COMPANY RESEARCH AND ANALYSIS REPORT

# Estore Corporation

## 4304

TSE JASDAQ

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# Index

# Summary

## Adding marketing systems to EC systems and marketing services, and aiming to accelerate growth through these three businesses' synergies

Estore Corporation <4304> (hereafter, also “the Company”) is a comprehensive provider of e-commerce (EC) support services. After starting from the Systems Business for the provision of ASP services as a framework for EC, it is currently focusing on consulting and operations management agency services to support revenue growth at customer companies. Going forward, it plans to strengthen sales promotion systems.

**1. Although sales decreased in FY3/19 1Q, profits increased greatly**

In the Company's FY3/19 1Q results, although sales decreased slightly, profits increased greatly. Net sales were ¥1,206mn (down 1.0% year on year (YoY)) and operating profit was ¥144mn (up 33.5%). Sales declined slightly YoY because marketing services revenue and flow revenue within sales systems were sluggish. On the other hand, profits increased greatly, as the costs relating to growth investment, such as to acquire and develop human resources, were less than expected due to the delay in progressing this investment because of the impact of the labor shortage and other factors.

**2. The essence of the growth strategy is realizing synergies from the three businesses; aiming for growth through increasing flow revenue**

The Company's business domain is EC support services, while for its specific business strategy, it has established a strategy of conducting its business on dividing it into four quadrants created from two axes; sales and sales promotions, and systems and services. In the fall of 2017, it launched Compare and Query, which are MA (marketing automation) tools, and started a marketing systems business, and it is aiming for growth through combining its three businesses, of this business and sales systems (the ASP service Shopserve) and marketing services (consulting and operations agency services). The essence of its growth strategy is to aim for mutual cooperation between these businesses and to pursue synergies. At the present time, the core of the growth scenario is to sell marketing services and marketing systems to Shopserve's existing customers, to realize sales growth at customers, and then to increase the flow revenue that is linked to their sales.

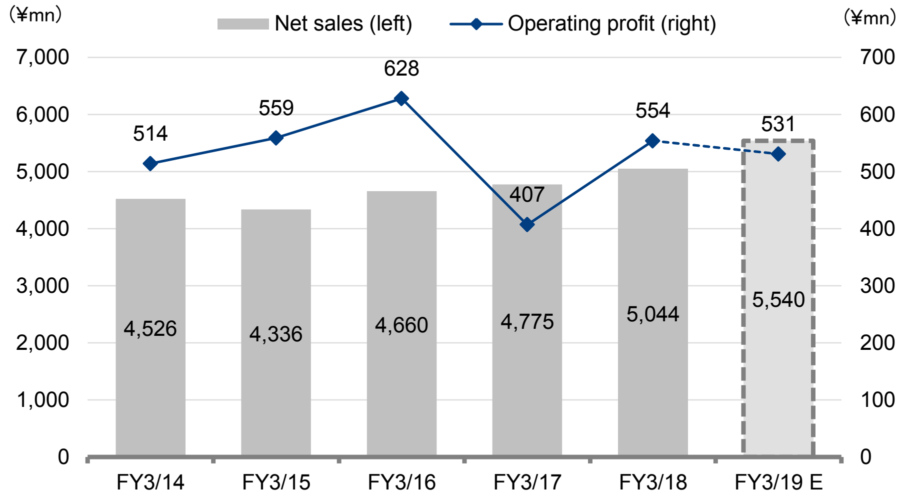
**3. Forecast is for higher sales but lower profits in FY3/19; from FY3/20 onwards, the focus will be on accelerating the increase in profits through growth investment and the restructuring**

The Company conducted a large-scale restructuring in August 2017 to appoint young employees to executive posts throughout the Company. Even while accepting some opportunity loss, it carried out this upfront investment toward the timing of the return for the next high-growth recovery. The effects of this restructuring have clearly been seen in the past one year when speaking from the points of the ability to act and the ability to act immediately. Going forward, if these employees also acquire the ability to make and execute decisions, then there is the sense that the restructuring will achieve the results it initially intended. As previously mentioned, the Company will also conduct growth investment to acquire and develop human resources, so the forecast for FY3/19 is for higher sales but lower profits. But at FISCO, we think that this thorough investment in the current fiscal period in the costs to acquire human resources toward growth in the future will lead to an increase in shareholder returns in the medium to long term.

**Key Points**

- Deploys three businesses–EC systems, marketing services, and marketing systems–and is aiming for growth through pursuing synergies between each of these businesses
- In marketing services, is accelerating the expansion of human resources toward realizing its growth strategy
- In marketing systems, Compare has acquired an excellent track record and reputation; is aiming for fully fledged sales expansion from this fiscal period

Results trends (standalone basis)




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

# Business overview

## Steadily strengthening the revenue base and customer base by shifting the focus business every seven years
## In 2018, is taking on the challenge of the fully fledged deployment of marketing systems

### 1. Company history and shifts in the focus business

Since the Company was established in 1999, it has grown by shifting its focus business roughly every seven years. As each business hit its stride and reached the stage of establishing an earnings base, the Company would use these earnings to expand into creating a new business to contribute to earnings in a repeated cycle. The details are given below, but the current year of 2018 is the period to shift from the third to the fourth cycle.

Estore's history and the shifts in its business development

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

Source: Prepared by FISCO from Company materials

**(1) 1999-around 2006**

The Company's business first started from shopping cart services. After that, it started the provision of rental servers that are needed in order to establish a website, and the rental server business became the main support for the Company's early days. While retaining the rental server business as its core operation, the Company rolled out a series of services needed for conducting e-commerce in addition to its shopping cart services. These paved the way for the Shopserve ASP service providing comprehensive EC support, launched in 2006.

