COMPANY RESEARCH AND ANALYSIS REPORT

Syuppin Co., Ltd.

3179

Tokyo Stock Exchange First Section

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Summary

Completed the platform to drive expansion of income
Aims to accelerate income growth by fully leveraging this effect from FY3/19

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 scope of its business.

1. Posted higher sales and profits in FY3/18; beat revised guidance and set all-time highs in sales and profits

The Company posted sharply higher sales and profits in FY3/18 with ¥30,921mn in net sales (+23.7% YoY) and ¥1,536mn in operating income (+40.1%). By product category, sales growth rates exceeded 20% in mainstay cameras and watches. All sales channels delivered higher sales - e-commerce, stores, and duty-free sales at stores (inbound sales). In earnings, the SG&A expenses ratio dropped 0.9ppt YoY to 11.5% and operating margin rose to 5.0%.

2. Making healthy progress with various measures, completed the platform to drive expansion of income

We have repeatedly explained in past reports that the Company's excellent business model is the main source of its success up to now. The Company has taken steps to rationally and incrementally strengthen various aspects of its business model, including reinforcement of one-to-one marketing and launching EVERYBODY×PHOTOGRAPHER.com. These measures are making healthy progress and the platform to drive expansion of income was finished through FY3/18. The platform refers to a framework (environment) that facilitates collaboration and interaction of measures promoted by the Company to expand income. The Company aims to fully utilize CGM marketing and other strategies in this environment in order to accelerate income growth.

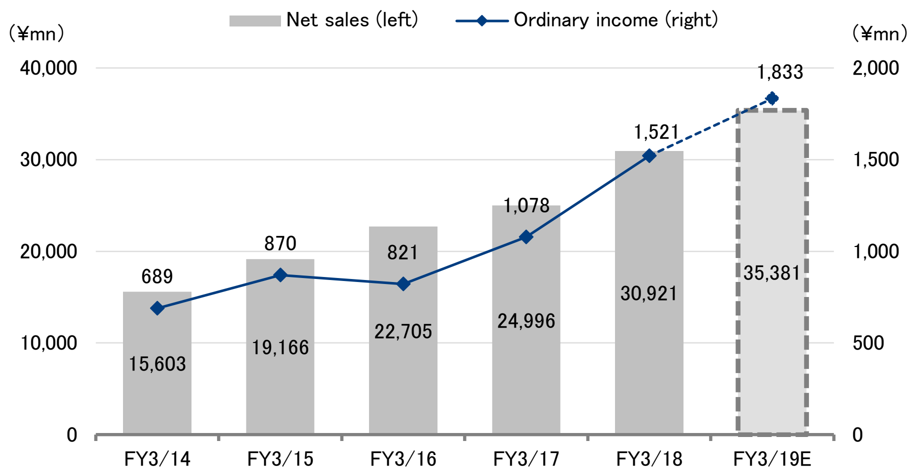
3. Focus on progress with measures and extent of upside in FY3/19

The Company annually announces a rolling medium-term plan for the next three years. This time it raised FY3/19 and FY3/20 targets from the previous plan and newly added FY3/21 targets. It forecasts ¥35,381mn in net sales (+14.3% YoY) and ¥1,842mn in operating income (+19.9%) in FY3/19, seeking to sustain annual growth rates of about 15% in net sales and in the 20% range in ordinary income. The outlook counts on contributions from the platform to expand sales mentioned above. Additionally, the Company plans to implement new initiatives from FY3/19, such as improvement of business efficiency and video distribution of product information. While medium-term goals are not at easy levels, we think the Company is capable of attaining results exceeding the medium-term business plan if these measures realize the anticipated effect.

Key Points

- Continually implementing effective measures that leverage the business model of e-commerce specialization
- Completed the platform to expand income through FY3/18, moving next to a stage of pursuing income growth through full-fledged utilization of CGM marketing
- Aiming for annual growth rates of about 15% in net sales and in the 20% range in ordinary income on success of sales expansion measures enacted thus far and new initiatives to improve business efficiency

Results trends



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

Results trends

Posted all-time highs with sharply higher sales and profits
Increased sales in all sales channels

1. Overview of FY3/18 results

The Company reported sharply higher sales and earnings in FY3/18 at ¥30,921mn in net sales (+23.7% YoY), ¥1,536mn in operating income (+40.1%), ¥1,521mn in ordinary income (+41.1%), and ¥1,077mn in net income (+45.4%). These results surpassed the upwardly revised forecast announced on February 5, 2018.

FY3/18 results summary

(¥mn)

	FY3/17			FY3/18				
	1H result	2H result	Full-year result	1H result	2H result	Revised full-year forecast	Full-year result	YoY
Net sales	11,161	13,834	24,996	14,435	16,486	30,770	30,921	23.7%
Gross profit	1,917	2,285	4,202	2,418	2,686	-	5,105	-
SG&A expenses	1,444	1,661	3,105	1,681	1,886	-	3,568	-
Operating income	472	624	1,096	736	800	1,523	1,536	40.1%
Operating margin	4.2%	4.5%	4.4%	5.1%	4.9%	4.9%	5.0%	-
Ordinary income	465	612	1,078	730	790	1,510	1,521	41.1%
Net income	319	421	741	503	574	1,044	1,077	45.4%

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

By product category, sales climbed sharply in mainstay cameras at just over 20% and watches at just over 30%. All sales channels delivered higher sales - e-commerce, stores, and duty-free sales at stores (inbound sales). The Company's businesses expanded income almost uniformly.

