the last four years, from 28,865 at the end of FY3/13 (the peak was 48,333 at the end of FY3/10) to 17,018 at the end of March 2017. The impression may be that the extent of this decline in the last four years, or from the peak, is excessive, but in fact, this is a positive for revenue. This is because a high percentage of subscriptions were OEM subscriptions, as previously mentioned.

Conversely, what is more important for the Company's revenue is direct sales in the form of Shopserve subscriptions. They have also been trending downward as part of the previously mentioned "shift to good products, good stores." A certain percentage of subscribing customers cancel, and this decline is because there have been fewer (strictly selected) new customers than the number of cancellations. However, the pace of the decline in subscriptions for Shopserve is moderate compared to that of total subscriptions. The number of Shopserve subscriptions peaked at the end of FY3/14 2Q at 14,489. By the end of March 2017, subscription numbers had fallen 20.0%, to 11,590. The Company anticipated that the number of subscriptions for Shopserve, its focus business, would fall below 10,000 in the process of conducting structural reforms. But based on the current trend, it is possible that they will not decline to this extent and that subscription numbers have already bottomed-out.

The main point for the stock revenue structural reforms is improving the quality of the subscribing customers, not reducing stock revenue. It seems that it will only become possible to achieve the objective of the reforms once the qualitative structure of its customers becomes as the Company anticipates and stock revenue returns to a growth path. Looking at the FY3/17 results, the number of subscriptions for Shopserve declined 8.0% from one year ago, and total subscriptions fell basically the same, by 8.9%. But despite this, stock revenue was ¥1,967mn, a decline of only 3.9% YoY. At FISCO, we evaluate this to be evidence that the Company is making steady progress in the shift to good products, good stores, and also in the structural reforms, just as intended.

Trend in stock revenue



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

What is most of interest is when will stock revenue change direction and increase. The same as previously mentioned, a situation is continuing in which the extent of the fall in stock revenue is smaller compared to the extent of the decline in the number of subscriptions. Clearly, the revenue scale of newly subscribing companies is larger than that of existing customers. As stock revenue is monthly systems usage fees, it does not become larger in proportion to the customer company's scale, but there is the tendency for the unit price to increase, such as from optional subscriptions. If the decline in the number of subscriptions in FY3/18 further slows down, at FISCO we think it is fully possible that stock revenue will become positive in FY3/19.

Net sales per store are steadily improving and flow revenue continues to smoothly increase

3. The flow revenue growth strategy

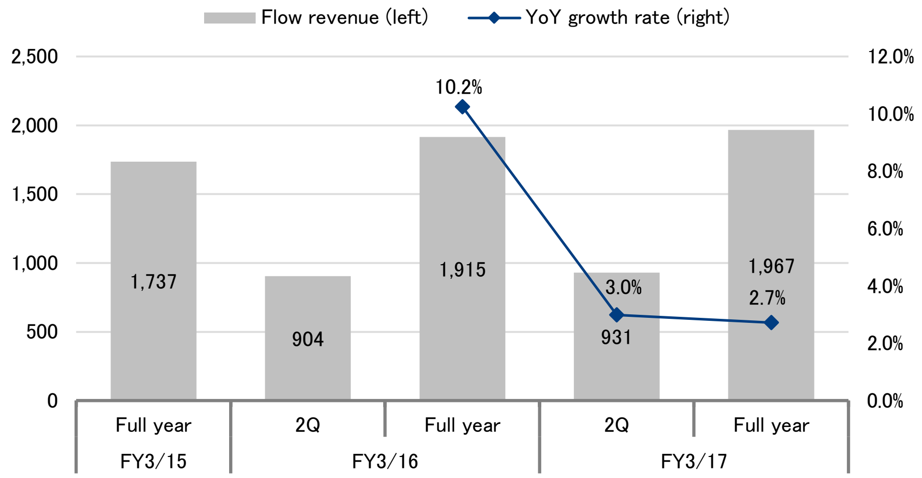
The Company collects flow revenue via Shopserve for the ASP services in the form of payment agency commissions as a fixed percentage of net sales. Therefore, it is the same as stock revenue in the sense that the customers are Shopserve subscribers. So the stock revenue structural reforms and the flow revenue growth strategy that are being advanced have the relationship of being two sides of the same coin.