**(2) 2006-2012**

Over the seven years from 2006, the EC systems business in the form of the Shopserve ASP service providing comprehensive EC support became an earnings source for the Company. Shopserve is an ASP service that provides, as a single service, management of elements such as the store's website, domain, email, payments, ordering, and customers. In terms of its revenue model, the Company collects monthly fees for the usage of the ASP service from customers, so it can be said to be a so-called stock-type model. Stock revenue is very effective for stabilizing the management foundation. The Shopserve customer base has steadily expanded and contributed significantly to the Company's growth and management stabilization.

Once the EC systems business hit its stride, the Company began a parallel project of supporting the growth in sales at customer companies and expanding revenue by collecting a fixed percentage of net sales from customers as payment agency commissions (via store websites on Estore's Shopserve). This type of revenue is described as flow-type revenue and is distinguished from the monthly fees from Shopserve (stock revenue) in revenue management, even though the revenue comes from the same customers.

### (3) 2012-2018

The net sales from existing customers (EC system customers) expanded steadily, with a good compositional balance between stock revenue and flow revenue. Meanwhile, the Company began strengthening the Marketing Business with an eye to developing it as the core business for contributing to earnings. This involved commercializing the Company's sales promotion support expertise for effectively expanding customers' net sales. The two main points were 1) "commoditizing" its sales promotion support expertise and policies and acquiring fees from consulting and operations management agency services, and 2) selling these services to customers other than existing customers (EC system customers).

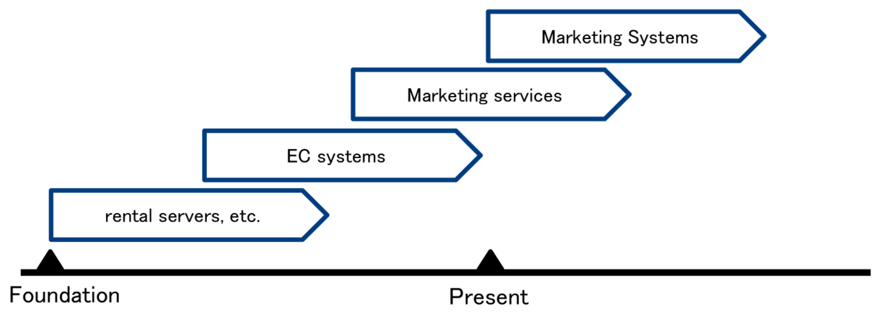
The Marketing Business initially consisted of two businesses, the "sales promotions business," which provided consulting and operations management agency services, and the "media business," which managed the PARK EC shopping mall. The Company has positioned the sales promotions business as the business domain it should focus on the most. It distinguishes it from the marketing systems business described below and it currently calls it the marketing services business. On the other hand, it has positioned the media business as a non-focus business, because it has powerful rivals, like Amazon, and it has fulfilled a certain purpose.

### (4) From 2018 to the present day

While the previously mentioned Marketing Business is mainly sales promotions, it also covers creations for sales (including website production), and the key point is that the content of these services is created through the work of employees, such as consultants and website designers.

Therefore, the Company has been working on systems development for sales promotions, and in the fall of 2017, is began to provide two software packages, Estore Compare and Estore Query (in some cases, they are collectively called the Back Store Group). This sales promotion systems business is called the marketing systems business, and although it is the same as the sales promotion business, it is distinguished from the marketing services business that is conducted by a work force. From 2018, the Company's strategy has been to fully expand sales of marketing systems, which is expected to lead to profit growth.

Changes in business




Source: Prepared by FISCO from Company materials

## Deploys its businesses in four quadrants created from two axes; sales and sales promotion, and systems and services

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

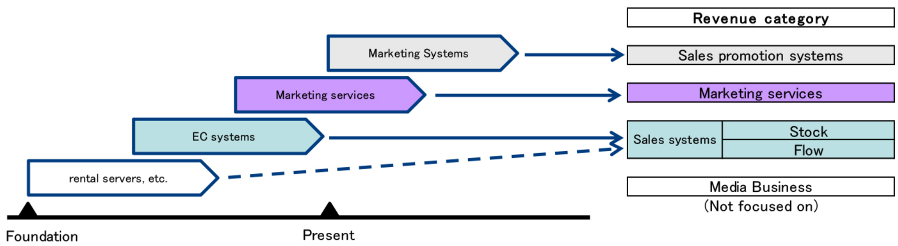
Reflecting the shift in the business field that it is focusing on as previously explained, the Company has changed its business segments and disclosure of their information.

The Company previously adopted a dual business structure comprising the Systems Business, which included the rental server business and the EC systems business, and the Marketing Business, which supported expansion of customers' sales. However, in FY3/17, the Company merged the two businesses and shifted to a single EC Business segment. The reason for this change was that the objectives of these two previous businesses were the same, of supporting the growth in sales at customers, so the significance of distinguishing between them had diminished.

So the Company now has only one business segment, but its business domain can be divided into four quadrants created from two axes; sales and sales promotion, and systems (machinery and software) and services (human labor). Following the launch of the marketing systems business, it has in place a structure covering all four quadrants (please refer to the medium- to long-term growth strategy section).

Based on this, from the FY3/18 results, the Company has disclosed results by business type and by revenue type, and it discloses the breakdown of net sales by dividing them into from marketing services, sales systems (which are further broken down into flow and stock), sales promotion systems, and the media business. Revenue from the rental server business is included in sales systems, but this business is contracting and its impact on revenue is limited.

**Businesses and services and their correspondence relationships for the disclosure of the net sales breakdown**




Source: Prepared by FISCO from Company materials

# Results trends

## Although sales decreased slightly, profit items from operating profit down increased greatly

● **Summary of the FY3/19 1Q results**

In the Company's FY3/19 1Q results, sales decreased slightly but profits increased greatly, with net sales of ¥1,206mn (down 1.0% YoY), operating profit of ¥144mn (up 33.5%), recurring profit of ¥143mn (up 35.1%), and net profit of ¥97mn (up 36.0%).