In earnings, while gross margin slipped by 0.3ppt from 16.8% in FY3/17 to 16.5% in FY3/18, the Company effectively controlled SG&A expenses again and lowered the SG&A expenses ratio by 0.9ppt from 12.4% to 11.5% respectively. Operating income hence improved by 0.6ppt YoY to 5.0%.

Decline in gross margin occurred for the same reasons explained in our previous report (December 22, 2017) following 1H results. Primary pressures came from change in the sales composition of watches due to upbeat activity and sales promotion costs to maintain suitable and fresh inventories amid healthier buying of used cameras than expected. We maintain our existing view on buying that used products play a key role in the Company's business model and it is vital for the Company to sufficiently purchase used products.

SG&A expenses increased 14.9% YoY to ¥3,568mn. Looking at the breakdown, while almost all items moved higher YoY, ratios to sales dropped for most items. Advertising and promotional costs, which are given particularly close attention, fell 15.0% (¥9mn) YoY and eased to 0.2% of sales. We think the Company's low advertising and promotional costs, despite its more than ¥30bn in sales, highlights the uniqueness and strength of the business model.

Breakdown of SG&A expenses

(¥mn)

	FY3/17				FY3/18				
	1H	2H	Full year	Ratio to net sales	1H	2H	Full year	YoY change	Ratio to net sales
Personnel expenses	493	588	1,081	4.3%	517	631	1,148	66	3.7%
Advertising expenses	32	31	63	0.3%	26	27	53	-9	0.2%
Sales promotion expenses	177	224	401	1.6%	270	275	545	144	1.8%
Outsourcing expenses	67	64	131	0.5%	76	91	167	36	0.5%
Commissions paid	293	333	626	2.5%	352	395	747	120	2.4%
Depreciation and amortization	97	100	197	0.8%	94	101	195	-1	0.6%
Land rent	105	106	211	0.8%	105	113	218	7	0.7%
Other	176	216	392	1.6%	224	268	492	99	1.6%
SG&A expenses	1,444	1,661	3,105	12.4%	1,681	1,886	3,568	462	11.5%
Ratio of SG&A expenses to net sales	12.9%	12.0%	12.4%	-	11.7%	11.4%	11.5%	-	-

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

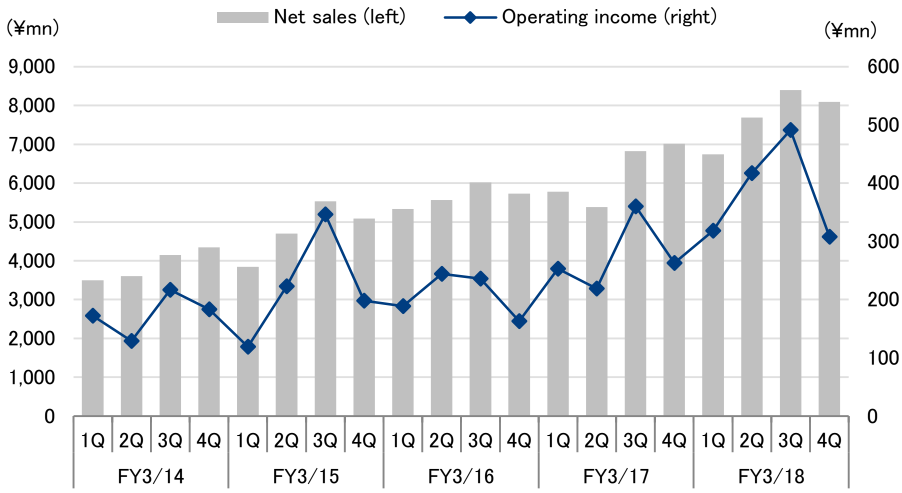
Healthy trends in main indicators, such as used goods purchase value, the used goods ratio, and duty-free sales

2. Quarterly results and KPI trends

(1) Trends in quarterly business performance

In quarterly results, sales climbed at an upbeat pace of 32.0% YoY in 3Q, the main demand period, and then only dropped 3.6% QoQ in 4Q (rising 15.4% YoY). Continuation of healthy camera purchases and sales in 4Q enabled the Company to sustain momentum in 4Q in the absence of major new products. We think the Company's one-to-one marketing and other measures contributed substantially to this outcome.

Trends in quarterly business performance



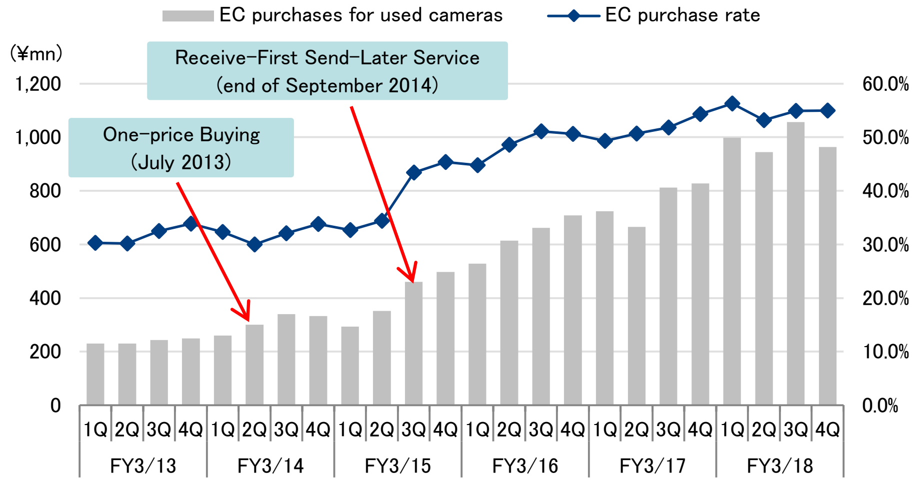
Source: Prepared by FISCO from the Company's financial results

(2) Used product purchase value

While this overlaps some with previous points, purchasing used products is the most important issue for the Company and other reuse business operators. The Company has sought to increase buying value with its one-price buying, receive-first send-later service, and other industry-first initiatives and innovative ideas. In Phase 2.0 of one-to-one marketing, which started in October 2016, the Company incorporated a function to send notifications by e-mail of changes in buying prices as a mechanism aimed at boosting purchase value. This feature delivered more of an effect than expected and contributed substantially to higher purchase value in FY3/18.

