COMPANY RESEARCH AND ANALYSIS REPORT

Syuppin Co., Ltd.

3179

Tokyo Stock Exchange Prime Market

24-Jan.-2024

FISCO Ltd. Analyst
Ikuo Shibata

FISCO Ltd.
https://www.fisco.co.jp

Index

Summary

In 1H FY3/24, record-high net sales achieved on a 1H basis amid steady growth persisting in the Camera Business. Full-year forecast unchanged amid likelihood of higher net sales and profits driven by brisk EC performance

Syuppin Co., Ltd. <3179> (hereafter, also "the Company") is an e-commerce (EC) enterprise specializing in "valuable items," such as cameras and luxury watches. Utilizing the different customer needs and product characteristics between used and new items, the Company has realized an expansion of the membership base and results growth, while having used and new items interact to support the other's sales. Recently, it has been working on initiatives including proprietary EC purchases, one-to-one marketing, and the utilization of CGM, and it continues to evolve its platform-type business model. During the past few years, store sales have been lackluster due to the COVID-19 pandemic, and the Watch Business, which has been engaged in strategic inventory investment, has temporarily lost steam as prices have fallen globally. In contrast, the mainstay Camera Business has been steadily growing led by EC with the introduction of new AI-based features*, etc., so it can be said that the Company has entered a new stage in terms of business model evolution.

* AIMD (AI-driven merchandising system), AI-driven content recommendations (using an AI engine that analyzes customer preferences and distributes a large number of content articles created and owned by the Company.), etc.

1. Overview of 1H FY3/24 results

In 1H FY3/24, the Company's net sales grew 6.8% year-on-year (YoY) to ¥23,381mn, but operating income declined 0.1% to ¥1,625mn. Although sales rose but profit declined, net sales reached a record high on a 1H basis. The core Camera Business encountered brisk performance both with EC and store results, thereby driving growth in earnings overall. Growth in duty-free sales in addition to continued success achieved with one-to-one marketing utilizing AI contributed to the increase in net sales. On the other hand, whereas the Watch Business encountered a downturn in earnings results due to a significant decrease in global market prices in 2H FY3/23, it has since turned toward recovery amid a scenario of market price stability, albeit sales were lower relative to the same period of the previous fiscal year. In terms of profit, the Company has been maintaining a high gross margin centered on the Camera Business, particularly through AIMD upgrades. Operating income was on par with that of the same period of the previous fiscal year amid a scenario where growth in gross profit absorbed higher personnel expenses attributable to higher average salaries. The operating margin is holding to a high level of 7.0%. In terms of activities, the Company has managed to improve various KPIs as a result of it having engaged in initiatives that have included upgrading AIMD, bolstering online purchase estimates for watches, and enhancing content centered around video streaming.

2. Outlook for FY3/24

The Company maintained its initial forecasts of higher sales and profits in FY3/24, with net sales to rise 9.7% YoY to ¥50,028mn and operating income to grow 26.8% to ¥3,122mn. It assumes the strongly performing Camera Business will continue to drive net sales growth, mainly in EC. On the other hand, the Company has left its initial conservative outlook unchanged for the Watch Business despite greater stability of market prices, which were attributable to the segment's weak performance in FY3/23, and recovery in inbound demand (duty-free sales). In terms of profit, the Company expects growth in the Camera Business and earnings improvement in the Watch Business to drive profit growth. In particular, it envisions the gross margin making a V-shaped recovery to 18.0% from 17.0% a year earlier, owing to the effects of using AIMD (including upgrades), as well as the erasure of one-offs (sales of goods at a loss and posting of losses on valuation of merchandise inventory) incurred by the Watch Business in the previous fiscal year.

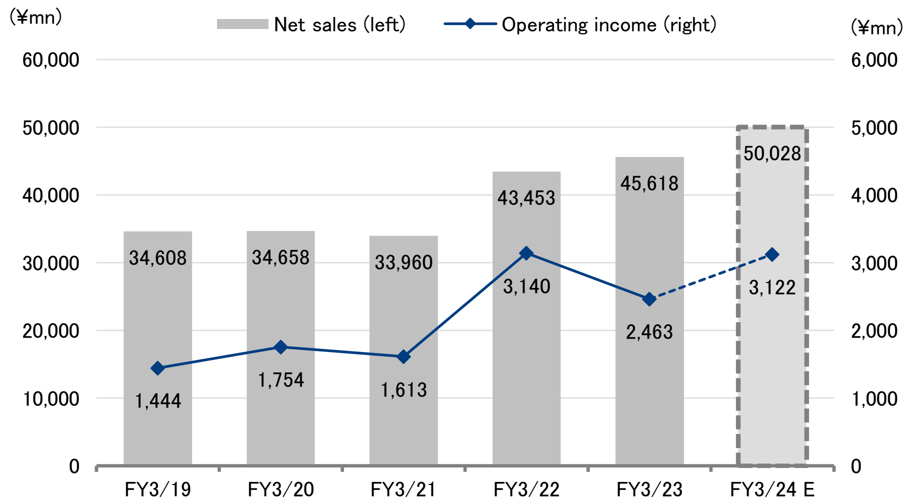
3. Strategy for future growth

The Company updates its three-year medium-term management plan annually on a rolling basis, and in May 2023, it announced a new medium-term plan. It intends to continue to further grow its Camera and Watch businesses and revitalize its global expansion through cross-border EC, etc., positioning sustainable growth in EC net sales through expansion of market share as the main driver. The Company also plans to emphasize profit growth over growth in net sales by utilizing AI to improve profit margins and reducing its SG&A expense ratio through lean management. For FY3/26, the final year of the current plan, it aims to achieve net sales of ¥63,141mn (a three-year average annual growth rate of 11.4%) and operating income of ¥4,827mn (an operating margin of 7.6%). Moreover, in 2H and beyond the Company intends to place renewed focus on sustained investment in technology and inventory as it seeks to expand its business by procuring products through an approach that enlists AI and data. To such ends, the Company will strengthen its Information Systems Division and furthermore create a framework for enabling appropriate procurement and inventory investment by building an AI system to support merchandising of watches.

Key Points

- In 1H FY3/24, the Company achieved record-high net sales amid steady growth persisting in the Camera Business
- Whereas the Watch Business encountered a downturn due to a significant decrease in market prices in FY3/23, it has since turned toward recovery amid a scenario of market price stability
- Company maintains its forecasts of sales and profits to rise in FY3/24 as Camera Business grows and Watch Business earnings improve
- In its medium-term management plan, the Company intends to achieve sustainable growth in EC net sales and improve profit margins through AI utilization by working to further grow its Camera and Watch businesses as well as revitalizing global expansion through cross-border EC

Results trends



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

Business overview

Is developing an EC business specializing in valuable "new and used items," such as cameras and luxury watches. Continued unique evolution through aggressive use of AI technology

The Company is an e-commerce (EC) business specializing in valuable "new and used items." It achieved strong growth by establishing its own business model that harnesses the Internet and its positioning as a business dealing with highly specialized items, capitalizing on the expansion of the EC market. It continues to evolve into a specialist EC site that harnesses technologies by introducing AIMD and AI-driven content recommendations (using an AI engine, the service automatically distributes recommended articles selected from its broad collection by analyzing customers' preferences).