**Summary of the FY3/19 1Q results**

(¥mn)

| | FY3/18 | | FY3/19 | | | | |
|---|---|---|---|---|---|---|---|
| | 1Q results | Full year | 1Q results | vs. FY3/18 1Q | vs. full-year forecast | Full-year forecast | vs. FY3/18 |
| Net sales | 1,218 | 5,044 | 1,206 | -1.0% | 21.8% | 5,540 | 9.8% |
| Operating profit | 108 | 554 | 144 | 33.5% | 27.2% | 531 | -4.1% |
| Operating profit margin | 8.9% | 11.0% | 12.0% | - | - | 9.6% | - |
| Recurring profit | 106 | 582 | 143 | 35.1% | 27.0% | 531 | -8.7% |
| Net profit | 71 | 411 | 97 | 36.0% | 26.7% | 367 | -10.7% |

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

For its FY3/18 full fiscal year results, the Company achieved higher sales and profits that greatly exceeded the initial forecasts, with net sales increasing 5.6% YoY and operating profit rising 36.1%. However, it is not the case that the Company was simply pleased with this performance as positive results. Although sales rose as targeted, the reason for the increase in profits was that it was not able to make progress in investing in the costs for growth investment as it had planned. For the Company at the present time, investment in growth means acquiring human resources. It is attempting to recruit human resources who already possess a certain level of skills and then to further develop them, but this is not progressing as planned (this situation has continued for the last few years).

The initial forecasts for FY3/19, which once again incorporated the implementation of growth investment, were for higher sales but lower profits. But in the 1Q results, while sales decreased slightly, profits increased greatly, which was the same structure as in the previous fiscal year. Therefore, naturally the Company's own evaluation is the same as in the previous fiscal year.

Looking at the breakdown of net sales by business, marketing services net sales were ¥267mn (up 12.0% YoY). Compared to up to the previous fiscal period, the growth rate in FY3/19 1Q slowed down. This was because the Company was unable to acquire contracts for large-scale customers to the same extent as in the previous fiscal period, and it was also unable to make progress as planned for its aim of strengthening human resources toward business expansion (by acquiring human resources from outside the company or developing them inside the company), which seems to have kept down the growth in net sales.

Within sales systems, which is revenue from the ASP service Shopserve, stock revenue decreased 7.1% YoY to ¥442mn. In a situation in which a certain percentage of the approximately 12,000 existing contract holders cancel their contracts, for the acquisition of new contracts, the Company is focusing on the number of large-scale customers. As a result, a situation is continuing in which stock revenue is declining due to the net decrease in the number of contracts, but this in itself can be said to be in line with the Company's expectation.

Flow revenue decreased 1.7% YoY to ¥486mn. Flow revenue is a major pillar of the Company's growth strategy; therefore it is necessary to treat this decrease seriously. However, at FISCO we do not think it is a cause for concern, as the distribution amount per customer, which is the main source of flow revenue, increased 8% YoY, and we can say that flow revenue will also likely grow from the expansion in marketing services in the future.

Marketing systems (sales promotion systems) net sales were ¥2mn. The marketing systems business was launched in the fall of 2017 and fully fledged sales growth started from FY3/19. While it seems that ¥2mn is less than the Company expected, the feedback from customers using the services has been good, which can be expected to add momentum to customer numbers and sales in the future.

Breakdown of net sales by business

(¥mn)

| | | FY3/18 | | | | | | FY3/19 | |
|---|---|---|---|---|---|---|---|---|---|
| | | 1Q results | 2Q results | 3Q results | 4Q results | Full fiscal-year results | vs. FY3/17 | 1Q results | vs. FY3/18 1Q |
| Marketing services | | 238 | 276 | 326 | 291 | 1,131 | 43.6% | 267 | 12.0% |
| Sales systems | Stock | 476 | 467 | 460 | 452 | 1,855 | -5.7% | 442 | -7.1% |
| | Flow | 494 | 481 | 567 | 482 | 2,024 | 2.9% | 486 | -1.7% |
| Sales promotion systems | | - | | - | 2 | 2 | - | 2 | - |
| Media business, other businesses | | 8 | 8 | 9 | 5 | 31 | -41.6% | 8 | -1.7% |

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

# Medium-term growth strategy and progress

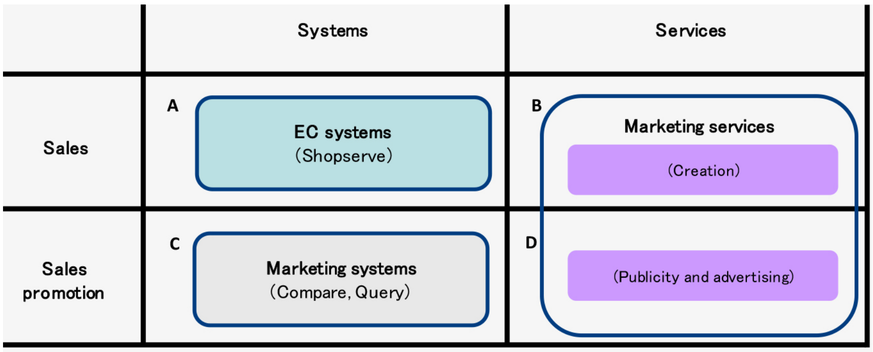
## Deploys three businesses–EC systems, marketing services, and marketing systems–and is aiming for growth through pursuing synergies between each of the businesses

### 1. Overall image of the growth strategy

As described in the business overview section, since it was founded the Company has repeatedly shifted the business that serves as the main axis of profits, and thereby expanded the scope of its business, on a cycle of approximately seven years. It newly started the marketing systems business in the fall of 2017, and as a result, it currently has a three business structure, of EC systems, marketing services, and marketing systems.