Camera inventory accumulated more than expected in FY3/18 due to this factor. Rather than being hesitant, the Company responded by increasing sales and accelerating inventory turnover. Its business model is highly committed to the belief that robust inventory is the most powerful way of attracting customers and a key weapon. Reinforcement of sales promotions to increase volume contributed to the decline in gross margin. Nevertheless, the Company started a new coupons initiative in FY3/18 and is likely avoid gross-margin downside in the future (details are provided below).

Trends in used product EC purchases for cameras business



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

(3) Used products ratio in sales

The used products ratio in sales held steadily at about 45% in FY3/18. Since used products generally have a larger profit margin than new ones in the Company's case, a high used products ratio would seem preferable. However, we think new product sales are also an important aspect and having an extremely high ratio of used products sales is not necessarily positive. One factor curtailing the used product ratio in FY3/18 was a vibrant 32.6% YoY increase in watches sales. The watches business has a substantial percentage of new products. Growth in this area hence leads to decline in the overall used products ratio.

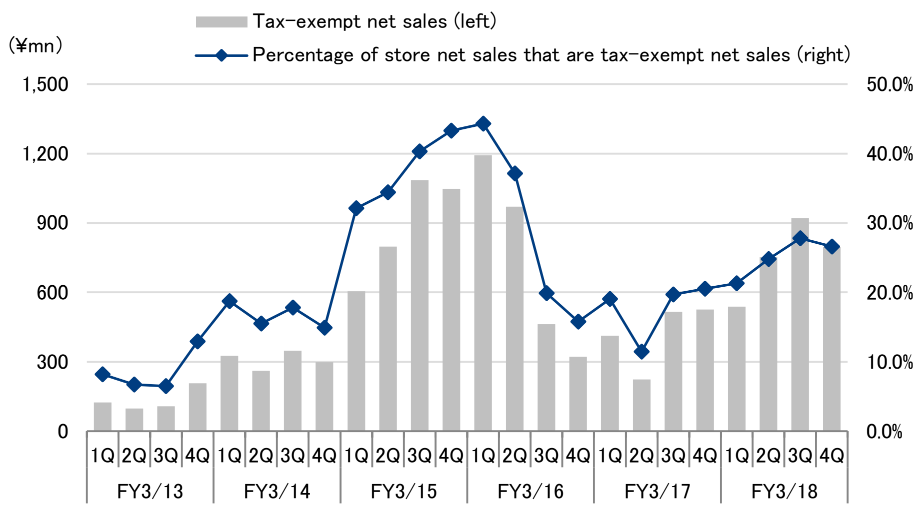
We believe gains in new product sales are driving the Company's growth. Expansion of used product transactions (purchases and sales) provides a catalyst for increase in new product sales. We conclude that the current used products ratio is at a suitable level for the Company in light of overall trends in FY3/18, particularly watches business.

(4) Tax-exempt net sales

Duty-free sales increased 79.1% YoY to ¥3,005mn in FY3/18. This was less than the peak of ¥3,535mn (FY3/15), but slightly surpassed FY3/16's ¥2,947mn and secured the No.2 spot. This category steadily trended upward from 1Q in quarterly results versus store sales. We think the Company had only factored in about ¥100-150mn in monthly duty-free sales, especially given its past experience with sudden fluctuation. Actual activity is coming close to the past inbound bubble period.

It is difficult to assess the current situation in duty-free sales. Because an upward trend is anticipated in the future, there are two kinds of movement to be considered. We either evaluate the situation positively, as a robust growth engine that is likely to continue fueling gains, or we consider the risk of sudden fluctuations in sales, as seen in the past. Our company believes we should take the positive view. Duty-free sales are currently only at 25% of store sales, in contrast to 30% in FY3/16. This means that store sales besides duty-free business are expanding at a healthy rate. E-commerce sales are similarly growing. We hence see less impact from fluctuations in duty-free sales than in the past.

Trends in tax-exempt net sales



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

Large sales gains in mainstay cameras and watches
Contributions from one-to-one marketing and other measures

3. Trends by business segment

Details by business segment

		FY3/17			FY3/18		
		Full year	YoY	EC ratio	Full year	YoY	EC ratio
Cameras	EC	12,802	20.7%	70.6%	15,545	21.4%	70.9%
	Stores	5,328	-10.6%		6,391	19.9%	
	Total net sales	18,131	9.4%		21,937	21.0%	
	Segment operating income	1,442	23.4%		1,833	27.1%	
	Operating margin	8.0%	-		8.4%	-	
Watches	EC	2,288	22.4%	38.1%	2,784	21.7%	34.9%
	Stores	3,725	8.6%		5,190	39.3%	
	Total net sales	6,013	13.4%		7,974	32.6%	
	Segment operating income	307	33.0%		475	54.5%	
	Operating margin	5.1%	-		6.0%	-	
Stationery	EC	348	11.5%	68.1%	395	13.7%	68.9%
	Stores	163	2.8%		177	8.9%	
	Total net sales	511	8.6%		573	12.2%	
	Segment operating income	46	-14.4%		39	-15.6%	
	Operating margin	9.0%	-		6.8%	-	
Bicycles	EC	255	6.1%	75.2%	337	32.1%	77.3%
	Stores	83	-29.9%		99	18.0%	
	Total net sales	339	-5.8%		436	28.6%	
	Segment operating income	-14	-		-4	-	
	Operating margin	-4.1%	-		-0.9%	-	
Company-wide	EC	15,694	20.4%	62.8%	19,062	21.5%	61.6%
	Stores	9,301	-3.8%		11,858	27.5%	
	Total net sales	24,996	10.1%		30,921	23.7%	
	Segment operating income	1,096	31.8%		1,536	40.1%	
	Operating margin	4.4%	-		5.0%	-	