The Company currently has over 640,000 web members (as of the end of September 2023). This number has been steadily increasing through continued net growth of 4,000 new members every month. On the other hand, it has established a physical store network of five stores in the Tokyo metropolitan area, with its basic policy being one store for one item. Stores contribute to results to a certain extent, but their main function is to complement the EC business as bases to disseminate information. Also, the composition of sales broken down by new items and used items is stable at around 1:1, and they each play important roles, generating synergies while mutually interacting to increase the other's sales.

There are four business segments: Camera Business, Watch Business, Stationery Business, and Bicycle Business*. The mainstay Camera Business provides approximately 75% of net sales. Meanwhile, the Watch Business is temporarily struggling with impact from falling global prices for luxury watches, but the Company still looks to accelerate growth by strategically enhancing the product lineup and expanding globally, while promoting a framework for enabling appropriate procurement and inventory investment.

* The Camera Business is conducted under the Map Camera brand, the Watch Business under the GMT and BRILLER brands (ladies' brand salon), the Stationery Business under the KINGDOM NOTE brand, and the Bicycle Business under the CROWN GEARS brand.

The Company's features

Strengths in platform-type business model, including its proprietary EC purchases, one-to-one marketing, and AI utilization

1. The growth model

The Company's net sales have grown alongside the increase in the number of web members. In other words, it can be said to have a recurring-revenue business model, in which alongside the acquisition of new customers through effective EC marketing, it captures members and promotes continuous purchases, which leads to sales growth. Therefore, in addition to the number of newly acquired members and the total number of members, the number of purchasing members and the active rate* are important KPIs. Currently, web numbers have grown to approximately 640,000 people, but there remains plenty of room for the number of newly acquired members (and total members) to further increase in the future through its proprietary business model, including strengthening measures for young and female members and expanding its market share in areas outside the Kanto region. Also, increasing the number of purchasing members through maintaining and raising the active rate can be expected to be beneficial for improving results and costs. Moreover, the accumulation of "merchandise" (the inventory of used items) is an important KPI that will lead to sales increasing in the future. Unlike other companies in the same industry (such as those involved in reusing and recycling) that collect used items by paying high advertising costs, the Company is focusing on collecting "valuable inventory items," which is its core value, including through its proprietary mechanism for EC purchases and powers of discernment in addition to utilization of AI, and it can be said that this has led to acquisitions of new members and continuous purchases.

* The Company defines the active rate as the number of members who make a purchase in a fiscal quarter (excluding new purchasing members) in relation to the total number of members at the start of that quarter.

2. The Company's features (strengths)

(1) Proprietary model specializing in EC

Since its foundation, the Company has focused on a model specializing in EC that is limited to "valuable items." In other words, it can be said to have established a unique position through specializing in high-value-added items and the convenience of EC. In particular, it is able to respond flexibly to economic fluctuations as it does not incur fixed costs. Additionally, it benefits from having few bottlenecks for increasing sales and from being able to focus on achieving high profitability alongside the growth of net sales. Another strength is that the Company has increased the percentage of sales on the Company's website to approximately 80% by providing its own services, in contrast to the high dependence of competitors on other companies' malls. This has enabled its platform-type business model described later, as well as a reduction in the burden of fees. Meanwhile, although stores have been affected by COVID-19 in the past few years, they have been making a certain contribution to business performance and serving as a base for disseminating information, driven by factors including inbound demand (duty-free sales). The Company intends to continue developing its business based around EC, especially by using its own website as a platform.

(2) Synergies between new items and used items

The composition of total net sales provided by new items and used items trend at around 1:1. For the Company, both play important roles and have contributed to expanding its customer base and its results growth, while mutually interacting to boost the other's sales. In other words, compared to used items with high profit margins, for which there are many single items, the significance of handling new items, for which competition is fierce, is not only their contribution to results, but also that they provide opportunities to acquire new members (capture new customers) and trade in used items. In particular, when the Company sells a new item, it has a major impact on results and also provides it with the biggest opportunity to acquire a new member. Therefore, the handling of new items functions as a catalyst in order to increase sales of used items. Conversely, for sales of new items as well, the Company is able to differentiate itself through trade-ins of used items owned by customers (by indicating purchase prices that are acceptable to customers), which generates synergies.

(3) Mechanism for collecting "valuable inventory items"

As previously explained, the Company's growth depends on how it collects "valuable inventory items" (used items). Preparing a high-quality inventory not only raises the value of the Company's brand and attracts buyers, it also creates a virtuous cycle through building trust with sellers, which in turn leads to the collection of more high-quality inventory items. It has been able to differentiate itself from other companies by working to enhance functions, including by 1) indicating purchase prices that are acceptable to customers and that correspond to the item's value determined by detailed assessment standards, 2) responding to trade-in needs by handling new items, and 3) enabling estimated purchase prices to be easily obtained on the internet. It is also introducing its own mechanism for EC purchases, including one-price buying®*1 and the receive-first, send-later service®*2, further raising convenience for the customers to sell, which has led to increases in the EC purchase amount. It also aggressively uses AI, working on improving efficiency (reducing opportunity losses) through an online personal identification service using AI facial authentication*3 and development of AIMD*4 and other measures. Going forward, the Company intends to adopt mechanisms in the Watch Business for making purchase decisions and determining prices in a manner that involves enlisting AI and data.

*1 A service to guarantee the fixed-price purchase amount of items specified by the Company (launched in July 2013). Following on its success in the Camera Business, the service has been fully adopted also in the Watch Business effective from FY3/24.
*2 A service that enables the customer to receive the item in advance when trading-in (exchanging) a camera that they own and purchasing a new item (launched in September 2014).
*3 The Company previously needed users to mail in a personal identity confirmation document (original certified copy of the resident's certificate) to authenticate their identity, but installation of a system capable of matching the user's face and image on an identification card allows authentication online (an ID and password are sufficient to complete the authentication procedure for second and subsequent purchases).
*4 An automated assist system that utilizes AI for the purchase and sales prices of used cameras. Originally, the Company decided prices manually for all the items its handles, which exceed more than approximately 20,000 items. However, it can conduct timely pricing only for some items, and as a result, there are many cases of opportunity loss. This system will enable fully automated pricing and it is expected to reduce opportunity losses through determining prices appropriately and in a timely manner.

(4) Platform-type business model

Another feature of the Company is that it has built a platform-type business model to encourage continuous purchases by providing valuable information within the sequence of pre-purchase → time of purchase → post-purchase. In other words, its strategy is to create a virtuous cycle of information about enjoying cameras (pre-purchase) → services to make purchases easier (time of purchase) → services to enjoy an item after purchasing (post-purchase). By making this cycle bigger, it can expand and activate its membership base, which in turn leads to further results growth. In particular, for the services at the time of purchase, it realizes one-to-one marketing through the personalization of its EC website (including a wish list, an email notifying of product arrivals, and personal recommendations). Also, with aims including supplementing information and cultivating fans, it is working on utilizing CGM*1 and communication via the Web magazine*2, with the goal of being Japan's largest portal website specializing in cameras. In the past few years, it has continued to evolve in its own way by harnessing AI to introduce unique features such as AIMD and AI-driven content recommendations*3.