As flow revenue is a fixed percentage of net sales, growth in the customer companies' sales increases this revenue. While various approaches are conceivable for this approach, the two that the Company are taking are 1) supporting the marketing of existing customers and realizing their higher sales, and 2) changing the customer company mix and increasing the percentage of customers with large sales. Specifically, 1) are cases in which Shopserve's existing subscriber companies subscribe as customers to the marketing that the Company focuses on (sales promotions consulting and operations and management agency services), resulting in higher sales. Conversely, for 2), the Company is progressing the stock revenue structural reform of "shifting to good products, good stores," which changes the composition of Shopserve subscriber companies by company scale. As previously described, the Company is making steady progress for this approach.

These measures by the Company are proving successful and customer net sales per store are steadily expanding. For the FY3/17 full year, customer net sales per store for Shopserve subscriber companies was ¥6.92mn, which is an increase of 9.5% on the previous year of ¥6.32mn. In terms of the analysis of the factors behind this, while it is not clear which of the previously described factors of 1) and 2) are greater, at FISCO we estimate that when considering the progress made in the last few year in the shift to good products, good stores, currently the effects of 2) are likely to be greater. Since measures 1) and 2) described above do not have a selective relationship, it is hoped that in the future, the increase in customer net sales per store will be accelerated from a combination of these two factors.

Reflecting the steady expansion in customer net sales per store, the Company's flow net sales are also continuing to rise

Trend in flow revenue



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

Revenue has reached a stage of accelerating growth. Large-scale orders are also trending upward.

4. The marketing revenue growth strategy

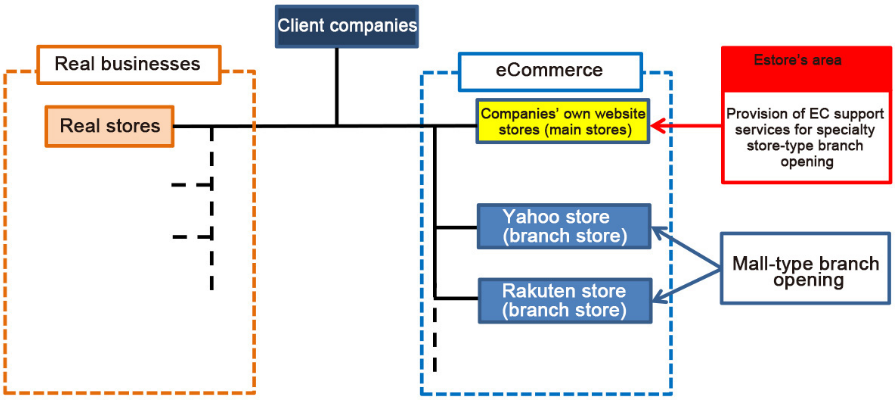
(1) Business overview

Marketing revenue is revenue from the fees for the consulting and operations management agency services for sales promotion and growth in net sales.

Looking at the marketing business area, we see that most of the companies that have advanced into the EC market have EC stores on their own websites (main store sites), and also that in many cases, they have branch stores, such as Amazon, Rakuten <4755>, and Yahoo! The ability of stores that open in a shopping mall to attract customers is greatly affected by the ability of the mall itself to attract customers. In contrast, a feature of a company's own site is that on the one hand it must attract customers through its own efforts, but on other hand it is highly profitable compared to a branch store (as it does not have to pay fees to the shopping mall). The Company provides marketing support services aiming to improve its customer companies' ability to attract customers to their main store stores, and thereby increase their sales.

Also, while somewhat paradoxical, it would seem that is those companies that are of a certain scale and strength that are able to firmly invest in their own sites. This is considered to be why many SMEs decide for the time being to start an EC business at low cost by opening a store in a shopping mall. The Company's marketing, which provides sales-promotion support for companies' own sites, is estimated to be much larger than the business model up to the present time, of the provision of Shopserve as ASP services, from the aspect of the scale of customer companies. From the current situation described above, the Company's objectives can be evaluated as being realistic ones.