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

(1) Cameras business

Camera business posted higher sales and profits at ¥21,937mn in sales (+21.0% YoY) and ¥1,833mn in operating income (+27.1%). Operating margin improved by 0.4ppt from 8.0% a year ago to 8.4%. In sales channel data, e-commerce sales rose 21.4% to ¥15,545mn and store sales increased 19.9% to ¥6,391mn, exhibiting similar growth rates. Many of the measures promoted by the Company address cameras, the largest sales category. In FY3/18, one-to-one marketing actions had a full-fledged impact on sales efforts and fueled higher sales. Specifically, the service of sending price change and arrival information on products in customer "wish lists" interacted favorably with the above-mentioned rise in purchase value to drive a beneficial cycle of "higher used camera purchases leading to higher camera sales and thereby increase in used cameras purchases" and raised sales.

(2) Watches business

Watches business reported ¥7,974mn in sales (+32.6% YoY) and ¥475mn in operating income (+54.5%). Operating margin improved by 0.9ppt from the previous year's 5.1% to 6.0%. In sales channel results, e-commerce sales were up 21.7% to ¥2,784mn and store sales expanded 39.3% to ¥5,190mn. Core store sales realized stronger growth. The Company aggressively invested in inventories in FY3/18. Luxury mechanical watches, the area it handles, attract substantial customer interest just by being in inventory (having the actual products). While this is true about the full range of the Company's products, the pattern is particularly evident in watches. In e-commerce, we attribute sales growth to the ability of customers to confirm the state of the product in images based on a presentation with 30 still images as well as the positive effect of one-to-one marketing, similar to cameras.

(3) Stationery business

Stationary business recorded lower profits on an increase in sales with sales gaining 12.2% YoY to ¥573mn, while operating income dropped 15.6% to ¥39mn. Viewed by sales channels, e-commerce sales improved 13.7% to ¥395mn and store sales were up 8.9% to ¥177mn. Sales strengthened on inroads by the Kingdom Note brand and introduction of Kodawari Kensaku searches and reinforcement of image data. Operating income weakened on decline in gross margin due to aggressive sales measures.

(4) Bicycles business

Bicycles business recorded ¥436mn in sales (+28.6% YoY) and a ¥400mn operating loss (vs. a ¥14mn loss in FY3/18). The Company successfully lifted sales with rollout of Kodawari Kensaku searches, expansion of image data, and promotion of omni strategy (attracts customers through the e-commerce site and bolsters store sales). In sales channels, e-commerce sales increased 32.1% YoY to ¥337mn and store sales rose 18.0% to ¥99mn. E-commerce grew at a faster pace. Operating income just barely missed realization of a profit due to accumulating various costs in order to boost sales.

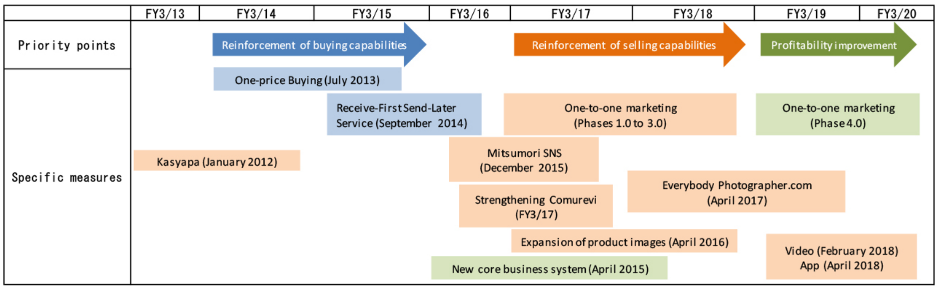
Measures for growth and updates

The Company is continuously implementing 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 – 1) limiting scope as a reuse company to products with "value," 2) utilizing an e-commerce model (it only has one real-world store), and 3) seeking growth through expansion of used goods and new products. Looking back at the Company's track record, we believe its rational and incremental implementation of correct measures for achieving growth have led to the success it has today.

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 and then changed course to increasing sales and quickly rolling out a variety of measures. It focused on and leveraged consumer generated media (CGM) marketing, a good fit with the e-commerce business model, at an early stage. Some examples are its launches of "Mitsumori (estimate) SNS" and "Comurevi." It also adopted high-precision 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.

Finished Phase 3.0, clear effect in boosting activity by existing members

2. Progress in one-to-one marketing

The Company placed emphasis on measures to expand sales in FY3/17-18. A key element is one-to-one marketing that strengthens marketing to individuals. The initiative consists of Phases 1.0 to 4.0, and Phase 3.0 was finished through FY3/18.