On the other hand, the Company's business domain can be divided into four quadrants created from two axes; sales and sales promotion, and systems (machinery and software) and services (human labor). The start of the marketing systems business means it has a structure in place that covers all four quadrants.

The Company's business domain




Source: Prepared by FISCO from Company materials and interviews

There is no doubt that each of the four business domains, from A to D, are important. But it is not the case that A to D exist separately (independently) from each other on the same plane, but rather that they are related to each other in various ways, such as having causal, substitution, and complementary relations. It can be said that they have an image close to the reality of a three-dimensional and multilayered existence according to their respective relations.

At FISCO, we do believe it is crucial to consider the Company's growth strategy while constantly keeping this image in mind. This is because while there is no doubt that it is aiming to grow each of the three businesses as its growth strategy, on taking one more step beyond this, we see that the essence of its growth strategy is pursuing synergies by actively utilizing the relations that exist between these three businesses (or the four domains, from A to D).

The details are given below, but when looking on a medium-term time axis (assuming around three to five years), as a result of the growth measures that the Company is implementing for each business, at FISCO we expect it to realize its strategy in the form of the growth of flow revenue within EC systems and the growth in sales of marketing services that are highly related to this business. Looking at this from the opposite direction, the growth in these two types of sales is a key performance indicator (KPI), and it is not possible to evaluate profit growth without this indicator. On the contrary, if this KPI is present, then profits are sure to follow, whatever the profits at hand. We think that this is precisely the reason why in the last few years, the Company has focused on conducting growth investment even though this has meant having to sacrifice profit growth in the short term.

## Aiming to once again accelerate the growth of flow revenue from synergies between marketing services and marketing systems

### 2. The EC systems growth strategy

The fundamental product in EC systems is Shopserve, which is an EC comprehensive support ASP service. It is an ASP service that integrates into one all of a store's sales-related elements, such as its website, domain, email, payments, ordering and customer management. Its revenue model is that the Company collects monthly ASP service usage fees from customers, and this revenue is recorded as stock revenue. The Company supports the expansion of sales at customer companies, and it concludes contracts with Shopserve customers to collect a certain percentage of their net sales (via the store's website on the Company's Shopserve site), such as in the name of payment of agency fees. This sales-linked revenue is recorded as flow revenue. Since stock and flow are different types of revenue, naturally their growth strategies will also be different.

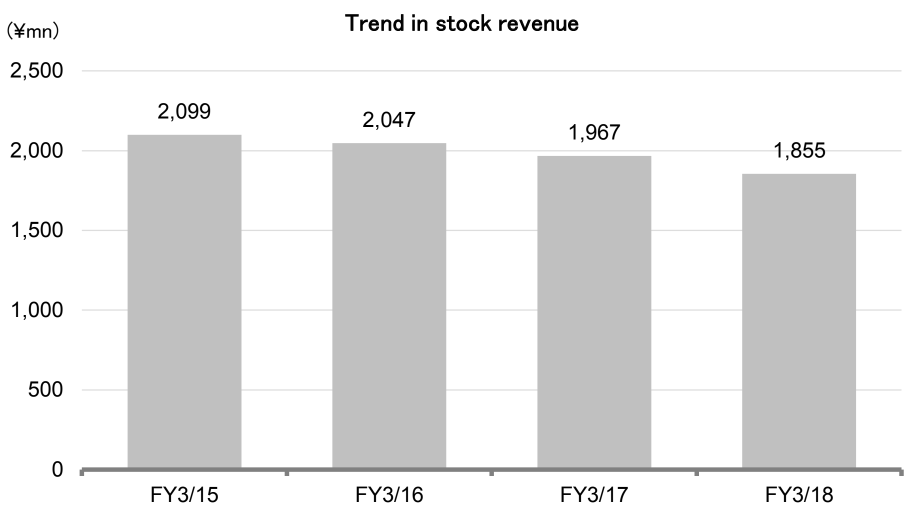
(1) The stock revenue growth strategy

Stock net sales are calculated as the product of the number of Shopserve contracted customers and the average spend per customer. Within these two, the Company has stated that it does not focus on the number of contracted customers and that rather, it focuses on raising up the average spend per customer.

Two conceivable approaches to increasing average spend per customer are changing the composition of the customers (increasing the ratio of large-scale customers) and raising the level of monthly fees by expanding the services used by the existing customers. The Company is working on both strategies but is focusing on the former. Under a slogan of “shift to good products, good stores,” the Company is approaching the acquisition of new customers by thoroughly focusing on stores that handle competitive products, stores with high profit growth potential, or medium-sized companies with large sales revenue and high monthly fees.

These measures have gradually borne fruit, with the average spend per customer steadily increasing. However, the declining trend in the number of customers continues. As a result, stock revenue is also continuing to trend downward. But the Company itself considers this point to be as expected and that it is absolutely not a cause for concern.

As described below, the policy of “shifting to good stores and good products” is also in order to grow flow revenue. In other words, even if the decline in stock revenue continues, this will be actually recovered by the increase in flow revenue. It would seem that this is one of the reasons why the Company is not concerned about the decline in stock revenue.