*1 An abbreviation of Consumer Generated Media, which refers to media with content involving general users, including bulletin boards and word-of mouth websites.
*2 A magazine that can be viewed online. The Company distributes the Web magazine StockShot that brings together 4 types of content, and it has more than 1mn PV per month.
*3 A service that uses as AI engine to analyze customers' browsing and purchase histories to distribute recommended StockShot articles by LINE, e-zine, and push notifications in the app automatically. This gives customers access to information that not only gives them an idea of whether a price is high or low, but also whether it reflects the features, performance, and preferred attributes that they are looking for.

Summary of results

In 1H FY3/24, record-high net sales achieved on a 1H basis amid steady growth persisting in the Camera Business. Watch Business previously affected by downturn in market prices but now on path to recovery

1. Summary of the 1H FY3/24 results

(1) Results summary

In the 1H FY3/24 results, net sales increased 6.8% YoY to ¥23,381mn, operating income decreased 0.1% to ¥1,625mn, ordinary income declined 0.8% to ¥1,632mn, and net income decreased 1.3% to ¥1,111mn. Although sales rose but profit fell, the Company achieved record-high net sales on a 1H basis. Meanwhile, despite net sales having slightly underperformed relative to the Company's initial forecasts, operating income exceeded such expectations.

The core Camera Business encountered brisk performance both with EC and store results, thereby driving growth in earnings overall. Net sales increased due to growth in sales of new products in 1Q and duty-free sales in stores, in addition to ongoing success achieved with one-to-one marketing utilizing AI. On the other hand, whereas the Watch Business encountered a downturn in earnings results due to a significant decrease in global market prices in 2H FY3/23, its results are now mounting a recovery amid a scenario of market price stability, albeit sales were lower relative to the same period of the previous fiscal year. Particularly looking solely at 2Q results, net sales were more than 1.4 times those of 1Q and accordingly shifted to a YoY increase. The Stationery and Bicycle businesses both incurred decreases in net sales.

In terms of profit, the Company has been maintaining a high gross margin centered on the Camera Business, particularly through AIMD upgrades. Operating income was on par with that of the same period of the previous fiscal year and the operating margin has been holding to a high level of 7.0% amid a scenario where growth in gross profit absorbed higher personnel expenses attributable to higher average salaries.

In terms of financial condition, total assets decreased 2.1% from the end of FY3/23 to ¥14,757mn, mainly reflecting a decrease in merchandise (inventory). Shareholders' equity increased 8.5% from the end of FY3/23 to ¥7,026mn due to higher retained earnings, so the equity ratio improved to 47.6% from 42.9%. Despite there having been a decrease in merchandise (inventory) largely due to inventory turnover, the Company has secured inventory sufficient for the year-end shopping season given that it has maintained a high level of EC purchases of used items.

Summary of the 1H FY3/24 results

(¥mn)

	1H FY3/23		1H FY3/24		Change	
	Result	%	Result	%	Amount	%
Net sales	21,885		23,381		1,496	6.8%
Cameras	15,341	70.1%	17,591	75.2%	2,250	14.7%
Watches	5,871	26.8%	5,154	22.0%	-716	-12.2%
Stationery	214	1.0%	207	0.9%	-6	-2.9%
Bicycles	458	2.1%	427	1.8%	-31	-6.9%
Cost of sales	17,769	81.2%	18,983	81.2%	1,214	6.8%
Gross profit	4,116	18.8%	4,398	18.8%	281	6.8%
SG&A expenses	2,488	11.4%	2,772	11.9%	284	11.4%
Operating income	1,628	7.4%	1,625	7.0%	-2	-0.1%
Cameras	1,763	11.5%	2,072	11.8%	308	17.5%
Watches	320	5.5%	187	3.6%	-133	-41.5%
Stationery	15	7.3%	25	12.2%	9	61.2%
Bicycles	30	6.6%	18	4.3%	-12	-39.7%
Adjustment	-501	-	-677	-	-175	-
Ordinary income	1,645	7.5%	1,632	7.0%	-13	-0.8%
Net income	1,125	5.1%	1,111	4.8%	-14	-1.3%
EC net sales	17,009	77.7%	17,853	76.4%	843	5.0%
Store net sales	4,875	22.3%	5,528	23.6%	653	13.4%

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

Financial condition at the end of September 2023

(¥mn)

	End of March 2023 Result	End of September 2023 Result	Change	
			Amount	%
Current assets	13,202	12,847	-355	-2.7%
Cash and deposits	1,423	1,425	1	0.1%
Accounts receivable - trade	2,469	2,388	-80	-3.3%
Merchandise	8,812	8,549	-262	-3.0%
Non-current assets	1,863	1,910	46	2.5%
Property, plant and equipment	320	311	-8	-2.7%
Intangible assets	624	759	134	21.6%
Investments and other assets	919	839	-79	-8.7%
Total assets	15,066	14,757	-309	-2.1%
Current liabilities	5,640	5,486	-153	-2.7%
Accounts payable - trade	1,374	1,165	-209	-15.2%
Interest-bearing debt	2,902	2,697	-205	-7.1%
Contract liabilities	232	281	49	21.2%
Non-current liabilities	2,946	2,242	-704	-23.9%
Interest-bearing debt	2,903	2,189	-714	-24.6%
Net assets	6,479	7,028	548	8.5%
Shareholders' equity	6,477	7,026	549	8.5%
Total liabilities and net assets	15,066	14,757	-309	-2.1%

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

(2) Gross margin and SG&A expenses conditions

Gross margin (overall) for 1H FY3/24 was at the high level of 18.8%, on par with the 18.8% of a year earlier. The high level is attributable to AIMD upgrades in the Camera Business and also attributable to efforts to promote sales by securing profits through inventory turnover in the Watch Business. As for SG&A expenses, meanwhile, personnel expenses rose accompanying higher average salaries, and sales-linked promotion expenses, credit usage fees, and other such costs increased. Whereas the SG&A expense ratio consequently inched up to 11.9% from 11.4% in the same period of the previous fiscal year, it is reasonable to view the ratio as under control at the 11% level.