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

Sales moved above ¥30bn in FY3/18. While the Company sustained growth at a 20% annual pace during the period of raising sales from ¥10bn to ¥30bn, even 15% growth at this point with sales above ¥30bn requires about ¥5bn a year. This is not a simple hurdle (refer below for a detailed explanation of the results plan). The Company achieved growth up to now by striving to improve its own (and e-commerce site) recognition and reliability and uncover needs to purchase high-priced products, such as cameras and watches, through e-commerce. With sales above ¥30bn, however, it is vital to not only recruit new customers (or new members), but also stimulate activity by existing members. This is the real aim of one-to-one marketing. Even more pointedly, the program targets further stimulation of current active members, rather than trying to elicit activity from quiet members.

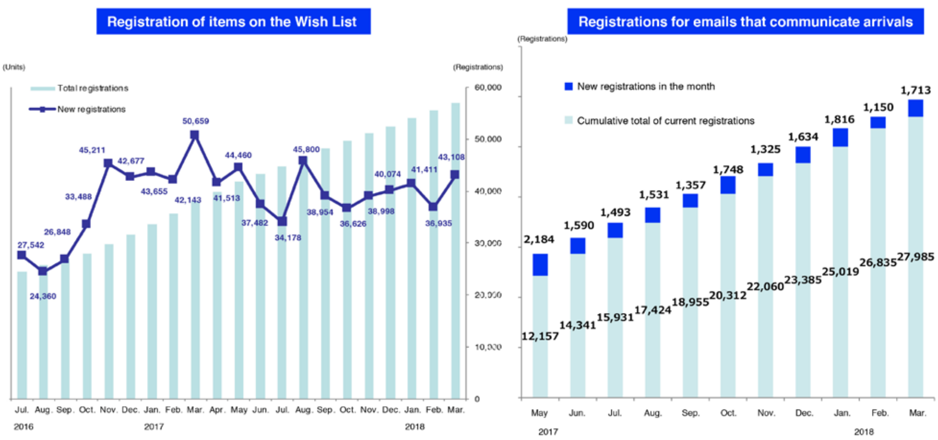
Completion of one-to-one marketing through Phase 3.0 means that top-page personalization for individual customers is ready. Specific personalization content includes 1) display of recommendations based on viewing history, 2) display of recommendations based on purchase records and My Items, 3) listing purchase price change information for purchased products and owned products, and 4) listing arrival and sales price change information for products registered on the wish list.

The one-to-one marketing effect shows up clearly in numerical data.

The Company measures the active rate of Web members (existing members). This rate is defined as the percentage of active members (members with one or more purchases during the subject period) to the total number of members in each period (period-start level for the subject quarters on a quarterly basis). The number of active (buying) members and the active rate are both increasing and rising each quarter. Monthly gains in total member volume keep increase in the active rate at a moderate level. Nevertheless, we think the active rate's upward trend, despite steady additions, confirms that "further stimulation of active members" is having the targeted effect.

Main contributors to lifting the active 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: From the Company's results briefing materials

Completed the income expansion platform with the launch of Everybody Photographer.com, moving to a stage of full-fledged utilization of CGM marketing and pursuit of income growth

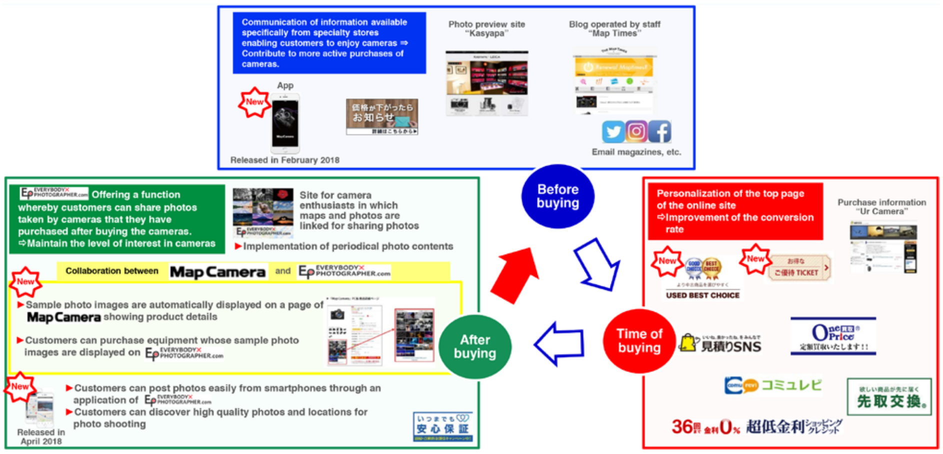
3. Everybody Photographer.com and completion of the platform

Everybody Photographer.com is the name of the dedicated web site for camera enthusiasts to upload their creations. While it initially started as an opportunity for the Company's customers to enjoy photos utilizing cameras and lenses they buy from the Company, it has become an independent presence (from MapCamera) and widely accepts high-level amateur cameramen unrelated to whether they are members. The Company promotes the EVERYBODY X PHOTOGRAPHER.com website as an opportunity for enjoyment after a camera purchase, but is looking beyond to stimulation of the camera market and increased sales. Uploads to the website totaled about 24,000 photos since the launch as of end-April 2018. The website carries many sophisticated creations by high-level amateurs (refer to our report issued on December 22, 2017 for more details on EVERYBODY X PHOTOGRAPHER.com).

The launch of EVERYBODY X PHOTOGRAPHER.com completes creation of an environment (platform) that facilitates camera purchases from the Company (MapCamera) by arranging involvement in all steps of the buying process for camera users, including before a purchase, at the purchase, and after the purchase.

Platform refers to an "environment that gets something to happen." The Company's platform seeks to enhance the effect of above-mentioned CGM marketing. Mitsumori SNS, Comurevi, and other features are part of the environment as CGM marketing and platform components. By fostering collaboration and interaction among initiatives and measures implemented thus far, the Company wants to maximize the effect of CGM marketing. EVERYBODY X PHOTOGRAPHER.com was the final piece to complete the ring of collaboration.