The content of the marketing business and the targeted areas



Source: Prepared by FISCO from Company materials

The Company sells consulting and operations management agency services to new customers, as well as to existing customers that have Shopserve subscriptions. As the scales of these companies are different, there are major differences in their subscription fees. But conversely, existing customers tend to be more flexible and make decisions faster, so at FISCO we estimate that they exceed new customers in terms of the number of subscriptions. In the case of existing customers, we think that the revenue model is appealing on the point that the Company receives a certain percentage of net sales, or in other words, flow revenue, in addition to marketing revenue (fees for the provision of services).

The marketing sales strategy

	Existing clients in the Systems Business	New clients
Targeted clients	Private stores, recently established eCommerce companies	eCommerce companies handling specific specialty merchandise
	Annual sales of millions of yen to hundreds of millions of yen	Annual sales of hundreds of millions of yen to several billion yen
Sales entity	The Systems Business sales team	Specialist team
Business content	Cross-selling of marketing support services to clients of Shopserve, the EC management ASP service	Targeting medium-size to major companies, the aim is to attract more customers and increase sales at the EC main store websites through providing services such as research and analysis, website production agency services, management agency services, and other marketing support services
Revenue model	Service provider fee, fixed percentage of net sales	Service provider fee

Source: Prepared by FISCO from Company materials

(2) Estore's strengths

The Marketing Business model is a labor-intensive type that relies greatly on human power, so acquiring human resources is basically the only way to strengthen the organization and reinforce capacity. In the last few years, the Company has focused on acquiring human resources who are able to provide its consulting and operations management agency services. The "upfront investment at the expense of profits" that the Company has been conducting in the last few years mainly means actively recruiting human resources in this area, with the accompanying increase in personnel expenses.

At FISCO, we think that there are two major reasons why the Company is able to demonstrate its strength in its sales promotions consulting and operations management agency services. The first is its experience and expertise in growing EC sales that it has accumulated since it was founded. It is considered that having more than 50,000 customer companies in total, and the data and expertise acquired from having them, is sufficient to form its strengths.

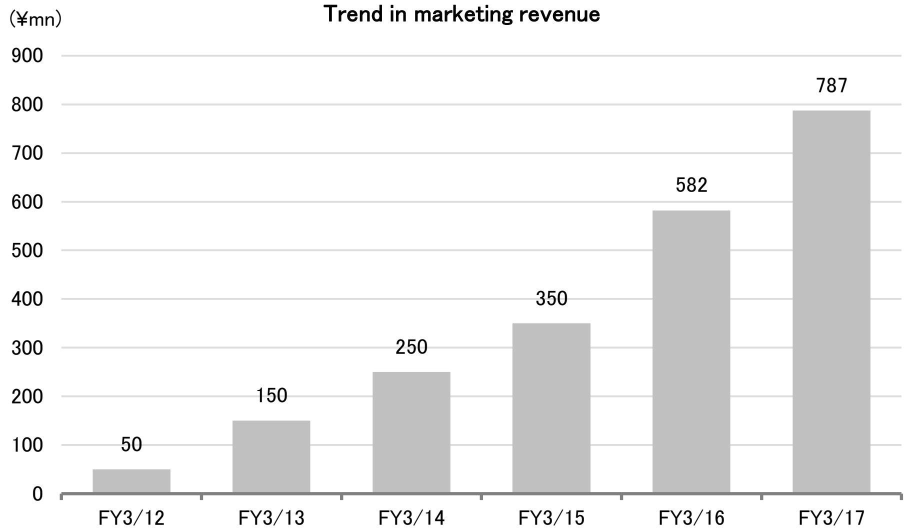
The second is that the Company specializes in EC support. There are many companies claiming to provide EC support, but most of them have their origins in areas such as advertising, media, and SEO measures, and in many cases they propose solutions for EC support only in their own specialist area. But the Company does not specialize in one specific area and can provide comprehensive EC support, meaning it can constantly take a 'customer first' approach. For the Company, all of the elements such as advertising, SEO, and media are nothing more than tools to use to increase sales, meaning it can always propose the best possible approach and methods to customers. This has led to its track record of increasing EC sales, which we think enables it to acquire the trust of customers, which in turn is reflected in its revenue growth.