Breakdown of SG&A expenses

(¥mn)

	1H FY3/23		1H FY3/24		Change	
	Result	Ratio to net sales	Result	Ratio to net sales	Amount	%
SG&A expenses	2,488	11.4%	2,772	11.9%	284	11.4%
Personnel expenses	693	3.2%	797	3.4%	103	15.0%
Advertising expenses	19	0.1%	30	0.1%	10	57.9%
Promotion expenses	447	2.0%	530	2.3%	83	18.6%
Outsourcing expenses	185	0.8%	184	0.8%	0	-0.5%
Commission expenses	592	2.7%	630	2.7%	37	6.4%
Depreciation	96	0.4%	88	0.4%	-8	-8.3%
Rent expenses on land and buildings	176	0.8%	176	0.8%	0	0.0%
Other	277	1.3%	334	1.4%	57	20.6%

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

2. Results by business

(1) Camera Business (EC ratio: 85.3%)

Both net sales and profit recorded steady growth and achieved new record highs on a 1H basis. Net sales increased 14.7% YoY to ¥17,591mn and segment profit gained 17.5% to ¥2,072mn. The Company achieved favorable EC net sales amid its success derived from ongoing efforts involving one-to-one marketing utilizing proprietary mechanisms and services that harness AI, such as AIMD and AI-driven content recommendations. The frequency of changes in camera product sales and purchase prices in particular increased 1.2-fold as a result of the Company having upgraded AIMD, which has helped boost earnings results. In addition, store sales achieved substantial growth in conjunction with recovery of duty-free sales. In terms of profit, meanwhile, the segment profit margin attained a record-high of 11.8%, up from 11.5% in the same period of the previous fiscal year, as a result of the segment securing profits growth while contending with higher personnel expenses and other such costs, partially due to higher sales and positive effects regarding AIMD.

(2) Watch Business (EC ratio: 47.5%)

Both net sales and profit decreased YoY. Net sales declined 12.2% YoY to ¥5,154mn and segment profit fell 41.5% to ¥187mn. Net sales decreased more than in the same period of the previous fiscal year when effects of the market downturn in luxury watch prices had remained relatively small. However, this was in line with expectations. Looking solely at 2Q results, net sales were more than 1.4 times those of 1Q and accordingly increased YoY, given that net sales began mounting a recovery in June. In terms of profit, a downturn in net sales prompted a decrease in profit and also culminated in a decline in the segment profit margin to 3.6% (5.5% a year earlier). However, the profit margin improved substantially in 2Q* given that the segment generated sales sufficient to secure profits without reliance on higher market prices amid a scenario of market prices becoming more stable. In terms of activities, the Company engaged in initiatives for bolstering online purchase estimates with its sights set on enhancing inventories. It accordingly made one-price buying applicable to over 99% of more than 6,000 items, thereby exceeding its target.

* The segment profit margin was 2.6% in 1Q and increased to 4.4% in 2Q.

(3) Stationery Business (EC ratio: 71.0%)

Net sales declined but profit rose YoY. Net sales decreased 2.9% YoY to ¥207mn and segment profit gained 61.2% to ¥25mn. Despite sluggish growth in EC net sales, profit increased substantially given progress made in generating sales of high-value and high-margin products.

(4) Bicycle Business (EC ratio: 57.1%)

Both net sales and profit decreased YoY. Net sales declined 6.9% to ¥427mn and segment profit fell 39.7% to ¥18mn. The sluggish growth in EC net sales is attributable to rising prices of fully assembled bicycles due to yen depreciation and subsiding COVID-19 health-related demand.

3. Global expansion

In cross-border EC, Map Camera (Camera Business) opened a store on eBay, the world's largest online marketplace, in August 2017. GMT (Watch Business) also opened a store in May 2019 on Chrono24, a leading global luxury watches marketplace, and one on eBay in July 2020, and in 2022 it introduced Buyee Connect*, an overseas sales support service, to steadily establish a structure for business expansion. The Company's emphasis on quality of service has also enabled it to establish brand power overseas, and Map Camera notably received the highest award at the eBay Japan Awards 2022. Cross-border EC has been generating steady growth in net sales through such initiatives, having increased 14.6% YoY to ¥1,536mn in 1H FY3/24.

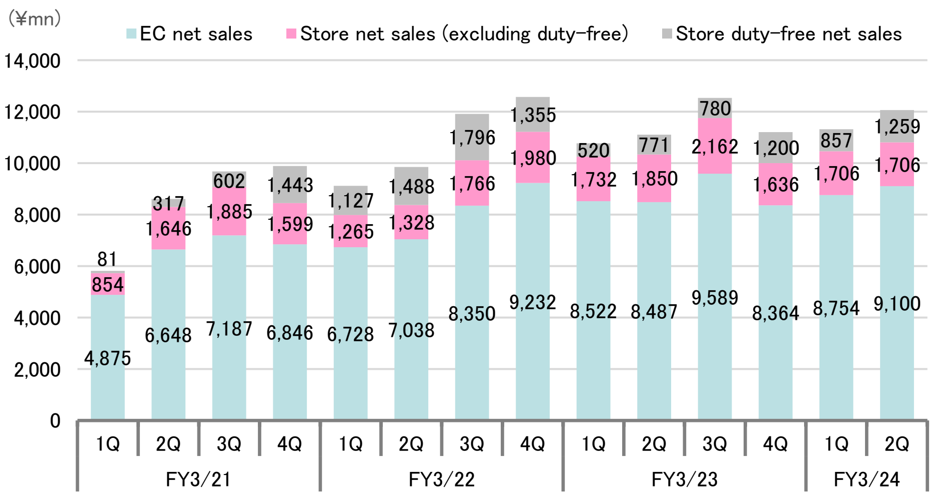
* A purchase support service for overseas customers provided by BeeCruise inc., a consolidated subsidiary of BEENOS <3328>.

4. Trends in quarterly results and KPI

(1) Trends in quarterly results

Looking at the quarterly trend in net sales from FY3/21, sales fell greatly in the 1Q of FY3/21 due to the pandemic but from 2Q onward, sales benefited from the tailwind of nesting demand and the effect of various measures. Consequently, EC net sales were brisk and even exceeded prepandemic levels. In FY3/22, although COVID-19 continued to have an impact, EC net sales expanded steadily, while tax-free sales in the Watch Business also made a significant contribution due to strategic enhancement of the product lineup. As a result, results in the 4Q set a new record high on a quarterly basis. In FY3/23, the Watch Business was weak because duty-free sales were depressed by lockdowns in China and global prices fell sharply, but the Camera Business continued on a growth trajectory, so overall results levels have stayed high led by EC net sales. Since the outset of FY3/24, the Camera Business has continued to grow and the Watch Business has also been mounting a recovery. Meanwhile, EC net sales surpassed ¥9.0bn for the first time ever in the three months of 2Q.