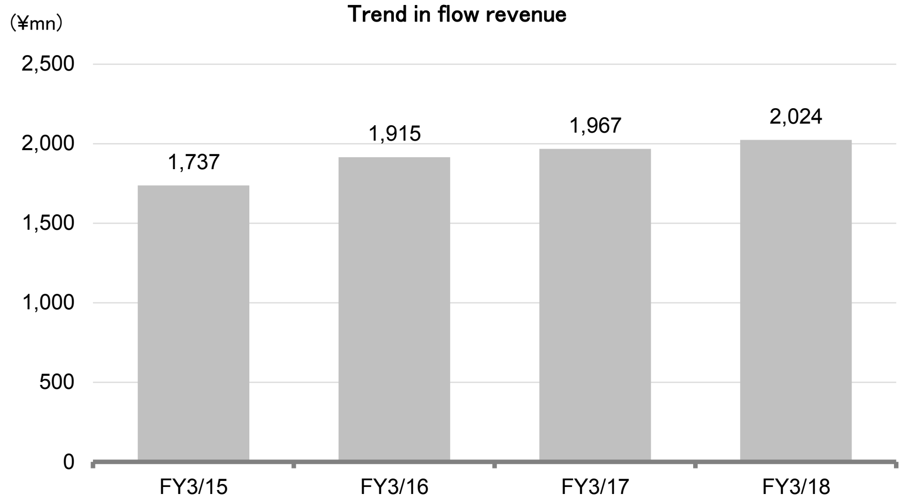

Source: Prepared by FISCO from the Company's financial results

(2) The flow revenue growth strategy

As previously explained, flow revenue is actually one of the main engines that drive the Company's growth, and it can be said that how to realize this growth is one of the priority issues for management.

The current state of flow revenue is that it is approaching a plateau, and so a key point will be whether or not the Company can get beyond this and return to a growth path.

Trend in flow revenue




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

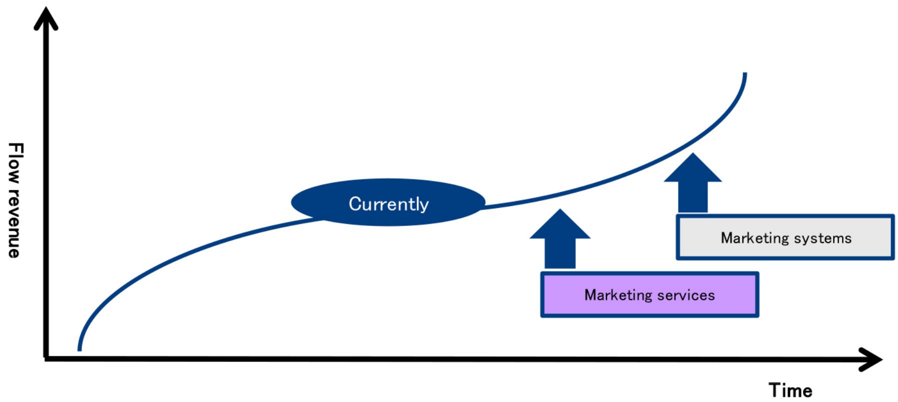
Its two main initiatives are 1) supporting the marketing of existing customers and realizing their higher sales and 2) changing the customer company mix and increasing the percentage of customers with large sales.

In approach 1) the Company has made agreements with existing Shopserve customers in the marketing services business. With this initiative, an increase in customers' net sales leads to expansion of the Company's flow revenue. In essence, this approach is to pursue synergies between flow revenue and marketing revenue.

Approach 2) involves a compositional change by company scale in the Shopserve subscriber companies by advancing the stock revenue structural reform initiative "shift to good products, good stores." With this initiative the Company is able to improve both stock revenue and flow revenue together.

In addition to these approaches, going forward we can expect flow revenue to grow from the synergies with the marketing systems business. Both Compare and Query (described below) provided through the marketing systems business are sales promotion support tools that aim to increase their users' sales. With FY3/19 as the first year of their fully fledged deployment, the Company's policy is to focus on sales to existing customers (in other words, customers who already have a Shopserve contract).

Image of the re-acceleration of the growth of flow revenue




Source: Prepared by FISCO from Company materials and interviews

## The growth strategy is to increase customer numbers and acquire large-scale customers
## Is accelerating the expansion of human resources toward realizing this

### 3. The marketing services business growth strategy

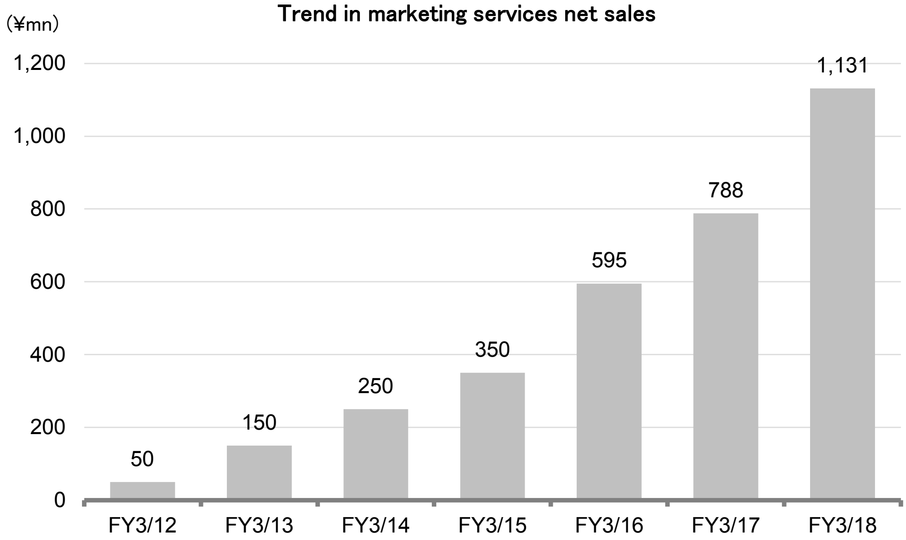
The business model of the marketing services business involves providing customers with consulting and operations management agency services for sales promotion (marketing), for which the Company receives consideration in the form of fees. The actual business straddles two domains, sales support and sales-promotion support.

The Company launched a marketing services business, with the targets for sales initially being its existing Shopserve customers. Subsequently, it also began to work to acquire contracts from new, external customers, and the business expanded.

Looking at the trend in net sales in the marketing services business, we see that they have continuously grown at a high rate each year, and in FY3/18, they increased 43.6% YoY to ¥1,131mn. However, as described in the results trends section, in FY3/19 1Q, the sales-increase rate slowed down to 12.0%.

The reason for this slowdown is that in the previous fiscal year, the Company achieved high growth for large-scale customer contracts, but subsequently it was unable to acquire contracts from these customers. In terms of the outlook for the future and its response to this situation, while it is forecast that the effects in 1Q will remain in part in 2Q, the Company is scheduled to start contracts with other large-scale customers from 2H, and it is strengthening sales toward acquiring customers. Therefore, it is likely to be able to recover the high growth rate in 2H.

Trend in marketing services net sales




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

At FISCO, we think the most urgent issue for the Company is securing human resources. For this, the strengthening of human resources is the focal point of the growth investment that it has been focusing on, and it seems that this is also the point that the Company itself is most keenly aware of. But even so, it has been noted that while its strategy of growing business profits through expanding its human-resources capacity is a good one, in terms of the tactics to actually acquire human resources, it is considered that other techniques might be necessary. A situation in which costs are less than forecast and profits are more than forecast (as pointed to by the Company itself) can be evaluated positively in the short term, but it is not preferable not to leave this situation unaddressed from the perspective of the Company's medium- to long-term growth strategy. Therefore, it can be said that expanding its human-resources capacity continues to be its biggest focal point.

## Compare is acquiring an excellent track record and reputation
## Is aiming to leverage this to rapidly increase customer numbers

### 4. Growth strategy in the marketing systems business

The marketing systems business refers to the development and sales of sales promotion support systems, which is to say software. The objective of the business is to expand customers' sales, which overlaps with that of the marketing business; however, the revenue model is made up of fixed basic monthly fees and a pay-for-use charge according to the number of times the services is used.

By autumn of 2017, the Company launched two marketing automation (MA) tools: Estore Compare ("Compare") and Estore Query ("Query"). Compare is a tool that helps to increase EC website sales by using A/B comparison testing for an EC website to determine in real-time which has the higher conversion ratio (CVR), number of conversions, and life time value (LTV). On the other hand, Query is an email marketing tool for business operators who already have an existing customer base of a certain size. The main feature of the tool is that it can refine customer characteristics and distribute personalized email.

In the breakdown of net sales in the marketing systems business, they are disclosed as sales promotion systems net sales. In FY3/18, net sales were ¥2mn (the four- to five-month portion in 2H). In FY3/19 1Q, net sales were again ¥2mn.

The Company began fully fledged efforts to grow sales of the two marketing systems products from FY3/19. It is thought that the result in 1Q, of sales of ¥2mn, is not necessarily one it was satisfied with. If we calculate from this sales result and the average unit price of ¥40,000 per month, we find that the current number of customers is around 15 companies. Going forward, the Company plans to expand sales by targeting existing Shopserve customers, based on factors such as the results for the early-adopters.

According to the Company, in terms of the results up to the present time, its evaluation is particularly high for Compare, and there are cases in which sales have increased by around three times when comparing before and after its introduction. If such cases were to accumulate, its persuasive power toward its introduction will also rise, which can be expected to lead to an increase in the number of companies contracting to marketing systems. Also, sales to existing Shopserve customers will lead to increases in both marketing systems net sales and flow revenue. So this can be said to be an extremely rational approach, and we shall be paying attention to how it develops going forward.

## Acquiring momentum and the ability to act through the selection of young employees
## Aiming to further improve their actual abilities as they accumulate experience

**5. The progress made in the large-scale restructuring**

In August 2017, the Company conducted its largest ever restructuring. It was not a restructure in the sense of laying off employees, but rather a literal changing the business structure. The main focus of the initiative was a wide-ranging rejuvenation of the personnel occupying key management positions. In short, employees in their 30s were selected for positions across the Company that had been occupied by employees in their 40s to 50s. (For the details, please refer to the previous report of March 19, 2018.)

At present, about one year after execution, the Company believes desired effects in terms of the efficiency of large-scale restructuring and its progress are clearly appearing in the form of momentum and the ability to act as an organization. On the other hand, it appears the restructuring also revealed the young employees’ lack of experience on aspects such as final execution (the ability to make and execute decisions) But even when considering this negative aspect, the Company’s own self-evaluation is that the large-scale restructuring has been a success.

At FISCO, we also consider the bold restructuring to be significant. The last few years to the next one or two years is a period of growth investment for the Company. During this period, it is ready to accept a temporary slump in results. When replacing veterans with young employees, we can fully expect that, to a certain extent, there will be an opportunity loss and related issues. We think that a judgment of not postponing a temporary opportunity loss and an increase in costs and to accept these issues, together with conducting growth investment, is essential in order to realize the vertical raising-up of results in terms of the timing of the subsequent harvesting and recovery of sales. On this point, we evaluate that the Company’s bold restructuring was the correct judgment in terms of timing.

## Acquired an e-certification business in order to minimize the risks that create confusion in the EC market

**6. Launched an e-certification business**

On August 6, 2018, the Company launched an electronic certification (e-certification) business. It newly established CrossTrust, Inc., and the same subsidiary received the transfer of the business of CrossTrust, which has a track record of e-certification services. Going forward, the Company will conduct an e-certification services business through CrossTrust. Specifically, the content of the e-certification services will be encrypting communications and issuing SSL and TLS server certificates, which certify the existence of a company.

Both SSL (Secure Sockets Layer) and TSL (Transport Layer Security) are technologies that encrypt communications on the Internet and prevent third parties from unauthorized viewing and altering of the contents of communications. SSL and TLS have the same framework, and their relationship is that SSL was repeatedly upgraded and subsequently it was shifted to TLS.

SSL and TLS server certificates are e-certificates with a function that enables the identity of the company operating the website to be confirmed. It is forecast that in the extremely near future, there will be a major difference between the websites that have introduced (acquired) this certification and those that have not. Specifically, when you are about to browse a website that has not acquired an e-certificate, you will receive a warning from your browser. This could prevent visits to websites and therefore have a major impact on the profits of EC businesses.

As the initial business of the Company and CrossTrust, the plan during the early stage is to issue SSL and TLS server certificates free of charge to the Company's existing customers (Shopserve contracting companies). Although free of charge may sound like a peculiar approach, it is expected to be fully justified from its loss-avoidance effects for flow revenue. (SSL and TLS server certificates are normally paid for, with the industry average fee being ¥30,000 a year).

For its e-certification business, it goes without saying that the Company will also issue SSL and TLS server certificates to external, general customers, and it aiming for it to grow as an independent revenue business. Since the model for e-certification services is contracts that are renewed after one year, it is a stock-type revenue model and once it reaches a certain scale, it can be expected to contribute to stable revenue.

# Outlook

## Forecasts are for higher sales but lower profits, as the Company expects to steadily conduct growth investment

### ● Overview of the FY3/19 forecasts

Estore forecasts for a profit decline on increased sales in FY3/19 with ¥5,540mn in net sales (up 9.8% YoY), ¥531mn in operating profit (down 4.1%), ¥531mn in recurring profit (down 8.7%), and ¥367mn in net profit (down 10.7%). The Company has not changed its forecast from its initial outlook.

Overview of the FY3/19 forecasts

(¥mn)

| | FY3/18 | FY3/19 | | | | |
|---|---|---|---|---|---|---|
| | Full year | 1Q results | vs. FY3/18 1Q | vs. full-year forecast | Full-year forecast | vs. FY3/18 |
| Net sales | 5,044 | 1,206 | -1.0% | 21.8% | 5,540 | 9.8% |
| Operating profit | 554 | 144 | 33.5% | 27.2% | 531 | -4.1% |
| Operating profit margin | 11.0% | 12.0% | - | - | 9.6% | - |
| Recurring profit | 582 | 143 | 35.1% | 27.0% | 531 | -8.7% |
| Net profit | 411 | 97 | 36.0% | 26.6% | 367 | -10.7% |

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

The Company manages its budget forecasts on a full fiscal year basis only, and it does not have results forecasts for 1H. As the rates of progress toward the profit forecasts are high, it would seem that we could expect results to exceed the full fiscal year forecasts. But the Company's policy is to actively spend on costs for growth investment, mainly on human resources, so at FISCO we think it is better to avoid excessive expectations that the results will exceed the profit forecasts.

Rather, what we should be focusing on from FY3/19 2Q onwards is the trend in net sales. The initial forecasts for the full fiscal year was for a sale-increase rate of close to double digits. But sales declined slightly in 1Q, so the question will be whether the Company can recover this in 2Q and beyond.

At FISCO, we presume that the "miscalculation" for the FY3/19 1Q results might have been the slowdown of sales in marketing services. On this point, the Company is aiming for a recovery by acquiring new contacts, including from other than existing Shopserve customers, and also by focusing on acquiring large-scale customers. There seems to have been a positive response in terms of it achieving this strategy, including for the acquisition of large-scale customers.

At FISCO, we fully expect flow revenue to recover from 2Q onwards. Although the revenue declined YoY in 1Q, the distribution amount per customer increased 8%. Alongside the re-acceleration of the growth of the marketing services business, flow revenue can be expected to trend upward and recover. In addition, the focus will be on the size of the effects from the expansion of sales of marketing systems. The Compare and Query services are tools for customers' sales expansion, so if progress is made in their adoption by existing customers with Shopserve contracts, it is expected that this will contribute greatly to increasing customers' EC sales and thereby also pushing up the Company's flow revenue.

### Income statement

(¥mn)

| | FY3/15 full year | FY3/16 full year | FY3/17 full year | FY3/18 full year | FY3/19 | |
|---|---|---|---|---|---|---|
| | | | | | 1Q results | Full year (E) |
| Net sales | 4,336 | 4,660 | 4,775 | 5,044 | 1,206 | 5,540 |
| YoY | -4.2% | 7.5% | 2.5% | 5.6% | -1.0% | 9.8% |
| Gross profit | 1,649 | 1,769 | 1,548 | 1,449 | 365 | - |
| Gross profit margin | 38.0% | 38.0% | 32.4% | 28.7% | 30.3% | - |
| SG&A expenses | 1,090 | 1,140 | 1,141 | 895 | 220 | - |
| SG&A margin | 25.1% | 24.5% | 23.9% | 17.7% | 18.3% | - |
| Operating profit | 559 | 628 | 407 | 554 | 144 | 531 |
| YoY | 8.7% | 12.5% | -35.2% | 36.1% | 33.5% | -4.1% |
| Operating profit margin | 12.9% | 13.5% | 8.5% | 11.0% | 12.0% | 9.6% |
| Recurring profit | 562 | 628 | 401 | 582 | 143 | 531 |
| YoY | 8.9% | 11.9% | -36.1% | 44.9% | 35.1% | -8.7% |
| Net profit | 330 | 420 | 285 | 411 | 97 | 367 |
| YoY | 5.0% | 27.3% | -32.1% | 44.1% | 36.0% | -10.7% |
| EPS after adjustment for share split (¥) | 55.27 | 78.66 | 55.32 | 79.73 | 18.96 | 71.11 |
| BPS after adjustment for share split (¥) | 197.18 | 196.74 | 227.30 | 283.36 | - | - |
| Dividend after adjustment for share split (¥) | 17.00 | 24.00 | 24.00 | 28.00 | - | - |

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

### Non-consolidated balance sheet

(¥mn)

| | As of March 31, 2015 | As of March 31, 2016 | As of March 31, 2017 | As of March 31, 2018 | As of June 30, 2018 |
|---|---|---|---|---|---|
| Current assets | 2,797 | 3,058 | 3,012 | 3,568 | 3,354 |
| Cash and deposits | 2,155 | 2,385 | 2,312 | 2,778 | 2,637 |
| Accounts receivable | 528 | 553 | 575 | 604 | 569 |
| Fixed assets | 511 | 447 | 480 | 469 | 519 |
| Tangible fixed assets | 100 | 82 | 129 | 106 | 105 |
| Intangible fixed assets | 116 | 108 | 103 | 74 | 59 |
| Investments & other | 293 | 256 | 247 | 230 | 353 |
| Total assets | 3,308 | 3,505 | 3,492 | 3,979 | 3,873 |
| Current liabilities | 2,098 | 2,471 | 2,296 | 2,490 | 2,428 |
| Accounts payable | 180 | 173 | 190 | 226 | 205 |
| Short-term borrowings | 102 | 324 | - | - | - |
| Deposits held | 1,393 | 1,559 | 1,740 | 1,853 | 1,962 |
| Fixed liabilities | 40 | 18 | 22 | 26 | 26 |
| Long-term borrowings | 24 | - | - | - | - |
| Shareholders' equity | 1,162 | 1,012 | 1,173 | 1,461 | 1,414 |
| Paid-in capital | 523 | 523 | 523 | 523 | 523 |
| Capital surplus | 539 | 539 | 539 | 539 | 539 |
| Retained profits | 2,439 | 2,759 | 2,921 | 3,209 | 3,162 |
| Treasury stock | -2,339 | -2,810 | -2,810 | -2,810 | -2,810 |
| Other | 6 | 3 | -0 | 0 | 3 |
| Stock subscription rights | 0 | - | - | - | - |
| Net assets | 1,170 | 1,015 | 1,173 | 1,462 | 1,418 |
| Total net assets & liabilities | 3,308 | 3,505 | 3,492 | 3,979 | 3,873 |

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

# Shareholder returns

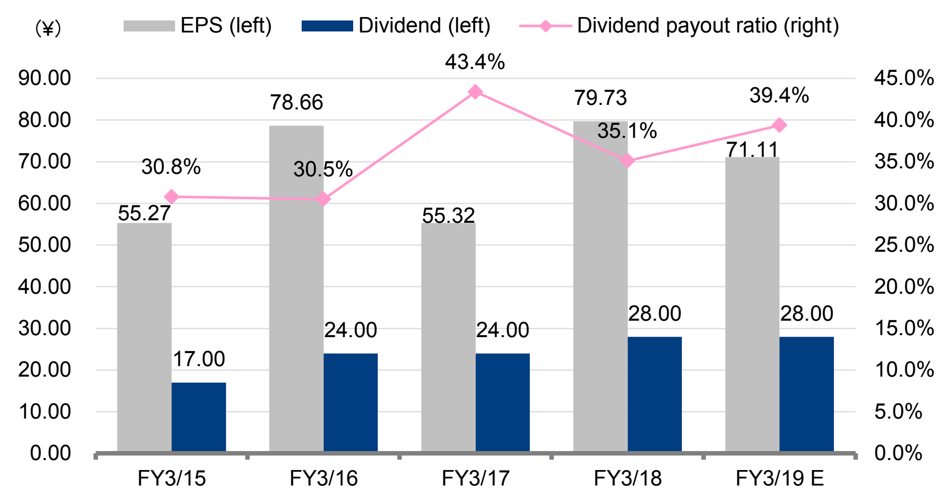
## In FY3/18, increased the dividend by ¥4 YoY to ¥28

The Company basically returns profits to shareholders through dividends. It pays dividends after taking into account a comprehensive range of factors, including business results, financial position, and the need to retain sufficient internal reserves to invest in growth. While it does not formulate an official dividend payout ratio, the foundation of Estore's thinking on the distribution of profits is its basic philosophy of "dividing profits between three groups; shareholders, customers, and staff." In the past also, it has a track record of determining the dividend based on this basic philosophy.

For FY3/18, the Company increased the dividend by ¥4 YoY to ¥28. It would seem that this reflects the high rates of increase, of around 40%, for each of the profit items from operating profit down. The dividend payout ratio was 35.1%. The Company has not decided on a dividend forecast for FY3/19, which is the same as in the past. In a typical year, it decides and announces its dividend forecast at the stage when the full fiscal year results are basically determined, and it would seem it will do the same in this fiscal year also.

Based on the FY3/19 Company forecasts, the earnings per share (EPS) is provisionally calculated to be ¥71.11. Supposing that the dividend will be ¥28, the same as in the previous fiscal year, the dividend payout ratio will be 39.4%. From its previously described basic philosophy of "dividing profits between three groups," it can be read that an appropriate dividend payout ratio would be from 30% to 35%. But the Company also has a track record of emphasizing stable dividends, so it is difficult to predict.

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




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

# Information security

## Steadily accumulating a track record of acquiring external certification in order to secure reliability

Based on its in-house development of various systems for EC support, the Company is constantly aware of constructing systems with high levels of security. Meanwhile, it has in place a system of checks by third parties for the level of security of its in-house systems.

The Company also provides a card payment service within its EC support ASP service. As it functions as a payment-receipt agency for this service, it holds consumers' credit card information. To ensure the security of this information, it has achieved the "PCI DSS" global security standard, which was jointly established by five international credit card companies and is operated and managed by PCI SSC and acquired the certification for it (the Company is a member of the Japan Card Data Security Consortium, which is the group managing PCI DSS in Japan).

## Disclaimer