(3) The marketing revenue conditions

As explained above, increasing marketing revenue has the aspect of being restricted by requiring the recruitment of more human resources. However, a situation has continued in which the pace of recruitment of human resources has lagged behind that planned. But reflecting the steady increase in human resources, marketing revenue is also smoothly trending upward and in the last one or two years, the pace of the growth in marketing revenue has been accelerating.

In FY3/17, marketing revenue increased 32.3% YoY to ¥787mn. Demand is strong for the Company's sales promotions support services, and the number of subscriptions with a value of a few million yen to more than 10 million yen is increasing. This trend seems to be strengthening year by year, and at FISCO we expect that in the future, marketing revenue will increase from the two axes of growth from the rise in the number of subscriptions and growth from the rise in the percentage of large-scale subscriptions.

Trend in marketing revenue



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

Marketing revenue itself continues to steadily increase, but we should also consider the profit aspect, or in other words, revenue potential. If net sales are secured for both stock revenue and flow revenue that simply cover fixed costs, then from this point, net sales will have a cost structure in which the profit margin rapidly improves. In contrast to this, for marketing revenue, investing in human resources is essential in order to acquire this revenue, so it has a cost structure in which it is difficult to raise the profit margin.

One of the approaches that can be considered to improve this point is, as previously mentioned, increasing large-scale subscriptions, or in other words, raising the order unit price. The actual marketing services, of providing sales promotions consulting or management agency services based on research and analysis of customer companies' sales trends, is not particularly affected by the scale of sales at the customer companies. Therefore, it can be said that it is preferable to acquire comparatively large-scale customers that purchase and subscribe to a wide variety of the sales promotions services that the Company provides.

The first version of Estore Compare, a sales-promotions systems, was released in July

5. Sales of sales-promotions systems

It would seem that the Company's next-generation focus field will be sales of systems for sales promotions support. In July 2017, it released the Estore Compare sales promotion system. This is a tool for determining which EC site is the most highly efficient, including by displaying two EC sites at the same URL, and measuring the conversion rate (CVR) and verifying the customer lifetime value (LTV).

The Company intends to sequentially release this system for sales promotions support. It seems that sales-promotions systems are being sold not just to existing customers, but also widely and generally to new customers. The area covered by the "sales promotion" field is wide, and there is little doubt that it is a market in which business opportunities are growing, such as the attention that is being focused on marketing automation (MA) as a new tool. Going forward, we shall be paying attention to what sales-promotions systems are developed by the Company, which has a wealth of expertise in EC customer support, and which markets it enters.

Outlook

The changes to the revenue structure suggest changes to the customer mix. Achieving the full-fiscal year Company forecasts is fully in sight.

Estore forecasts for a slight profit decline on increased sales in FY3/18 with ¥4,990mn in net sales (up 4.5% YoY), ¥403mn in operating profit (down 1.0%), ¥397mn in recurring profit (down 1.1%), and ¥274mn in net profit (down 3.8%).

In the FY3/18 1Q results announced on August 9, 2017, sales increased but profits decreased, with net sales of ¥1,218mn (up 5.5% YoY), operating profit of ¥108mn (down 10.6%), recurring profit of ¥106mn (down 11.3%), and net profit of ¥71mn ¥ (down 12.2%). The results were in line with the full fiscal year forecasts.

Overview of the FY3/18 forecasts

(¥mn)

	FY3/17		FY3/18				
	1Q result	Full year	1Q result	YoY	Fulfillment rate	Full year (E)	YoY
Net sales	1,154	4,775	1,218	5.5%	24.4%	4,990	4.5%
Operating profit	121	407	108	-10.6%	26.9%	403	-1.0%
Operating profit margin	10.5%	8.5%	8.9%	-	-	8.1%	-
Recurring profit	119	401	106	-11.3%	26.8%	397	-1.1%
Net profit	82	285	71	-12.2%	26.3%	274	-3.8%

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

As previously explained, the Company is focusing on increasing marketing revenue. On the other hand, the current situation is that it has to accept a temporary decrease in stock revenue, which is in a transition period. Looking at the current 1Q, each type of revenue is trending in line with the Company's aims for them.