Trend in quarterly net sales

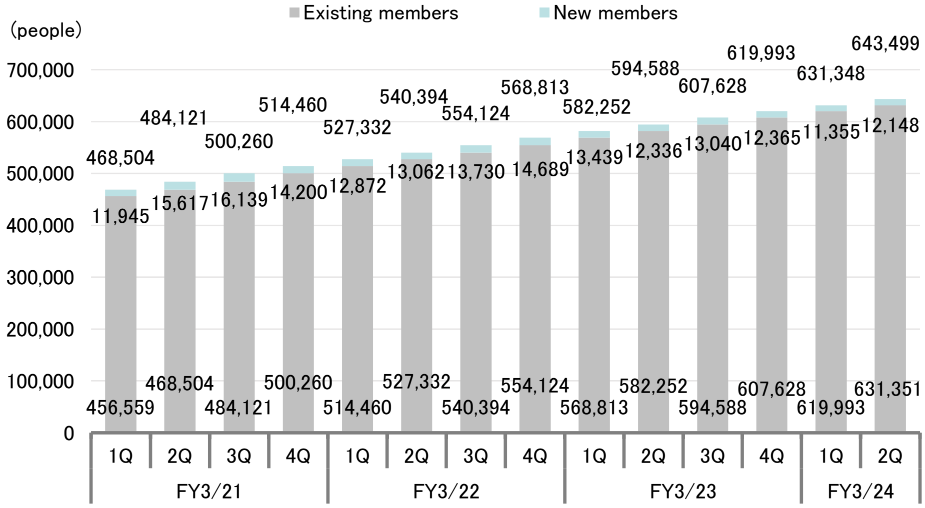


Source: Prepared by FISCO from the Company's results briefing materials

(2) Number of web members

The number of Web members exceeded 640,000 and continued to steadily increase to 643,499 people (up 23,506 people from the end of the previous fiscal year) at the end of September 2023. The factors in the background to this are considered to be that, partly as a result of stay-at-home orders due to COVID-19, an increasing number of people are purchasing cameras as a hobby that is affordable and familiar, and that in addition, the measures implemented up to the present time to strengthen EC are proving successful and awareness is rising of the Company's brand and the websites it operates. Looking at the percentages of sales by age group, the percentage of the group aged from 10 to 39 is 40.3%, while due to the spread of Instagram and other SNS, the percentage of females aged from 10 to 39 is high in comparison to other age groups at 23.3%, making them a new target group. Also, the percentage of the young generation is increasing, and it can be said that a noticeable trend is that even in this situation, the average use unit price is being maintained.

Quarterly trends in the number of Web members



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

(3) Purchasing numbers and the active rate

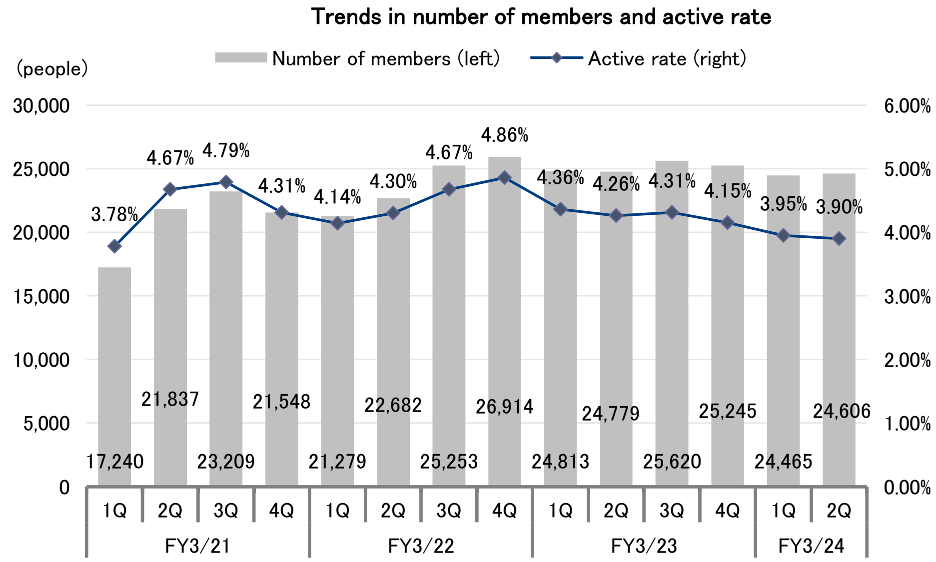
Both the number of purchasing members and the active rate continue to trend strongly, along with a net increase in the number of new members. The number of registrations for wish lists*1 and email notifications of product arrivals are also both growing steadily, and it seems that a factor for this is that these one-to-one marketing measures are maintaining a high active rate. In particular, the Company began providing product arrival notifications using LINE in addition to email and app notifications in May 2022, which resulted in a big increase in the number of communications*2. Further, combining one-to-one marketing, AIMD, and AI-driven content recommendations has also increased the number of requests sent out when registered products drop in price*3, which is contributing to the expansion of transaction opportunities. Moreover, with the Company having been focusing on enhancing content centered on video streaming, it has apparently been making progress in attracting viewers from the previously untapped younger demographic*4.

*1 The number of products registered on wish lists are on an uptrend at 60,000-70,000 items per month lately, and grew to 2,119,627 items at end of September 2023 (up 141,235 from the end of the previous fiscal year).

*2 The number of registrations for email notifications of product arrivals exceeded 130,000 to reach 134,292 (up 10,899 from the end of the previous fiscal year), and the monthly average number of emails sent out amounted to more than 400,000. In particular, the number of notifications sent using LINE increased more than tenfold in just over a year.

*3 The Company sends a monthly average of 5mn smartphone notifications. This combined with the aforementioned email notifications of product arrivals equates to a total of 16mn notifications on a quarterly basis, which thereby gives rise to information delivery capability and customer contact points equivalent to approximately 350 brick-and-mortar stores in terms of number of customers visiting stores.

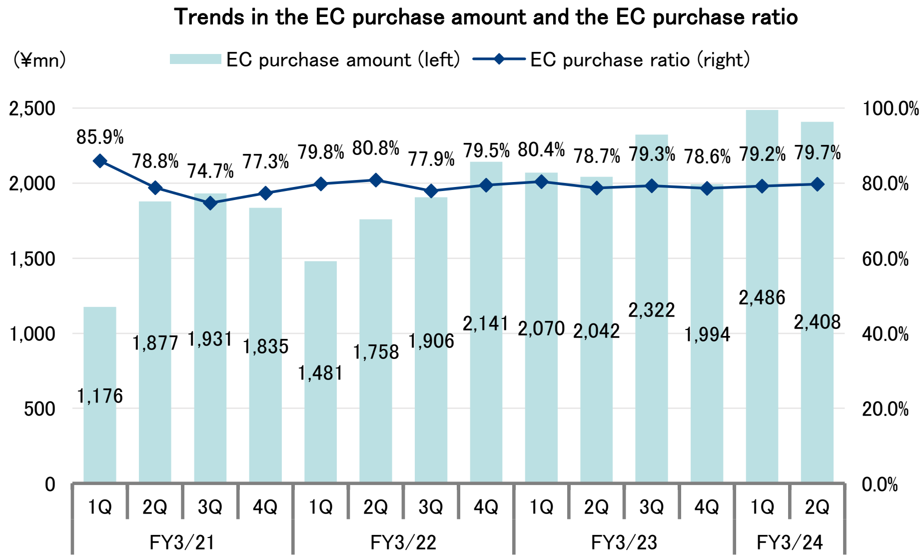
*4 The Company established the Content Creation Department to which it has assigned numerous professionals with practical experience in video production. Going forward, the Content Creation Department will focus on producing and streaming video content.



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

(4) Used cameras purchase amount

For the used cameras purchase amount also, the measures intended to strengthen EC, including introducing an AI facial authentication system (June 2020), AIMD (March 2021), and AI-driven content recommendations (March 2022) are proving successful, and the EC purchase ratio is trending at a level close to 80%. The receive-first, send-later service and the trade-in exchange service, which are two of the various differentiation factors, are also both performing well and contributing to the increase in the EC purchase ratio.