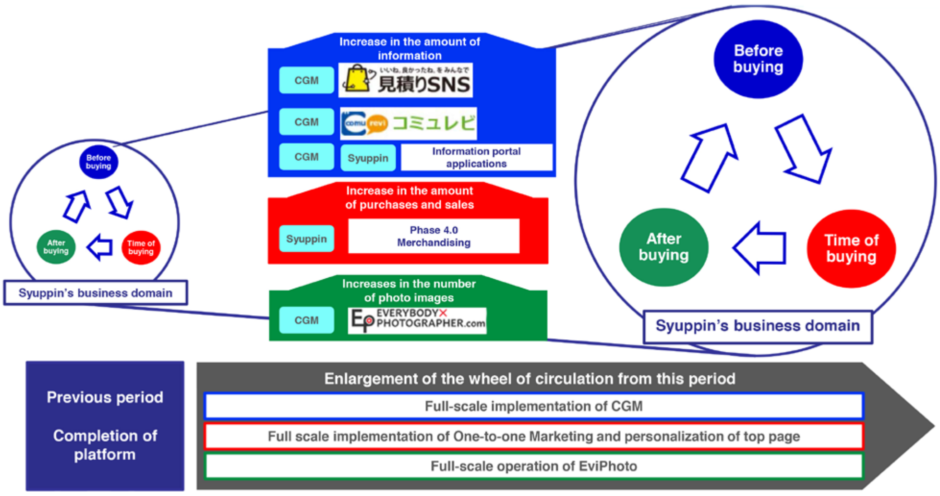
Platform related to the camera purchase cycle



Source: From the Company's results briefing materials

With the platform finished, the Company aims to ramp up CGM marketing and expand income. Mitsumori SNS and Comurevi are main features of the CGM marketing platform. While EVERYBODY X PHOTOGRAPHER.com is a forum for enjoyment after camera purchases as explained earlier, the Company utilizes photo data from EVERYBODY X PHOTOGRAPHER.com as links to MapCamera's individual product pages. MapCamera viewers hence can look at creations from subject model. We expect a large effect in CGM marketing from EVERYBODY X PHOTOGRAPHER.com through linking photos provided by general consumers to purchases of cameras by other consumers.

Image of expanding income through completion of the platform



Source: From the Company's results briefing materials

Medium-term management plan

Aiming for annual growth rates of about 15% in net sales and in the 20% range in ordinary income on success of sales expansion measures enacted thus far and new initiatives to improve business efficiency

The Company annually announces a rolling medium-term management plan for the next three years. In the rolling plan announced in May 2018, it raised FY3/19 and FY3/20 sales and profit targets from the previous plan and newly added FY3/21 targets.

Medium-term management plan: FY3/19–21

	FY3/18		2018 rolling medium-term plan (FY3/19–21)							
			FY3/19			FY3/20			FY3/21	
	Result	YoY	Previous plan	New plan	YoY	Previous plan	New plan	YoY	Plan	YoY
Net sales	30,921	23.7%	32,620	35,381	14.3%	37,575	40,896	15.6%	47,053	15.1%
Cameras business	21,937	21.0%	23,654	25,152	14.7%	27,517	29,163	15.9%	33,926	16.3%
Watches business	7,974	32.6%	7,794	9,128	13.9%	8,696	10,497	15.0%	11,738	11.8%
Stationery business	573	12.2%	713	621	8.5%	825	696	11.9%	780	12.1%
Bicycles business	436	28.6%	460	480	9.6%	537	540	12.6%	609	12.7%
Gross profit	5,105	21.5%	5,671	6,014	17.8%	6,548	6,950	15.6%	8,013	15.3%
Gross margin	16.5%	-	17.4%	17.0%	-	17.4%	17.0%	-	17.0%	-
SG&A expenses	3,568	14.9%	3,848	4,171	16.5%	4,305	4,683	12.3%	5,153	10.0%
Ratio of SG&A expenses to net sales	11.5%	-	11.8%	11.8%	-	11.5%	11.5%	-	11.0%	-
Operating income	1,536	40.1%	1,822	1,842	19.9%	2,243	2,268	23.0%	2,860	26.1%
Operating margin	5.0%	-	5.6%	5.2%	-	6.0%	5.5%	-	6.1%	-
Ordinary income	1,521	41.1%	1,811	1,833	21.4%	2,235	2,259	23.2%	2,854	26.3%
Net income	1,077	45.4%	1,241	1,251	19.6%	1,531	1,548	23.7%	1,955	26.3%

Source: Prepared by FISCO from the Company's materials

Closer review of the new three-year plan shows that it consists of three main points – 1) aiming for roughly 15% annual sales growth, 2) maintaining gross margin at 17.0% following the 16.5% result in FY3/18, and 3) seeking continuation of a downward trend in the SG&A expenses ratio by curtailing the growth pace in the absolute value of costs. We review the details below.

1. Sales stance

The Company is aiming for roughly 15% average annual sales growth with a channel breakdown of about 20% in e-commerce sales and roughly 8% in store sales. While the e-commerce sales outlook is on par with the current situation, the store sales view is fairly weak compared to the 27.5% gain in FY3/18. We think this reflects a cautious stance toward the inbound impact.

The goal of 15% sales growth, meanwhile, is not an easy hurdle and works out to about ¥5bn in additional sales. We estimate annual sales growth of about ¥3bn based on past results with continuation of the current new member (buyer) acquisition pace and keeping the average purchase price at about the same level. The Company hence needs to obtain the other ¥2bn by boosting activity among existing members.