In the current 1Q, marketing revenue increased 41.8% YoY to ¥238mn. The background to this would seem to be the steady rise in the percentage of orders that are large scale, in addition to the increase in the number of subscriptions. At FISCO, we think that achieving the FY3/18 full year forecast of around ¥1,000mn is fully in sight.

For flow revenue, in the current 1Q net sales rose 5.7% YoY to ¥494mn, and the FY3/17 full year growth rate accelerated from 2.7%. This continual, steady growth is also from the two factors of the changes to the customer mix from the "shift to good products, good stores," and the growth in sales from existing customers. We think that growth of around 5% on a full fiscal year basis is fully possible.

Stock revenue decreased 4.9% YoY to ¥476mn. At the end of March 2017, the number of Shopserve subscriptions had decreased 8.0% compared to one year ago, and when considering this, a decrease in sales of 4.9% is to be expected, and we did not think it is cause for concern.

Breakdown in net sales by revenue type

(¥mn)

	FY3/15	FY3/16	FY3/17		FY3/18	
	Full year result	Full year result	1Q result	Full year result	1Q result	YoY growth rate
Total net sales	4,336	4,660	1,154	4,775	1,218	5.5%
Stock	2,112	2,060	500	1,967	476	-4.9%
Flow	1,737	1,915	467	1,967	494	5.7%
Marketing	350	582	168	787	238	41.8%
Media	136	103	18	53	8	-49.8%

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

In addition to the previously described trends by three revenue type, another point to focus on in the current fiscal period is the sales situation for sales-promotions systems. Continuing on from the release of the first version of Estore Compare in July, it seems that the Company will be launching new products in 2H also, and we shall be paying close attention to ascertain their future growth potential.

We believe it is fully possible that the Company will achieve its initial forecasts for FY3/18. If the decline in stock revenue is kept down to 4% YoY, flow revenue increases 6%, and marketing revenue reaches around ¥Y1,000mn, we estimate that net sales will exceed ¥5,000mn. In terms of profits also, the percentages of profits provided by revenue type continued to steadily change in 1Q also. This suggests that that the customer mix is also smoothly shifting toward large-scale customers, just as the Company intended, so we can expect profitability to steadily improve in the future.

Simplified income statement and main indicators

(¥mn)

	FY3/14 full year	FY3/15 full year	FY3/16 full year	FY3/17 full year	FY3/18 full year	
					1Qresult	Full year (E)
Net sales	4,526	4,336	4,660	4,775	1,218	4,990
YoY	0.7%	-4.2%	7.5%	2.5%	5.5%	4.5%
Gross profit	1,728	1,649	1,769	1,548	351	-
Gross profit margin	38.2%	38.0%	38.0%	32.4%	28.9%	-
SG&A expenses	1,214	1,090	1,140	1,141	243	-
SG&A margin	26.8%	25.1%	24.5%	23.9%	20.0%	-
Operating profit	514	559	628	407	108	403
YoY	-15.3%	8.7%	12.5%	-35.2%	-10.6%	-1.0%
Operating profit margin	11.4%	12.9%	13.5%	8.5%	8.9%	8.1%
Recurring profit	516	562	628	401	106	397
YoY	-17.0%	8.9%	11.9%	-36.1%	-11.3%	-1.1%
Net profit	314	330	420	285	71	274
YoY	-17.4%	5.0%	27.3%	-32.1%	-12.2%	-3.8%
EPS after adjustment for share split (¥)	47.56	55.27	78.66	55.32	13.94	53.09
BPS after adjustment for share split (¥)	162.04	197.18	196.74	227.30	-	-
Dividend after adjustment for share split (¥)	15.50	17.00	24.00	24.00	-	

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

Standalone balance sheet

(¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Current assets	3,395	2,562	2,797	3,058	3,012
Cash and deposits	2,737	1,910	2,155	2,385	2,312
Accounts receivable	517	544	528	553	575
Fixed assets	691	589	511	447	480
Tangible fixed assets	197	159	100	82	129
Intangible fixed assets	268	207	116	108	103
Investments & other	225	223	293	256	247
Total assets	4,087	3,152	3,308	3,505	3,492
Current liabilities	1,991	2,036	2,098	2,471	2,296
Accounts payable	169	178	180	173	190
Short-term borrowings	-	100	100	324	-
Deposits held	1,385	1,392	1,393	1,559	1,740
Fixed liabilities	11	136	40	18	22
Long-term borrowings	-	124	24	-	-
Shareholders' equity	2,078	978	1,162	1,012	1,173
Paid-in capital	523	523	523	523	523
Capital surplus	539	539	539	539	539
Retained profits	2,007	2,203	2,439	2,759	2,921
Treasury stock	-991	-2,287	-2,339	-2,810	-2,810
Total valuation and conversion difference	3	0	6	3	-0
Stock subscription rights	2	0	0	-	0
Net assets	2,084	978	1,170	1,015	1,173
Total net assets & liabilities	4,087	3,152	3,308	3,505	3,492

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

Shareholder returns

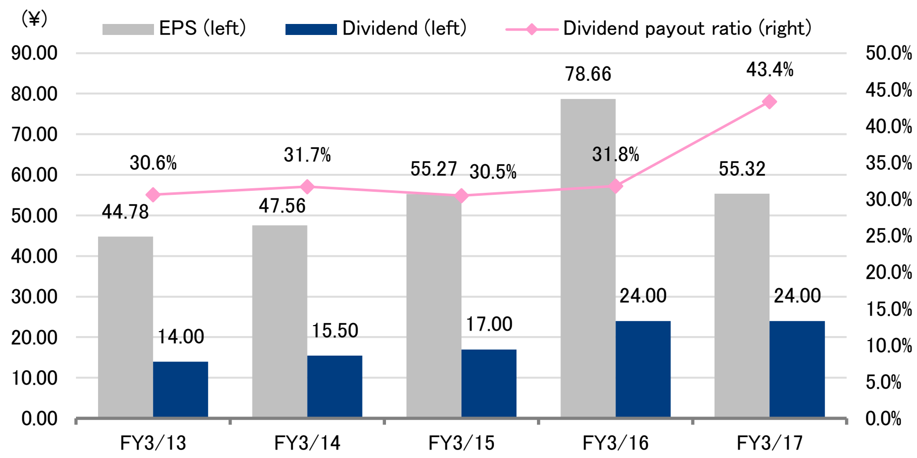
Paid a dividend of ¥24 for FY3/17 based on its basic philosophy of "dividing profits between three groups"

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 FY3/17, the Company paid a dividend of ¥24 (period-end dividend only), which is unchanged YoY. The dividend payout ratio is 43.4%, which is higher than the last few years when it continued to be around the 30% range. Although net profits declined 32.1% YoY, it seems that the Company is prioritizing dividend stability during a period in which profits are declining due it conducting upfront investment in return for growth in the future.

The Company has not yet decided a dividend forecast for FY3/18. Typically, it does not decide it at the start of the fiscal year, and in this fiscal year also, it seems that it will decide and announce the dividend forecast while watching to see how results trend. As the initial net income forecast for FY3/18 is ¥274mn (down 3.8% YoY), which is within the range to be considered basically unchanged YoY, it would seem reasonable to think that the dividend will also be basically unchanged YoY.

Trends in EPS, dividend, and dividend payout ratio
(results on a standalone basis)



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

Information security

In addition to undergoing regular external checks, it has already obtained PCI DSS certification for card payments

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. Conversely, it outsources its security at a pace of once a year, and 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 card payment service within its EC support ASP services. 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 which is operated and managed by PCI SSC, and it has already acquired the certification for it (it is a member of the Japan Card Data Security Consortium, which is the group managing PCI DSS in Japan).

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