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

5. Summary of the 1H FY3/24

In summary, the Company's performance in 1H FY3/24 is commendable in that we have identified two key points that collectively underscore strengths of the Company's business model. First, 1) the Company managed to boost earnings overall as a result of having achieved ongoing growth in the Camera Business by enlisting various EC initiatives, including application of AI. Second, 2) the Company mounted a firm recovery also in the Watch Business, which had encountered a slowdown in the latter half of the previous fiscal year. Meanwhile, the Company's activities also suggest upside potential in terms of prospects for further evolution going forward. Specifically, the Company has managed to improve various KPIs as a result of it having engaged in initiatives that have included upgrading AIMD, bolstering online purchase estimates for watches, and enhancing content centered around video streaming.

Business forecasts

FY3/24 outlook unchanged with expectations of higher sales and profits amid growth in the Camera Business centered on EC and earnings improvement in the Watch Business

1. FY3/24 forecasts

The Company maintained its initial forecasts of higher sales and profits in FY3/24, with net sales to rise 9.7% YoY to ¥50,028mn, operating income to grow 26.8% to ¥3,122mn, ordinary income to rise 26.8% to ¥3,092mn, and net income to increase 25.7% to ¥2,133mn.

It assumes the strongly performing Camera Business will continue to drive net sales growth, mainly in EC. On the other hand, the Company has left its initial conservative outlook calling for slightly lower sales unchanged in the Watch Business, despite greater stability of market prices, which were attributable to the segment's weak performance in FY3/23, and recovery in inbound demand (duty-free sales). Also, the Company expects ongoing steady growth in the Stationery and Bicycle businesses.

In terms of profit, the Company expects growth in the Camera Business and earnings improvement in the Watch Business to significantly drive profit growth. In particular, it envisions the gross margin making a V-shaped recovery to 18.0% from 17.0% a year earlier, owing to the effects of using AIMD (including upgrades), as well as the erasure of one-offs (sale of goods at a loss and posting of losses on valuation of merchandise inventory) in the Watch Business. In addition to an increase in sales-linked expenses such as promotion expenses and credit usage fees, it also expects a higher gross margin to offset higher SG&A costs accompanying the reinforcement of human capital with an eye to future business expansion and the renewal of mission-critical systems, such that operating income grows and the operating margin improves to 6.2% from 5.4% a year earlier.

FY3/24 forecasts

(¥mn)

	FY3/23		FY3/24		Change	
	Result	%	Forecast	%	Amount	%
Net sales	45,618		50,028		4,409	9.7%
Cost of sales	37,864	83.0%	41,027	82.0%	3,162	8.4%
Gross profit	7,753	17.0%	9,001	18.0%	1,248	16.1%
SG&A expenses	5,290	11.6%	5,879	11.8%	588	11.1%
Operating income	2,463	5.4%	3,122	6.2%	658	26.8%
Ordinary income	2,439	5.3%	3,092	6.2%	652	26.8%
Net income	1,697	3.7%	2,133	4.3%	435	25.7%

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

2. FISCO's outlook

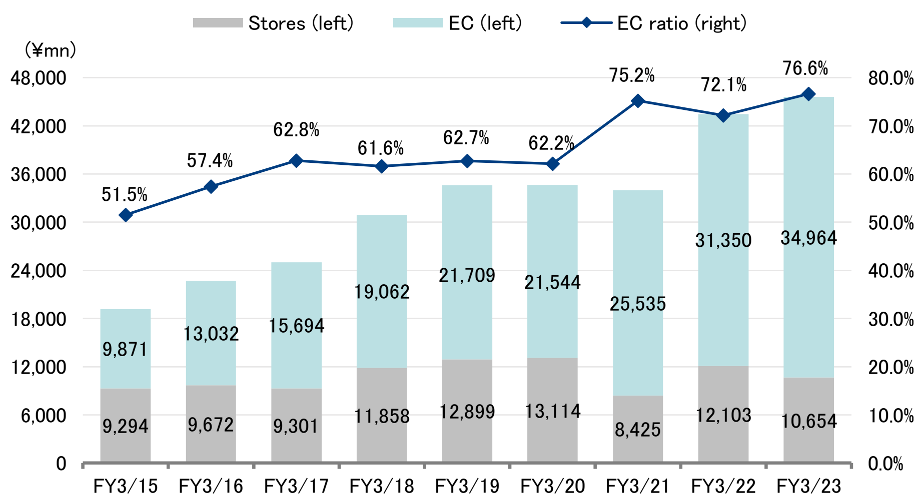
The Company needs to generate net sales of ¥26,646mn and operating income of ¥1,496mn in 2H in order to achieve results in alignment with its results forecasts. Although effects of the unstable economic climate and market fluctuations continue to require attention, FISCO also believes that the Company is fully capable of attaining its forecasts given factors that include: the Company's business model centered on EC is continuing to steadily evolve; its Watch Business is on path to recovery and one-offs incurred in the previous fiscal year (sale of goods at a loss and posting of losses on valuation of merchandise inventory) have been resolved, and; results will benefit from seasonal factors during the 3Q period of high demand. In particular, there is potential for results to outperform the Company's forecasts if market prices for luxury watches remain stable and brisk inbound demand persists. FISCO will closely monitor the Company's initiatives and investment toward achieving further evolution, particularly with regard to effects brought about by upgrading AIMD and bolstering online purchase estimates in 1H, and with regard to its development of its AI system to support merchandising of watches, which is slated for implementation this fiscal year.

Results trends up to the present time

Realized upward growth through the increase in the number of Web members resulting from unique EC initiatives, including those harnessing AI

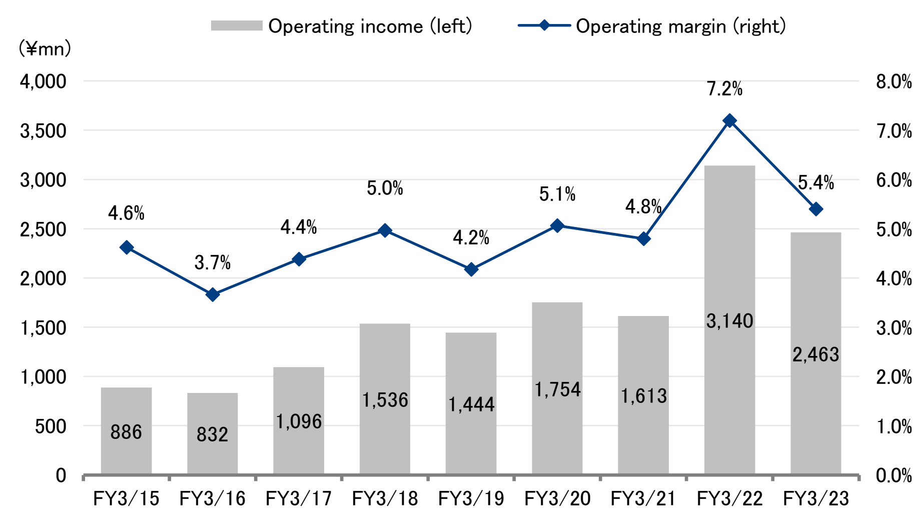
Looking back at the Company's results through the previous fiscal year, net sales have achieved steady growth along with an increase in web members and growth in EC net sales. Although sales growth was sluggish for two consecutive fiscal years from FY3/20 onward due to the Company's focus on improving gross margins over sales growth, the impact of the consumption tax hike, and a drop in store sales due to COVID-19, in FY3/22, the Company achieved a significant increase in sales with the impact of a variety of EC measures (including the introduction of AIMD) and growth in the Watch Business resulting from strategic inventory investments. Average annual growth rate over the nine years from FY3/13, when the Company went public, to FY3/23, is 13.86% (of which the average annual growth rate of EC net sales was 18.81%). Profits (operating income) have also generally increased along with sales growth. While operating margin has been in the 4%-5% range for some time, the introduction of AIMD improved gross margins and helped curb SG&A expenses, resulting in a significant improvement in the profit margin in FY3/22. In FY3/23, an operating margin of 5.4% was secured despite a temporary slump in the Watch Business, so it can be said that the Company's real earnings capacity has increased.