A specific measure in this direction is CGM marketing described above. With the platform finished, the next step is actually going through the PDCA cycle with individual CGM marketing programs and enhancing precision. We also think efforts to strengthen measures that support CGM marketing (such as increasing the number of photos on EVERYBODY X PHOTOGRAPHER.com, boosting the number of community reviews, and improving operability of Mitsumori SNS) will become more important.

The Company started cross-border e-commerce in FY3/18. It currently has a store on the eBay e-commerce mall in North America and appears to be within reach of ¥500mn in FY3/19 sales based on recent activity. However, domestic business remains the main focus because the Company is already generating sales in Japan, while cross-border e-commerce is positioned as a test initiative for the future.

2. Gross margin and costs

The Company expects gross margin at 17% during the three years covered by the medium-term business plan. We think this stance sends a dual message of resolve to improve margin from the 16.5% result in FY3/18 but also not being overly optimistic about gross margin prospects.

In costs, the Company plans to add about 30 employees, including new university graduates, in FY3/19. Increase in personnel expenses, the largest item in the Company's SG&A expenses, is likely to raise the SG&A expenses ratio by 0.3ppt versus the previous year to 11.8%. Nevertheless, the plan subsequently calls for curtailment of the pace of adding people and return to a downward trend in the SG&A expenses ratio.

3. One-to-one marketing Phase 4.0

The Company is putting emphasis on Phase 4.0 of one-to-one marketing in future measures. As explained previously, it mainly targeted top-line growth, such as expanding sales and increasing purchases, in Phases 1.0 to 3.0. In Phase 4.0, meanwhile, consists of backyard side measures to improve business efficiency. Balanced reinforcement of front and back operations is important, in our view, and we hence have a very favorable assessment of management capabilities in carrying out these measures.

Phase 4.0 specifically seeks automation of the task of updating purchase prices and sales prices in a timely manner in light of the supply-demand balance. The Company conducted this process manually up to now. Since it is covering about 20,000 items, however, continuation of manual handling of this operation is not efficient. We think the effort to make improvements is a major turning point.

Even more important is close linkage of Phase 4.0 business content to Phase 1.0 to 3.0 measures. In decisions on the supply-demand balance, which is the basis of setting prices, the system will incorporate not only logistics volume flowing through the Company's system, but also registrations to the wish list, now-in-stock notification email, and buying price change mail services. The key point is the ability to match sellers and buyers by fully utilizing information on potential buyers and sellers and accumulated data on market prices and transaction results. It is the largest feature and strength of Phase 4.0 and reason for inclusion of Phase 4.0 in one-to-one marketing. While Phase 4.0 is nominally an initiative to improve business efficiency, it actually seeks to expand income.

Business outlook

Monitor effects from new measures such as BEST CHOICE, coupons, and video product explanations

● FY3/19 outlook

The FY3/19 forecast calls for ¥35,381mn in net sales (+14.4% YoY), ¥1,842mn in operating income (+19.9%), ¥1,833mn in ordinary income (+20.5%), and ¥1,251mn in net income (+16.1%).

Outlook for FY3/19

	FY3/18			FY3/19					
	1H result	2H result	Full-year result	1H forecast	YoY	2H forecast	YoY	Full-year forecast	YoY
Net sales	14,435	16,486	30,921	16,366	13.4%	19,015	15.3%	35,381	14.4%
Gross profit	2,418	2,686	5,105	-	-	-	-	6,014	17.8%
SG&A expenses	1,681	1,886	3,568	-	-	-	-	4,171	16.9%
Operating income	736	800	1,536	814	10.5%	1,028	28.5%	1,842	19.9%
Operating margin	5.1%	4.9%	5.0%	5.0%	-	5.4%	-	5.2%	-
Ordinary income	730	790	1,521	809	10.9%	1,024	29.6%	1,833	20.5%
Net income	503	574	1,077	549	9.3%	702	22.3%	1,251	16.1%

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

We explained FY3/19 targets and the general framework of initiatives to realize these levels.

The Company started multiple measures to expand income besides the ones addressed above at the end of FY3/18. It also plans to begin new measures during FY3/19. We describe the main initiatives below. Depending on effects from these measures, we see a good possibility of income beating the outlook.

BEST CHOICE and GOOD CHOICE display: Sometimes many products with the same rank are shown in used popular models. This format can confuse consumers and lead to hesitancy. Solution proposals to deal with the uncertainty are a vital aspect that occurs at stores but not in e-commerce (they also result in discrepancy in conversion rates). The Company began a program of assigning BEST CHOICE and GOOD CHOICE indications based on scratch locations, accessories, and other features (since March 2018).

Giving coupons: The Company previously provided discounted sales as a promotional measure. However, this approach directly lowers gross margin and runs the risk of weakening volume and the turnover rate through postponement of purchases. Instead the Company began the coupon feature. It can give coupons to all site users and achieve the same effect as a discounting sale. The difference is avoidance of nominal price erosion. It is also possible to attract additional purchases and bulk purchases by only giving coupons to customers who satisfy certain conditions or for related products to product buyers (started in March 2018).

Listing product introduction videos: Product images are extremely important in e-commerce. The Company lists numerous high-precision images (20-30 photos) of the products it sells. Nevertheless, there is still a portion not communicated by still images and the Company plans to supplement current image provision with the addition of video product information. It is starting with watches (used watches) and bicycles (used finished bikes) that offer the most potential in 1H and intends to broaden to cameras and stationary items in 2H. It hopes to expand recognition, including globally, because of planned distribution over You Tube.

Income statements

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19	
					1H (E)	Full year (E)
Net sales	19,166	22,705	24,996	30,921	16,366	35,381
YoY	22.8%	18.5%	10.1%	23.7%	13.4%	14.4%
Cameras business	13,758	16,572	18,131	21,937	-	-
Watches business	4,680	5,301	6,013	7,974	-	-
Stationery business	363	470	511	573	-	-
Bicycles business	363	360	339	436	-	-
Gross profit	3,348	3,729	4,202	5,105	-	-
Gross margin	17.5%	16.4%	16.8%	16.5%	-	-
SG&A expenses	2,461	2,897	3,105	3,568	-	-
Ratio of SG&A expenses to net sales	12.8%	12.8%	12.4%	11.5%	-	-
Operating income	886	832	1,096	1,536	814	1,842
YoY	26.4%	-6.1%	31.8%	40.1%	10.5%	19.9%
Operating margin	4.6%	3.7%	4.4%	5.0%	5.0%	5.2%
Ordinary income	870	821	1,078	1,521	809	1,833
YoY	26.2%	-5.6%	31.3%	41.1%	10.9%	20.5%
Net income	563	560	741	1,077	549	1,251
YoY	44.5%	-0.6%	32.2%	45.4%	9.3%	16.1%
After adjustment						
EPS (¥)	23.54	23.41	30.96	45.00	22.96	52.25
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)

	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18
Current assets	3,475	4,024	4,905	5,727	7,798
Cash and deposits	441	492	506	644	1,268
Notes and accounts receivable	1,049	917	1,327	1,612	1,851
Inventories	1,790	2,222	2,757	3,209	4,194
Other	195	393	315	262	485
Non-current assets	787	1,085	1,001	949	982
Property, plant and equipment	101	159	137	123	136
Intangible assets	210	607	530	468	443
Investments and other assets	475	318	333	356	402
Total assets	4,263	5,110	5,907	6,676	8,780
Current liabilities	1,906	2,260	2,585	2,954	3,353
Notes and accounts payable	727	656	940	823	1,045
Short-term loans payable, etc.	650	871	1,215	1,428	1,474
Other	529	733	430	703	834
Non-current liabilities	589	579	568	322	1,095
Long-term loans payable, bonds payable	584	577	568	322	1,095
Other	5	2	-	-	-
Shareholders' equity	1,766	2,270	2,746	3,392	4,325
Capital stock	508	508	508	508	508
Capital surplus	408	408	408	408	408
Retained earnings	849	1,352	1,829	2,474	3,408
Treasury shares	1	-	-	-	-0
Subscription rights to shares	-	-	6	6	5
Total net assets	1,766	2,270	2,753	3,399	4,331
Total liabilities and net assets	4,263	5,110	5,907	6,676	8,780

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

Cash flow statements

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18
Cash flows from operating activities	79	157	90	388	134
Cash flows from investing activities	-225	-262	-333	-122	-184
Cash flows from financing activities	16	154	257	-128	675
Effect of exchange rate change on cash and cash equivalents	0	-	-	-	-1
Change to cash and deposits at start of period	-130	50	14	137	624
Balance of cash and deposits at start of period	571	441	492	506	644
Balance of cash and deposits at end of period	441	492	506	644	1,268

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

Shareholder returns

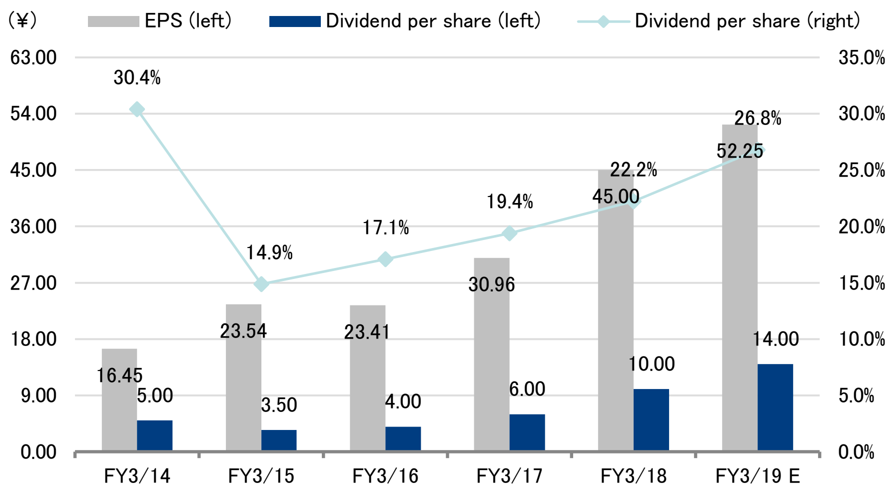
Conducted a 1-to-2 stock split and paid a ¥10 dividend in FY3/18 Planning a ¥14 dividend in FY3/19 (hike of ¥4)

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 conducted a 1-to-2 stock split on January 1, 2018 and paid a ¥10 dividend, a hike of ¥1 versus the initial plan, at the period end in FY3/18. Compared to the previous year, this level represented a ¥4 increase in real terms after factoring in the split (the FY3/17 dividend after the stock split adjustment worked out to ¥6). The dividend payout ratio was 22.2%.

The FY3/19 outlook projects a ¥4 hike to ¥14 and thereby puts the payout ratio using our EPS estimate (¥52.25) at 26.8%. We think the anticipated dividend hike demonstrates confidence in the ability to sustain double-digit sales and profit gains.

Trends in EPS, the dividend, and the dividend payout ratio



Source: Prepared by FISCO from the Company's materials

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 340,000 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.

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