Trends in net sales (store and EC) and EC ratio



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

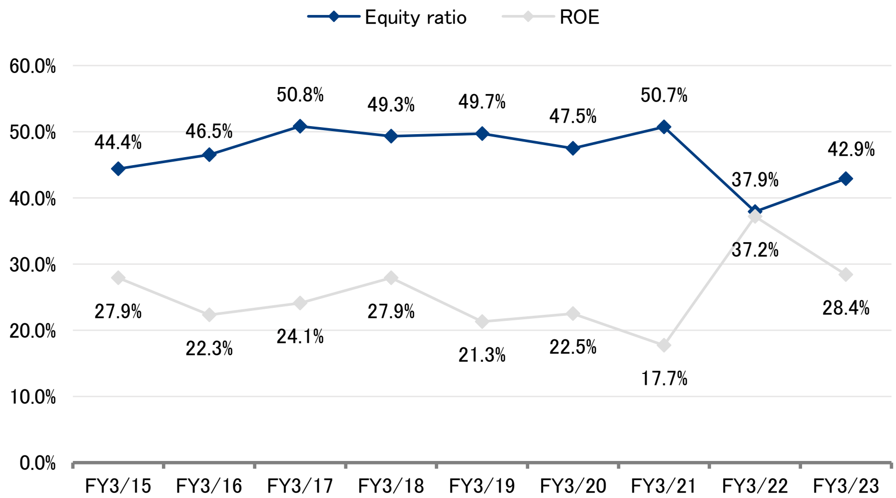
Trends in operating income and the operating margin



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

Meanwhile, in terms of finances, while the shareholders' equity ratio remained stable at the 50% level for some time, it fell to 37.9% in FY3/22 due to the acquisition of treasury shares from the founder. Nevertheless, ROE, an indicator of capital efficiency, rose to 37.2% and remained close to 30% in FY3/23.

Trends in the equity ratio and ROE



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

Medium- to long-term strategy

Promoting 3-year medium-term management plan (rolling method). No change in the Company's direction of aiming for profit growth through the use of AI and lean management while working toward further growth in Camera and Watch businesses and on cross-border EC

1. Business environment

(1) Cameras market

The camera market contracted for some years amid the spread of smartphones, but has picked up since FY2020, when the transition to full-size mirrorless cameras began in earnest and companies all began releasing highly anticipated new products, which has been a boon for specialty camera stores. Full-fledged migration to full-size mirrorless cameras is especially expected to gain steam accompanying the resolution of the semiconductor shortages through the first half of 2022. The number of people taking up photography seriously as a hobby and engaging in video-related work is on an upward trend, which has led to a shift in camera buying activity from volume retail stores to specialty camera stores in the quest for more "professional" equipment. The used camera market is also expected to remain brisk for some time, because products that are replaced by the latest model go on sale as used items.

(2) Watches market

In 2022, the imported watch market in Japan is estimated to have grown 26% YoY to ¥738.1bn (Japan Clock & Watch Association “January-December 2022 Size of the Japanese Watch Market (Estimated)”). This is partly because there was strong motivation to sell products even if it meant lowering prices amid weak inbound demand (duty-free sales) due to COVID-19 and falling global prices for luxury watches. Since the market remains on a growth trend even excluding impact from temporary market fluctuations, the Company’s view that it will continue to be an attractive market in the future is unchanged. It is a market with significant room for growth for the Company, which has a roughly 2% share. The Company has been investing strategically in inventory since announcing in September 2021 its aim to become the top Rolex store in Japan. It expanded its Rolex R listings to one of the largest in Japan at the end of 2021 and has worked to further enhance its product lineup, but that proactive approach was affected by falling market prices, which led to temporary struggles. However, since the beginning of 2023, market prices have stopped declining and price fluctuations have stabilized.

2. Medium-term management plan

Each year, the Company updates its three-year medium-term management plan on a rolling basis, and in May 2023, it announced a new medium-term plan. The Company intends to continue to focus on EC by utilizing new technology, further grow its mainstay Camera Business, take its Watch Business from recovery to expansion, and to revitalize its global expansion through cross-border EC, etc. It looks to 1) use AI to improve profit margins and 2) prioritize profit growth over sales growth by reducing the SG&A expense ratio through lean management. Regarding 1), it will work on improving inventory turnover for cameras by upgrading AIMD, and building an AI system to support merchandising in the Watch Business to promote a framework for enabling appropriate procurement and inventory investment. Regarding 2), some technology-related expenses may increase with growth in transaction volume, but the Company plans to curb fixed costs and reduce variable costs by introducing systems and reinforcing data infrastructure to make operations more efficient. Moreover, it targets 1.25-fold increase in net sales per employee by FY3/26 through investments in IT to improve productivity and operating efficiency. As a result, the Company aims to achieve net sales of ¥63,141mn (a three-year average annual growth rate of 11.4%) and operating income of ¥4,827mn (an operating margin of 7.6%) in FY3/26, the final year of the plan.

Overview of the new medium-term management plan

(¥mn)

	FY3/23		FY3/24		FY3/25		FY3/26		Average growth rate
	Result	%	Forecast	%	Forecast	%	Forecast	%	
Net sales	45,618		50,028		56,173		63,141		11.4%
Cameras	37,721	71.7%	37,196	74.3%	41,347	73.6%	45,982	72.8%	6.8%
Watches	11,603	25.4%	11,345	22.7%	13,083	23.3%	15,116	23.9%	9.2%
Stationery	438	1.0%	507	1.0%	597	1.1%	705	1.1%	17.2%
Bicycles	854	1.9%	980	2.0%	1,144	2.0%	1,337	2.1%	16.1%
Gross profit	7,753	17.0%	9,001	18.0%	10,160	18.1%	11,461	18.2%	13.9%
SG&A expenses	5,290	11.6%	5,879	11.8%	6,267	11.2%	6,633	10.5%	7.8%
Operating income	2,463	5.4%	3,122	6.2%	3,893	6.9%	4,827	7.6%	25.1%
Ordinary income	2,439	5.3%	3,092	6.2%	3,863	6.9%	4,797	7.6%	25.3%
Net income	1,697	3.7%	2,133	4.3%	2,665	4.7%	3,310	5.2%	24.9%
Number of employees*	263		285		286		287		3.0%
Net sales per employee	176		182		196		220		7.7%

* Includes dispatched and part-time workers
Source: Prepared by FISCO from the Company’s financial results and results briefing materials

3. FY3/24 initiatives, progress, and plans going forward

For FY3/24, the Company cited four initiatives at the outset of the fiscal year: 1) upgrading AIMD (Camera Business), 2) building the AI system to support merchandising of watches* (Watch Business), 3) bolstering online purchase estimates for watches, and 4) enhancing LINE and YouTube content (all businesses). The initiatives have already yielded some positive results, with the exception of 2) the AI system to support merchandising of watches, which is currently in under development.

Moreover, in 2H and beyond the Company intends to place renewed focus on sustained investment in technology and inventory as it seeks to expand its business by procuring products through an approach that enlists AI and data. To such ends, the Company's initiatives will involve strengthening its Information Systems Division, replacing mission-critical systems, and furthermore creating a framework for enabling appropriate procurement and inventory investment by building the aforementioned 2) AI system to support merchandising of watches.

* A system that uses a financial engineering approach to support merchandising decision-making. By analyzing changes in watch prices by product to estimate and promptly ascertain uptrends and downtrends, it looks to facilitate the optimization of inventory levels and enhancement of profit in the Watch Business.

4. SDGs initiatives

Regarding SDGs (sustainable development goals) that have been receiving strong interest from investors, the Company wants to leverage initiatives aimed at resolving social issues in boosting its own enterprise value, just as it has done up to now, through "newly created businesses for important products with value" and "development of an easy-to-work environment." In particular, as one concrete example of an effort in "newly created businesses for important products with value," it replaced all the paper used in items like product packaging and name cards with eco-friendly materials. Its policy is also to change the original goods and the novelty goods in consideration of the environment. In addition, the Company enhanced its information disclosure in 2022, including by starting to disclose information based on the recommendations of the Task Force on Climate-related Disclosures (TCFD)*1 and responding to the CDP questionnaire*2. It also concluded an official partner agreement in July 2022 with Shougaisha Jiritsu Suishin Kikou Association*3 to take part in Paralym Art, a program that supports disabled artists. Since the outset of 2023, the Company has also become a signatory to the United Nations Global Compact and has raised its target for reducing greenhouse gas emissions*4.

*1 This organization was established by the Financial Stability Board to promote understanding and disclosure of the financial impacts on companies brought about by climate change. It published a final report compiling recommendations regarding information disclosure in June 2017.
*2 This questionnaire is sent out to obtain companies' environmental information based on requests from major purchasing companies that are enthusiastic about supply chain engagement, institutional investors that make ESG investments, and so forth.
*3 The Association offers the use of art works such as paintings and designs to help disabled artists become financially independent.
*4 The Company raised its Scope 2 emissions target from a 27% reduction in emissions by 2030 relative to its emissions in 2020 to a target of net zero emissions by 2030.

5. Medium- to long-term focus points

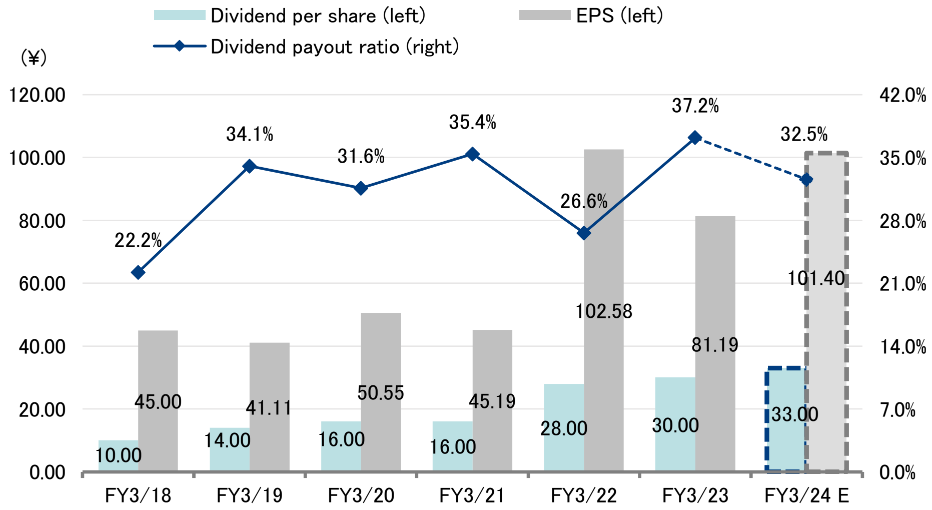
FISCO thinks the Company's strategy of further boosting its presence in designated areas by using AI, pursuing various types of value, and placing emphasis on profit growth is reasonable. Also, FISCO has high expectations regarding evolutionary development going forward in the Watch Business, with respect to which the Company has taken a strategic approach thus far. Accordingly, whereas the Watch Business has been affected by unforeseen market fluctuations, this situation could serve as an opportunity. The Company could potentially encounter a significant turning point in terms of differentiating itself from its competitors under a scenario where the Watch Business enhances precision of its business model by embracing the use of AI and other technologies, in a manner akin to the approach that has spurred progress of the Camera Business. In addition, potential upside drivers are full-fledged overseas activity, including M&A and business alliances, and creation of new income sources. Regarding overseas efforts in which the Company has already carried out test marketing and increased its visibility centered on the Watch Business, the Company has received positive feedback from customers and is likely to establish a new growth pillar through solidification of overseas (local) purchase formats, similar to Japan. In particular, FISCO expects further increase in feasibility from integration of the Company's success model based on collaboration with local companies that possess a customer base. In creation of further new income sources (such as the development of paid services that leverage its information capability and membership base and expanding into the media business), the key point is the extent to which the Company is capable monetizing a membership base with high loyalty and enhanced quality and quantity, and a format for gathering content information that is attractive to enthusiasts. FISCO will closely monitor the Company's progress in solidifying a unique business model, including the use of outside resources.

Shareholder returns

Plans to pay an ¥33 dividend in FY3/24 (up ¥3 YoY)

The Company sees shareholder returns as a management issue and has a basic policy of returning profits to shareholders through dividends. Previously, it had continuously paid a stable dividend, but from FY3/17, it changed its dividend policy to being based on the dividend payout ratio. It currently targets a dividend payout ratio in a range of 25% to 35%. For FY3/24, the Company plans to pay a dividend of ¥33 per share, an increase of ¥3 from the previous fiscal year. If realized, that would mark the third straight year of dividend growth.

Trends in EPS, the dividend, and dividend payout ratio



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

FISCO

Disclaimer

■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp