Syuppin Co., Ltd.
3179 Tokyo Stock Exchange First Section

20-Jul.-16

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Recovery to a growth trajectory in FY3/17 from a business that is not reliant on inbound

Syuppin Co., Ltd. <3179> (hereafter, also “the Company”) is an e-commerce enterprise specializing in “valuable items,” such as cameras and luxury watches. It utilizes the different customer needs and product characteristics of used goods and new goods, and so to speak, utilizes used goods to play the role of the catalyst for the expansion of sales of new goods. It is succeeding in creating a flow of a positive spiral to increase sales of both new and used goods and is rapidly expanding the scope of its business.

At FISCO, we think that the sluggish results in FY3/16 were temporary and they will return to a phase of increased sales and profits in FY3/17, and that the Company’s Medium-term Management Plan results targets are fully achievable. The direct reason we think this is the continued high level growth of EC sales. The background to this is the steady increase in Web members, which is the result of the Company’s effective marketing measures. That is to say, as before it is maintaining a positive spiral in its EC business, which we think symbolizes the Company’s strengths.

The Company downwardly revised its results targets during FY3/16, and sales increased but profits declined year-on-year (y-o-y). The reasons for the decline in profits were that the excessive holding of sales caused the gross profit margin to fall. The Company experienced problems following the launch of a new system and a sharp decline in inbound sales from the middle of the year, and in order to catch up with the portion that was below the sales target, it held sales on a scale greater than normal. Within the SG&A expenses, expenses such as depreciation and amortization, land rent, and commissions paid each increased, and the Company was unable to cover for the decline in the gross profit margin.

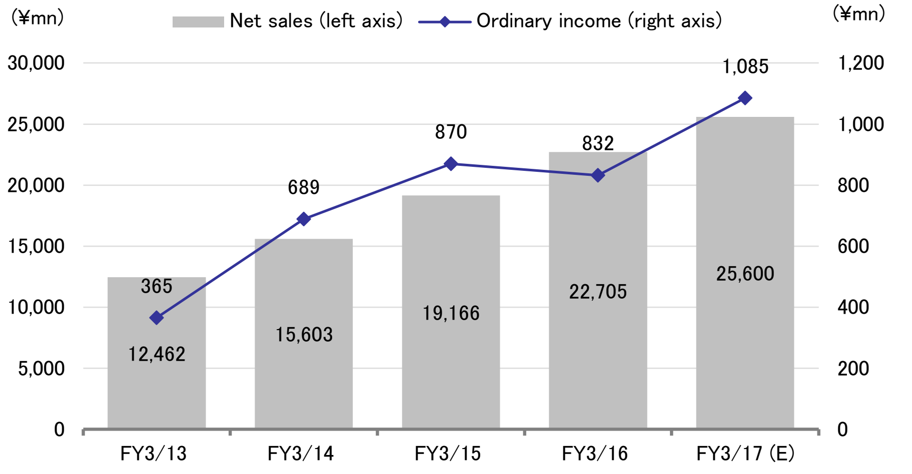
The Company has lowered its results targets in its new three-year Medium-term Management Plan (rolling Medium-term Management Plan). The main reason for this is the lower forecast for inbound net sales. Reflecting this, the growth rate for store net sales was lowered to a range of from minus 2% to plus 5%. Conversely, it maintained its forecast that EC net sales would continue to grow at a rate of 20%.The net sales growth rate on a Company-wide basis is now an annual 15%, which is a more realistic target than the previous forecast of annual growth of 18% to 20%.

In terms of its measures to increase sales, in FY3/16 the Company launched Web marketing and “Mitsumori SNS.” Further, in FY3/17 it plans to introduce “Guaranteed Peace of Mind Forever” (provisional name) and information marketing (CGM marketing). At FISCO, we expect that these measures will function effectively and contribute to higher profits.

Check Point

- Characterized by a business model of handling used goods and new goods at the same time and in parallel
- Is proceeding to Phase 2 of Web marketing
- Will measures such as Mitsumori SNS, Web marketing, and information marketing be successful in the medium term?

Results trends



Analysis of the FY3/16 results

Sales increased but profits decreased in FY3/16

(1) Results summary

In the FY3/16 results, net sales were ¥22,705mn (up 18.5% y-o-y), operating income was ¥832mn (down 6.1%), ordinary income was ¥821mn (down 5.6%), and net income was ¥560mn (down 0.6%), for an increase in sales but a decrease in profits. Compared to the targets, operating income was 25.6% below the initial forecast, and in addition, the profit items were slightly below the profits forecasts that were downwardly revised at the time the Q3 results were announced.

Net sales increased 18.5% y-o-y, but even so they were 1.8% (¥416mn) below the initial target. At first glance the sales trend appears positive, but as is described below, the Company's efforts to secure sales ultimately caused profits to decline. At FISCO, we think that this is the most important point for the FY3/16 results.

FY3/16 results summary

(¥mn)

	FY3/15	FY3/16				
	Full fiscal year	Full fiscal year				
		Initial forecast	Revised forecast	Result	y-o-y	vs. initial forecast
Net sales	19,166	23,121	22,670	22,705	18.5%	-1.8%
Gross profit	3,348	-	-	3,729	11.4%	-
SG&A expenses	2,461	-	-	2,897	17.7%	-
Operating income	886	1,118	910	832	-6.1%	-25.6%
Operating income margin	4.6%	4.8%	4.0%	3.7%	-	-
Ordinary income	870	1,100	890	821	-5.6%	-25.4%
Net income	563	734	585	560	-0.6%	-23.7%

Source: prepared by FISCO from Company materials

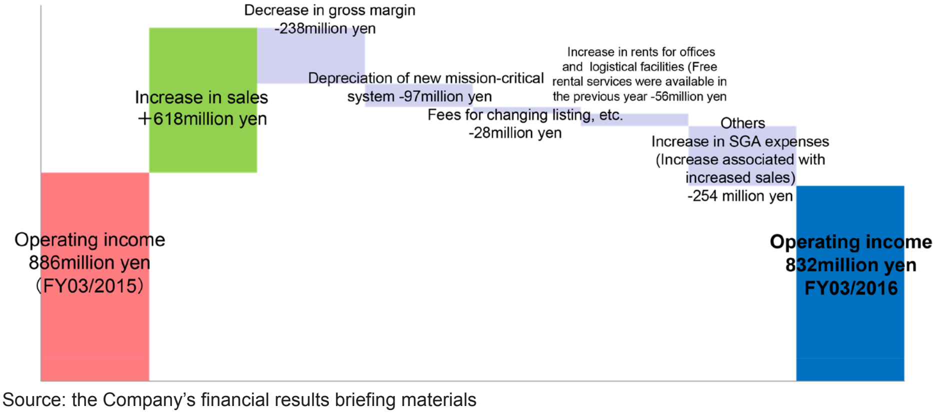
The factors pushing down net sales in FY3/16 occurred one after another from the initial period. The first was the problems following the launch of the new operations core system, which the Company introduced as its trump card to improve operational efficiency. As it was supposed to cover customer management, these problems resulted in an opportunity loss of approximately ¥60mn of net sales. The Company covered this loss by holding a sale in July. One more factor was the sudden decline in inbound demand. Inbound sales (tax-exempt sales in stores), which had maintained a high level, suddenly declined from October onwards, and the Company held a sale during the December shopping season to cover this decline.

The sales themselves involved normal sales promotion activities for the Company, but the sales held in July and December of FY3/16 included popular items that are normally not included in sales. The cost of popular products is high, so their gross margin is reduced (instead, the turnover is made more effective). As a result of the sales including these products, the gross profit margin (gross margin) ended up being greatly reduced.

In addition, for watches, which in particular are frequently imports, the strong yen was a factor behind the decline in the gross margin. This was because the stock that was purchased at a time when the yen was weak was priced and sold at a time when the yen had strengthened.

As a result of these factors, the gross profit margin declined 1.1 percentages points from the previous fiscal year, to 16.4%. The higher sales pushed-up profits ¥618mn, but the 1.1 percentage point fall in the gross margin pushed them down ¥238mn, and moreover SG&A expenses as a whole rose ¥435mn. As a result, operating income declined ¥54mn y-o-y.

Analysis of changes to operating income

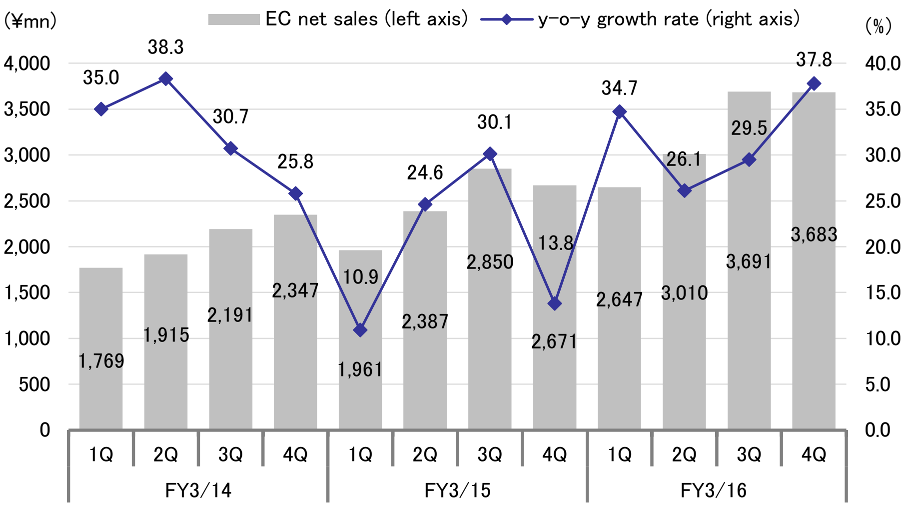


Source: the Company's financial results briefing materials

(2) Trends in EC net sales

For the Company as an e-commerce (EC) enterprise, EC net sales can be said to be the most important key performance indicator (KPI). EC net sales maintained a high level of growth throughout FY3/16, with growth from 20% to 30% y-o-y being achieved on a quarterly basis, and net sales increasing 32% on a full fiscal year basis.

EC net sales quarterly trends



Source: prepared by FISCO from Company materials

As previously described, in FY3/16 the Company held sales in which it placed more goods on sale than normal, which had the aspect of generating sales. It is difficult to measure precisely the amount generated from this effect, but at FISCO we estimate it might have been in the region of ¥500mn, when back calculating from factors like the Company holding this sort of sale that went beyond the scope of a normal one. Also, in Q4, the launch of new luxury camera models pushed up sales, which we estimate had an increase effect of about ¥200mn. On subtracting this combined amount of ¥700mn from the FY3/16 annual EC net sales of ¥13,032mn, the total becomes ¥12,332mn. This is an increase of 24.9% y-o-y, and based on this, we estimate that the momentum of the EC net sales growth rate remains undiminished.

In April 2016, EC net sales increased 66.2% compared to the same period in the previous fiscal year*, to ¥1,268mn, which was separately due to the launch of new luxury camera models. When excluding the impact of these new model launches, at FISCO we think that the growth rate was probably in the region of 30%.

* Due to the problems when replacing the system in April 2015, there was a period when the EC site was closed.

(3) Trends by business segment

In the mainstay cameras business, net sales were ¥16,572mn (up 20.5% y-o-y) and operating income was ¥1,168mn (down 3.4%), for an increase in sales but a decline in profits. Cameras were the main product in the previously described sale, and it is considered that the impact of the expansion of the items included in this sale led to the decline in operating income. The EC ratio rose from 56.7% in the previous fiscal year to 64.0%, which was due to the actual increase in EC sales and also from the rapid fall in inbound sales (tax-exempt sales in stores) in 2H. More details are given below, but with regards to cameras, a virtuous circle, of purchases and sales of used goods and sales of new goods, is being formed, and it seems that the Company is maintaining a merchandise stock turnover at the high level it is aiming for.

In the watches business, net sales were ¥5,301mn (up 13.3% y-o-y) and operating income was ¥231mn (up 6.5%), for increases in both sales and profits. The strong yen put pressure on profits from watches. The background to this is that as a high percentage of watches are imports and the inventory turnover of watches is in the region of 30%, inventory that was purchased in the last few years during a period in which the yen was weak had remained in stock. As the Company prices goods at the time they are sold based on the exchange rate, the gross profit can take a hit from the difference in the exchange rate, depending on the product, which can cause the profit margin to shrink. However, substantially there are no major changes to demand trends for watches, and in particular, the trend for products in the middle price band, which are particularly frequently distributed in EC, has remained firm.

In the luxury writing materials business, net sales were ¥470mn (up 29.5% y-o-y) and operating income was ¥54mn (up 157.1%), for major increases in sales and profits. While the luxury stationery market is not as generally established as the markets for cameras and watches, to a certain extent it has a fan base. In addition, it would seem that many members of this fan base for luxury stationery are also interested in watches and cameras, as many of them are thought to be people who are highly selective about the goods that they purchase. In these circumstances, the Company has established high awareness for its sales of cameras and watches in the EC market and boasts a rich lineup of luxury stationery items. So inevitably, awareness and name recognition of Kingdom Note, its luxury stationery EC site, is high. Further, the fact that there are no powerful competitors in this area is also leading to profit growth.

In the bicycles business, net sales were ¥360mn (down 0.7% y-o-y) and the operating loss was ¥7mn (operating loss of ¥15mn in the previous fiscal year). It was profitable up to Q2, but in 2H profits deteriorated due to seasonal factors, and it once again recorded an operating loss for the full fiscal year. From a safety perspective, customers have the strong need to test ride a bicycle and to check the size is right for them at the store, so demand for store sales is stronger than for EC sales, which can be said to act negatively on the Company as an EC enterprise. This is symbolized by the point that in FY3/16, EC net sales declined 11.4% y-o-y. But at FISCO, we expect that if the Company can breakthrough this barrier, it can get the bicycle business back on track.

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Detailed results by segment

(¥mn)

		FY3/15	FY3/16		
		Full fiscal year	Full fiscal year	y-o-y	EC ratio
Cameras	EC	7,805	10,609	35.9%	64.0%
	Stores	5,952	5,962	0.2%	
	Total net sales	13,758	16,572	20.5%	
	Segment operating income	1,209	1,168	-3.4%	
	Operating income margin	8.8%	7.0%	-	
Watches	EC	1,570	1,869	19.1%	35.3%
	Stores	3,110	3,431	10.3%	
	Total net sales	4,680	5,301	13.3%	
	Segment operating income	217	231	6.5%	
	Operating income margin	4.6%	4.4%	-	
Writing materials	EC	223	312	39.6%	66.4%
	Stores	139	158	10.3%	
	Total net sales	363	470	29.5%	
	Segment operating income	21	54	157.1%	
	Operating income margin	5.8%	11.5%	-	
Bicycles	EC	271	240	-11.3%	66.7%
	Stores	91	119	30.4%	
	Total net sales	363	360	-0.7%	
	Segment operating income	-15	-7	-	
	Operating income margin	-4.1%	-1.9%	-	
Company-wide	EC	9,871	13,032	32.0%	57.4%
	Stores	9,294	9,672	4.1%	
	Total net sales	19,166	22,705	18.5%	
	Operating income	886	832	-6.1%	
	Operating income margin	4.6%	3.7%	-	

Source: prepared by FISCO from Company materials

(4) Trends in SG&A expenses

In FY3/16, SG&A expenses increased ¥435mn y-o-y to 2,897mn, which was 12.8% of net sales, the same as in FY3/15. Breaking this down, the rise in commissions paid, of up ¥125mn, particularly stands out. This was due to payments based on sales to branch sites like Rakuten <4755> and Yahoo!<4689>. As sales at these mall branches grew significantly in FY3/16, particularly for new cameras, commissions paid also increased.

The increase in depreciation and amortization was due to the occurrence of full depreciation on the start of operations of the new core system. Also, the higher land rent was because the rent-free portion in FY3/15 ceased to be rent free from FY3/16.

The largest expenses item, personnel expenses, decreased ¥16mn y-o-y. This was because the Company adopts a system of bonuses linked to results, and as profits declined in FY3/16, it did not pay bonuses. While this had the effect of keeping down costs, it may also have had a negative impact on employee motivation, so at FISCO we will be paying close attention to the impact it may have had.

Breakdown of SG&A expenses

(¥mn)

	FY3/15	FY3/16	y-o-y Change
Personnel expenses	1,004	987	-16
Advertising expenses	42	66	24
Sales promotions expenses	261	352	90
Outsourcing expenses	106	148	41
Commissions paid	433	558	125
Depreciation and amortization	84	189	104
Land rent	169	210	40
Other	358	383	24
SG&A expenses	2,461	2,897	435
Ratio of SG&A expenses to net sales	12.8%	12.8%	-

Source: prepared by FISCO from the Company's briefing materials

The Company's ratio of SG&A expenses to net sales steadily declined up to recently, but this decline appears to have stopped in FY3/16. At FISCO, we think this point is not a cause for concern.

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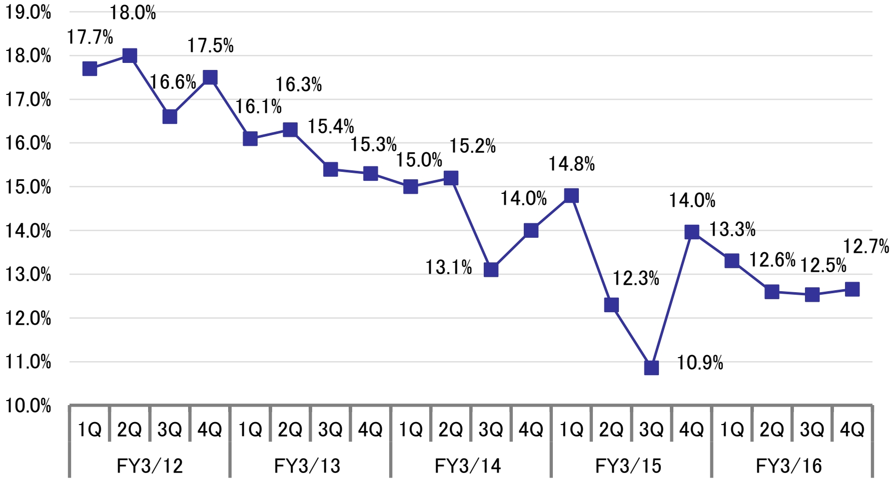
The biggest advantage of the start of operations of the new core system is that compared to before it was introduced, the Company can keep down the pace of the increase in personnel expenses, which rise according to the growth of net sales. In other words, it requires fewer people to deal with sales of the same scale as previously. Land rent does not entail store-type retail operations, so in principle it will not increase even if sales rise. Depreciation and amortization are expected to gradually decrease in the future.

Currently, the presence of commissions paid among the expenses is rising rapidly, but as they are expenses linked to sales, they have the characteristic of being a variable cost. The Company, instead of minimizing direct advertising expenses, adopts a strategy of aiming to increase sales from opening stores in EC malls that are able to attract customers, and in this strategy, commissions paid replace advertising expenses. At FISCO, we evaluate as correct this strategy of utilizing malls that are strongly able to attract customers. We think that the Company, at the same time as utilizing EC malls, will continue to invest in improving the appeal of its main store sites, and that the relative percentage of commissions paid will decline in this atmosphere.

From the perspective described above, at FISCO, we think that the Company's ratio of SG&A expenses to net sales still has considerable room to fall, and in the medium-to-long term, has room to fall to as far as around 10%.

Trend in the ratio of SG&A expenses to net sales



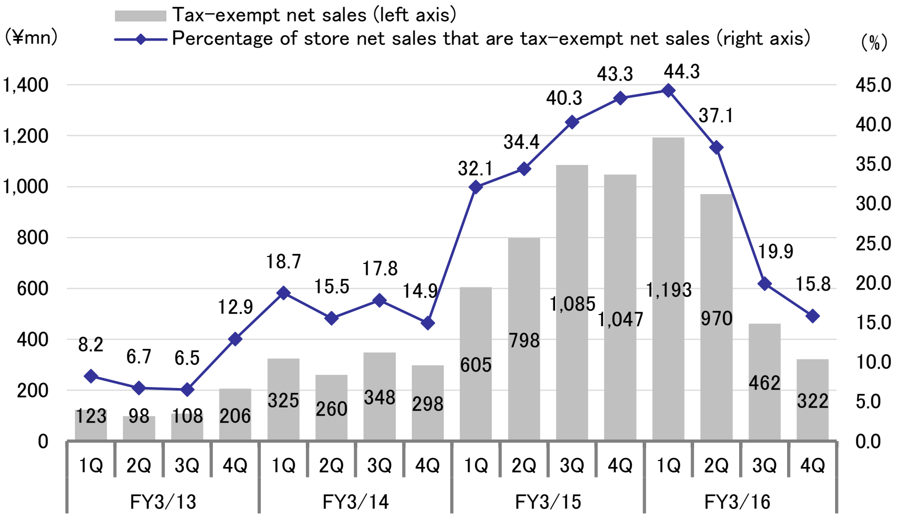
Source: prepared by FISCO from Company materials

(5) Trends in inbound net sales

The Company recognizes and aggregates inbound net sales, which are from tax-exempt sales in stores. Originally, the Company was an EC enterprise and so it had not necessarily been that active about capturing inbound demand. However, the impact of the rapid increase in tax-exempt net sales in FY3/15 was extremely large and could not be ignored, so from FY3/16, it seems that to a certain extent an expectation value for inbound demand was fostered within the Company and incorporated into the results forecasts.

But the reality is that inbound demand rapidly contracted in FY3/16. Looking at the Company's monthly net sales, we see that after peaking in May, they started to decline from the following month and a gap appeared between the initial sales targets and the results. As previously described, to fill in this gap the Company held a sale that was different than normal, which caused the gross margin to deteriorate. At the start of 2H FY3/16, the Company assumed that the "severe" October tax-exempt net sales (approximately ¥150mn for the month) would continue across the whole of 2H, but in fact the sales declined even further below this level.

Trends in tax-exempt net sales



Source: prepared by FISCO from the Company's briefing materials

Based on the FY3/16 results, the Company assumed inbound net sales on the scale of ¥100mn a month for its results forecasts and Medium-term Management Plan results target. The details are given below, but the downward-revised portions of the Medium-term Management Plan results targets can basically be entirely explained from the change to the outlook for inbound demand's impact on revenue. At FISCO, we think that the Company minimizing capital investment in response to inbound demand is a major factor behind the bold change in the outlook for inbound demand.

We consider that the current inbound demand adjustment phase will become prolonged, due to factors such as the changes to tariffs by the Chinese authorities. The Company's assumption of net sales of ¥100mn a month is from the understanding that net sales will correspond to the normal consumption amount by tourists visiting Japan, excluding "spending sprees" by Chinese consumers. However, the possibility cannot be ruled out that the actual result will fall below this assumption. But even supposing that it does, we think that as the expectation value has been reduced to a sufficiently low level, the damage will not be that serious.

Measures to recover onto a growth trajectory

Characterized by a business model of handling used goods and new goods at the same time and in parallel

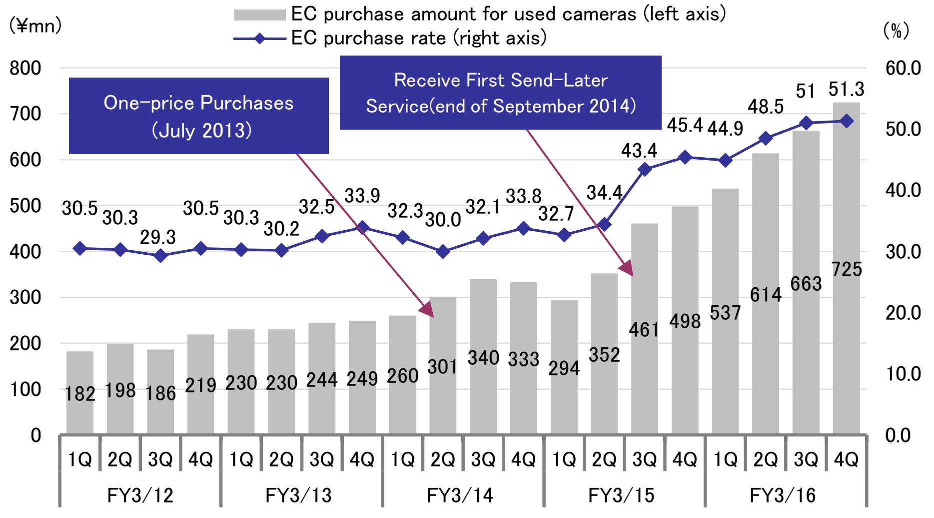
(1) Measures to accelerate purchases of used goods and an update to the current situation

A characteristic of the Company's business model is that it handles used goods and new goods at the same time and in parallel. From the viewpoint of consumers, this enables them to shop for the best mix while comparing high-quality, low-cost used goods and new goods. Conversely, from the viewpoint of the Company, it can utilize used goods as the catalyst to expand sales of new goods, which has the advantage of enabling it to realize growth at a faster pace compared to if it handled new goods or used goods alone. Therefore, at FISCO we think that the most important point for the Company's business model is securing a supply of used goods.

As measures to strengthen purchases of used goods, the Company introduced "One-price Purchases" in July 2013 and "Receive-First Send-Later Service" in September 2014. "One-price Purchases" explicitly show the purchase price for each product model, aiming to create an environment in which there is no room for negotiations, thereby eliminating the disadvantage of purchasing on the Internet and also the time spent negotiating. "Receive-First Send-Later Service" is a mechanism in which if the consumer is to make a purchase by trading-in their own item, they can trade-in this item once the item they purchased has been delivered. This eliminates the anxiety that users feel in a situation in which they no longer have on hand the item that they are trading-in, and it aims to encourage transactions. The Company is applying these measures to cameras and watches (it also applies One-price Purchases to luxury stationery and bicycles).

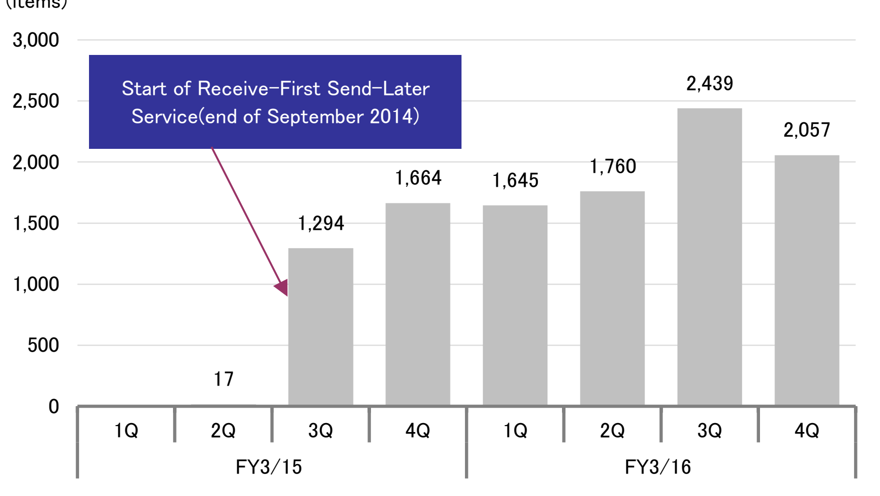
Both of these measures have demonstrated clear effects, and in terms of the EC purchase amount for cameras, both the actual amount and the EC purchase rate (the EC purchase amount as a percentage of the total purchase amount for cameras) are clearly trending upward.

Trends in the camera purchase amounts



Source: prepared by FISCO from the Company's briefing materials

Trends in the number of Receive-First Send Later Service



Source: prepared by FISCO from the Company's briefing materials

There are cases in which the pace of the Company's sales of new items leads its purchases of used goods. This is because trade-in demand increases according to the timing of launches of major new products. March and April 2016 saw the launch of two flagship camera models, the D5 from Nikon <7731> and the 1D X Mark II from Canon <7751>. Both are luxury models with camera bodies costing in the region of ¥600,000, and it seems that the Company receives orders on units of several hundred items a month. These launches temporarily push-up the new goods ratio (placing downward pressure on the gross margin). However, it would seem that the Company steadily captures trade-in demand on the back of the sales of these major models, so they can be expected to add momentum to sales of used models in the future.

Invoking demand for lot buying

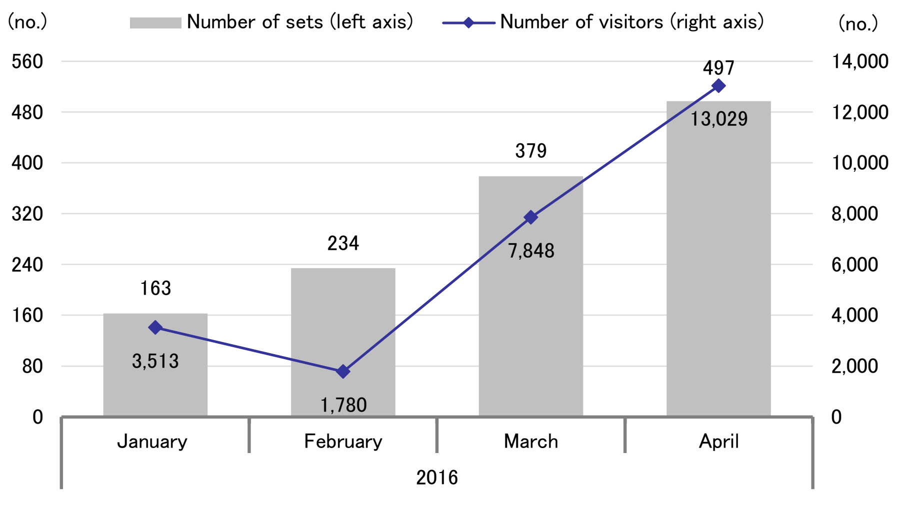
(2) Mitsumori SNS

Since FY3/16, the Company has been actively working to strengthen its marketing. As the first step for this, in December 2015 it launched “Mitsumori SNS”. This is a mechanism to receive proposals from the Company’s staff and expert-level users (such as semi-professional users and heavy users who have launched their own blogs) for a “recommended set” toward invoking demand for lot buying (buying multiple items at the same time). It is thought that a typical example of a proposal is a combination of a camera body and a matching lens, but there also seems to have been innumerable proposals for combinations for specific purposes (for example, a proposal for a lens, tripod, and filter for photographing the night sky). From the point of ease of use, if the shoppers are satisfied with the proposal, they can add all of the items to their shopping cart with just a single click.

The current Mitsumori SNS website is the second version, with the Company adding functions such as to post photos and reviews. Going forward, it plans to upgrade the site to the third version by improving the ease of viewing and the method for proposing a set.

Looking at the results up to the present time, the number of proposed sets in December 2015 was 104, but by April 2016 this had increased to 497. Similarly, the number of site visitors had increased from 3,707 people to 13,029 people. While site visitors are steadily increasing, the Company is strengthening its measures in order to further increase both the number of proposed sets and the conversion rate (the rate of views leading to actual purchases).

Trends in the number of proposed sets and site visitors on “Mitsumori SNS”



Source: prepared by FISCO from the Company’s briefing materials

At FISCO, we think that this mechanism is extremely effective, particularly for beginners and users who have just started, and we evaluate that it has achieved a certain level of effects up to the present time. What can be most positively evaluated is the number of site visitors. On looking at the content of the sets proposed on Mitsumori SNS (three-item sets including the camera body and lens), we consider that there might be many cases in which the consumer ends up buying the component parts one by one. In short, they are using Mitsumori SNS as one form of “word-of-mouth reviews”. The Company remains unsatisfied that the conversion rate is still low, but we think that there might also be an “invisible conversion rate,” and going forward, we will be paying close attention to the trends in the numbers of proposed sets and site visitors.

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Is proceeding to Phase 2 of Web marketing

(3) Web marketing

Web marketing is one more of the measures taken by the Company since FY3/16 to strengthen its marketing. Phase 1 began around the end of March 2016, in which the Company grouped its more than 280,000 members based on their customer information, and started an approach of manually optimizing planning and measures according to group. Specifically, previously the Company would send the same email magazine to all its registered customers, but instead in Phase 1, it sent information to members of the groups, such as the group of owners of Canon single-lens reflex digital cameras for a campaign for used lenses usable with their cameras. The effects were clear and the percentage of people opening the Company's emails has improved by 20 percentage points, from an average of 17% for the email magazine to an average of 37.6% for the emails sent according to group, and it plans to continue with the Phase 1 group approach in the future.

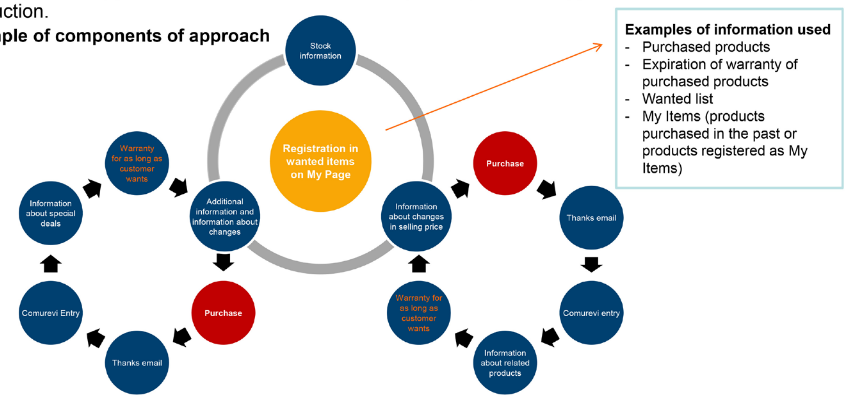
The plan is to proceed to the Web marketing Phase 2 during FY3/17. This will entail introducing CRM (customer relationship management) and a recommendation email delivery system, and then after that, launching an automated system for approaching each customer tailored to their individual needs, based on their customer information. The aim is to further increase the email opening rate and conversion rate compared to the rates from the group approach taken in Phase 1. Currently, the plan is to launch Phase 2 sometime from the end of September to around the first half of October 2016.

Web marketing Phase 2

Automated One To One approaches (plan to deploy by the end of 2Q FY03/2017)
Introduction of CRM and recommendation e-mail distribution system (plan to introduce by end of 2Q)

- Automatically make approaches suited to individual needs based on customer information.
- Plan to introduce application in 4Q of FY03/2017, and plan to push with application as well after introduction.

Example of components of approach



* CRM: Efforts to build long-term relationships with customers and improve customer satisfaction mainly by using information systems to record and manage customer attributes and customer contact history and provide services carefully tailored to each individual customer (cited from e-words)

Source: the Company's financial results briefing materials

At FISCO, we think that the Web marketing measures are extremely important. We must wait to see how they perform in the future before evaluating whether they have been a success or failure, but we consider that it is highly likely that they will be a success. The key points are that compared to Phase 1, the targets in Phase 2 have been expanded significantly, and also instead of being done manually, information is automatically sent to customers. In order to create information to send to customers that is truly and effectively individualized, in addition to the quantity and quality of the information within the database, a major key will be the degree of completeness of the algorithm to generate the individualized marketing information. On the point of the quality and quantity of the information in the database, the Company can access the data on its own performance since its establishment, and for the algorithm, its staff are extremely knowledgeable about products and technologies. Therefore, at FISCO we expect that it will be able to combine both these aspects and provide high-quality, individualized marketing information.

Expected to contribute to profits from the next fiscal year onwards

(4) "Guaranteed Peace of Mind Forever" (provisional name)

As a new measure from FY3/17, the Company plans to introduce "Guaranteed Peace of Mind Forever" (provisional name). The Company currently provides a guarantee period for the goods it sells, and will have the opportunity for a replacement purchase or trade-in after the guarantee period ends. However, many customers like the products they purchased and want to continue using them even after the initial guarantee period has passed, so this will be a service to extend the guarantee period for these customers.

At FISCO, we think there are two key points for this measure. The first is the direct revenue from guarantee premiums. The second is that the Company will maintain relations with customers by extending the guarantee period, which is a way to ensure that the relevant products and customers return to the Company, whether as trade-ins or for replacement purchases. At FISCO, rather than the business revenue aspect, we will be paying attention to the latter effect, of enabling it to capture customers and merchandise.

As the launch of this service is planned for Q4 FY3/17, substantially the impact on revenue will be felt from the next fiscal year and onwards. The Company is aiming to launch this service starting from for cameras and watches.

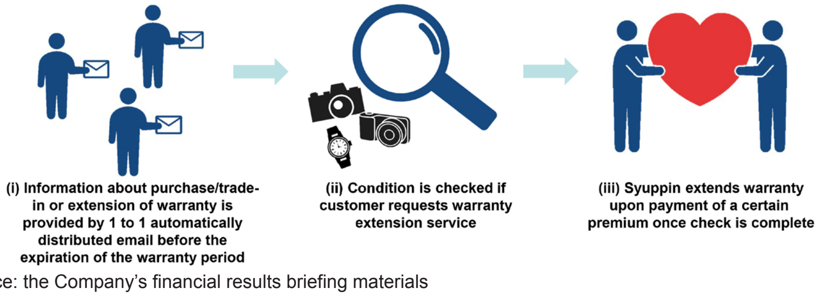
The "Guaranteed Peace of Mind Forever" (provisional name) service

Plan to introduce *Itsumademo Anshin* Warranty (provisional name) in 4Q

We currently propose trade-in and purchase when the warranty runs out, but we will provide a new service for customers who "continue using products."

Service whereby, after the warranty on products purchased with Syuppin expires, Syuppin extends the warranty for a certain premium once the condition of the products has been checked in accordance with Syuppin standards.

Warranty is extended after maintenance where necessary, for example, cleaning of sensors and lenses in the case of cameras and overhaul in the case of watches.



Source: the Company's financial results briefing materials

(5) Information marketing

As an EC enterprise, the Company develops the businesses for the four main merchandise on each of its respective EC main store sites. In the EC cameras business, this is "Map Camera". In addition to these sites, the Company operates a number of highly specialized EC sites, including "Kasyapa," which collects examples of various models of camera, and "Comurevi," which is a specialist review site. It aims to monetize these EC sites by developing them to be information platforms and implementing CGM (Consumer Generated Media; a type of media in which the consumers generate content, the information generated by consumers is made into a database, and websites are made into media) marketing.

As a specific example, we can consider the case of the establishment of a site specializing in events, such as photo exhibitions, and sales are generated from the fees paid to the photo exhibitors for the photographs exhibited within the frames. We can also think of other examples, for example establishing a site for information on spots to take photographs. The aim is to develop paid-for services in a variety of forms, if the number of page views (PV) increases and the value of the site rises.

FISCO

Syuppin Co., Ltd.
3179 Tokyo Stock Exchange First Section

20-Jul.-16

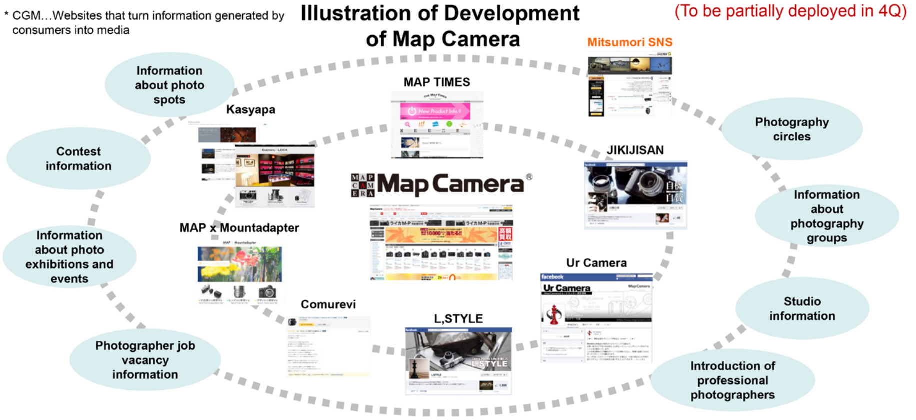
At FISCO, we think that this is an important measures, the same as Web marketing. We consider the main point here to be that for each respective specialist EC site, whether or not the Company is able to add "necessity" in terms of its association and linkage with the Map Camera site. For example, a sequence of events might be as follows; introducing spots to photograph the night sky in the above-described "information on spots to take photographs" site ⇒ "Mitsumori SNS" (provision on Mitsumori SNS of the optimum camera set for photographing the night sky) ⇒ "Map Camera" (purchase of the products in this set). Alternatively, the direction might be of the Company aiming to become the leading provider of a comprehensive portal site for cameras and photography related. We will be paying attention to how it develops in the future, including partnerships and collaborations with other companies.

The information marketing service

The principle strategy for online business remains the same, that is, to develop each highly specialist online site into an information platform and conduct user participation-type (CGM) marketing to attract more customers and increase access frequency.

*** Create a situation in which growth in new members is achieved without massive advertising investment (while reducing the SGA ratio). Also, aim to increase revenues through paid content, banner advertising, etc. in the future.**

* CGM…Websites that turn information generated by consumers into media



Source: the Company's financial results briefing materials

■ Medium-term Management Plan and results outlook

Will measures such as Mitsumori SNS, Web marketing, and information marketing be successful in the medium term?

(1) Medium-term Management Plan

The Company has formulated a Medium-term Management Plan for the next three years, which is rolling (revised) each year. For the present plan, last year it revised its targets for FY3/17 and FY3/18, newly formulated targets for FY3/19, as the 3 year Medium-term Management Plan for the period FY3/17 to FY3/19.

The Company downwardly revised its forecasts for net sales in FY3/17 and FY3/18, from the previous ¥27,046mn to ¥25,600mn for FY3/17, and from ¥31,815mn to ¥29,450mn FY3/18. Similarly, it downwardly revised the forecasts for ordinary income, from ¥1,512mn to ¥1,070mn for FY3/17 and from ¥2,027mn to ¥1,400mn for FY3/18.

Results targets for the 3 year Medium-term Management Plan from FY3/17 to FY3/19

(¥mn)

			Medium-term Management Plan (FY3/17 to FY3/19)					
			FY3/17		FY3/18		FY3/19	
	Result	y-o-y	2016 targets	y-o-y	2016 targets	y-o-y	2016 targets	y-o-y
Net sales	22,705	18.5%	25,600	15.0%	29,450	15.0%	33,850	14.9%
Cameras business	16,572	20.5%	18,790	13.4%	21,832	16.2%	25,280	15.8%
Watches business	5,301	13.3%	5,873	11.3%	6,535	11.3%	7,315	11.9%
Writing materials business	470	29.5%	537	15.5%	621	15.5%	720	15.9%
Bicycles business	360	-0.7%	398	15.5%	460	15.5%	533	15.9%
Gross profit	3,729	11.4%	4,389	17.7%	5,060	15.3%	5,858	15.8%
SG&A expenses	2,897	17.7%	3,303	14.0%	3,648	10.4%	4,044	10.9%
Operating income	832	-6.1%	1,085	30.4%	1,411	30.1%	1,813	28.5%
Ordinary income	821	-5.6%	1,070	30.4%	1,400	30.8%	1,805	29.0%
Net income	560	-0.5%	724	29.2%	947	30.8%	1,221	29.0%

Source: prepared by FISCO from the Company's briefing materials

At FISCO, we previously thought that in light of the present situation of the steady expansion of EC, it was highly possible that the Company would upwardly revise its results targets for FY3/17 and onwards. But in fact, it significantly downwardly revised them. The biggest factor behind this was the major downward revision to the forecast for inbound net sales (tax-exempt net sales from stores). After peaking in May, FY3/16 inbound net sales dramatically declined, and by Q4 had contracted to a pace of ¥100mn a month. Based on this, the Company downwardly revised its forecast for inbound net sales in the current rolling Medium-term Management Plan to sales of ¥100mn a month, and then incorporated this decline into the other targets.

In the new Medium-term Management Plan that includes the downwardly revised forecast for inbound net sales, the y-o-y growth rate for store net sales is assumed to be in the region of -2% to +5%. Conversely, the assumption is that EC net sales will continue to grow at an annual rate of 20%, the same as previously. As a result, net sales as a whole will grow by an annual rate of 15% (FY3/17, up 12.8%).

With regards to expenses, sales from Rakuten stores and Yahoo! Shopping stores are expected to increase, so in conjunction with this, commissions paid are also expected to rise. While the absolute number of employees is forecast to increase from the expansion in the business scope, it is anticipated that the pace of this increase will be fairly moderate due to the launch of the new core system. As a result of incorporating these elements, the ratio of SG&A expenses to net sales is forecast to fall to as far as 11.9% in FY3/19.

In terms of the current actual trends, as previously described, EC showed strong growth in FY3/16. At FISCO, we think that the essential part of the EC field has not changed from previously; namely, the points of the ability to appeal to customers and competitiveness compared to other stores (signifying not only prices, but a comprehensive appeal, including from services), and also growth potential for the future.

We consider that the recent downward revision to the results targets may actually have a positive effect in terms of the recovery of results in the future. The reason we think this is that it will improve employee motivation. The Company adopts a results-linked bonus system, so it did not pay bonuses in FY3/16 as the results did not achieve their targets. It is not hard to imagine that this damaged employee morale. We think that the results targets indicated in the current rolling Medium-term Management Plan are more realistic and achievable values and so provide an opportunity to restore employee moral that has temporarily fallen.

The specific measures to achieve these results targets are the items in the previously described "Measures to recover onto a growth trajectory." In addition to from the smooth functioning of the measures for sales of used goods, at FISCO we expect the Company to achieve the results targets in its Medium-term Management Plan through the success of its series of measures for the short-to-medium term, including Mitsumori SNS, Web marketing, and information marketing.

(2) FY3/17 results outlook

The details of the FY3/17 results forecasts have already been described, but at FISCO we think the point to focus on in these results is the recovery of the gross profit margin (gross margin). This is because the direct reason why the FY3/16 results landed where they did was the decline in the gross margin.

On arranging the factors that will act positively and negatively on the gross margin, for the present time of FY3/17, net sales seem to be growing rapidly due to the successive launches of flagship cameras model by both the major manufacturers of Nikon and Canon. As a result, the new goods ratio will increase, particularly in Q1, which might push down the gross margin. However, due to the launches of these expensive new models, there is also likely to be a steady arrival of trade-in used goods, so against the backdrop of the ample inventory from Q2 onwards, sales of used goods can be expected to increase.

Another point to keep in mind is once again the Company's holding of sales. It always holds sales and from within them, it controls the merchandise stock turnover and the gross margin. But in FY3/16, in order to generate sales, the Company expanded these sales to include items that it would not normally include, and as a result the gross margin took a hit. So the point for this fiscal period is for the Company to not once again fall into this sort of situation. It has downwardly revised its forecast revenue growth rate compared to the previous forecast, so at FISCO we think the risk of this has fallen compared to in the previous fiscal year.

The main positive and negative factors for the gross margin

Factors pushing-up (+) the gross margin	Factors pushing-down (-) the gross margin
Increase in the used goods sales ratio	Increase in the new goods sales ratio
Increase in the EC sales ratio	Increase in the store sales ratio
	Increase in the inbound sales ratio (to increase the store / new goods sales ratio)
Reduction in number of sales / areas	Expansion in number of sales / areas
Yen weakening in the purchases ⇒ sales period	Yen strengthening in the purchases ⇒ sales period

Source: prepared by FISCO

Although in Q1 it is possible that no clear improvements in the gross margin will be seen due to the previously explained factors, at FISCO we think that it will steadily improve from Q2 onwards. This is because the essential strength of EC has not changed and in fact the strong growth of EC sales is continuing, and also as we anticipate that the various marketing measures implemented in the previous fiscal year will be successful and that the Company will not excessively hold sales.

Another reason why we at FISCO are bullish about the Company's results is the trends in the number of Web members. Recently, new member numbers have been increasing at a pace of 7,000 to 8,000 people each quarter. The Company's definition of members is people who have newly purchased an item, so the number of new members signifies the number of new customers. Reflecting the steady accumulation of members, EC customer numbers are also steadily increasing. In addition the customer unit price is trending stably, and at FISCO we think that this shows that the growth model used up to the present time is still working. We consider that this trend will continue in FY3/17 and across the period of the current Medium-term Management Plan.

Simplified non-consolidated income statement

(¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17	
					1H	Full fiscal year (F)
Net sales	12,462	15,603	19,166	22,705	11,888	25,600
y-o-y	23.7%	25.2%	22.8%	18.5%	8.5%	12.8%
Cameras business	9,176	11,333	13,758	16,572	-	18,790
Watches business	2,838	3,640	4,680	5,301	-	5,873
Writing equipment business	223	309	363	470	-	537
Bicycles business	224	320	363	360	-	398
Gross profit	2,350	2,926	3,348	3,729	-	4,389
Gross profit margin	18.9%	18.8%	17.5%	16.4%	-	17.1%
SG&A expenses	1,961	2,225	2,461	2,897	-	3,303
Ratio of SG&A expenses to net sales	15.7%	14.3%	12.8%	12.8%		12.9%
Operating income	389	701	886	832	448	1,085
y-o-y	84.4%	80.2%	26.4%	-6.1%	3.4%	30.4%
Operating income margin	3.1%	4.5%	4.6%	3.7%	3.8%	4.2%
Ordinary income	365	689	870	821	440	1,070
y-o-y	88.8%	88.4%	26.2%	-5.6%	3.6%	30.4%
Net income	231	390	563	560	298	724
y-o-y	208.0%	68.3%	44.5%	-0.5%	5.3%	29.2%
After adjustment						
EPS (¥)	22.11	32.90	47.08	46.81	24.91	60.50
DPS (¥)	3.50	5.00	7.00	8.00	-	7.00
BPS (¥)	116.38	147.58	189.66	229.47	-	-

Balance sheet

(¥mn)

	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16
Current assets	2,284	2,952	3,475	4,024	4,905
Cash and deposits	380	571	441	492	506
Sales receivable	587	844	1,049	917	1,327
Inventory assets	1,199	1,362	1,790	2,222	2,757
Fixed assets	524	533	787	1,085	1,001
Tangible fixed assets	117	109	101	159	137
Intangible fixed assets	109	120	210	607	530
Investments and other assets	296	303	475	318	333
Total assets	2,810	3,487	4,263	5,110	5,907
Current liabilities	1,247	1,495	1,906	2,260	2,585
Notes and accounts payable	339	510	727	656	940
Short-term borrowing, etc.	557	610	650	871	1,215
Long-term liabilities	669	620	589	579	568
Long-term borrowing, corporate bonds	669	612	584	577	568
Shareholders' equity	893	1,371	1,766	2,270	2,746
Capital	350	485	508	508	508
Capital surplus	250	385	408	408	408
Retained earnings	293	500	849	1,352	1,829
Subscription rights to shares	-	-	-	-	6
Total net assets	893	1,371	1,766	2,270	2,753
Total liabilities and net assets	2,810	3,487	4,263	5,110	5,907

Cash Flow Statement

(¥mn)

	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16
Cash flows from operating activities	182	85	79	157	90
Cash flows from investing activities	-55	-129	-225	-262	-333
Cash flows from financing activities	13	234	16	154	257
Change to cash and deposits	140	190	-130	50	14
Balance of cash and deposits at start of period	240	380	571	441	492
Balance of cash and deposits at end of period	380	571	441	492	506

■ Returning profits to shareholders

Stably and continuously paying dividends

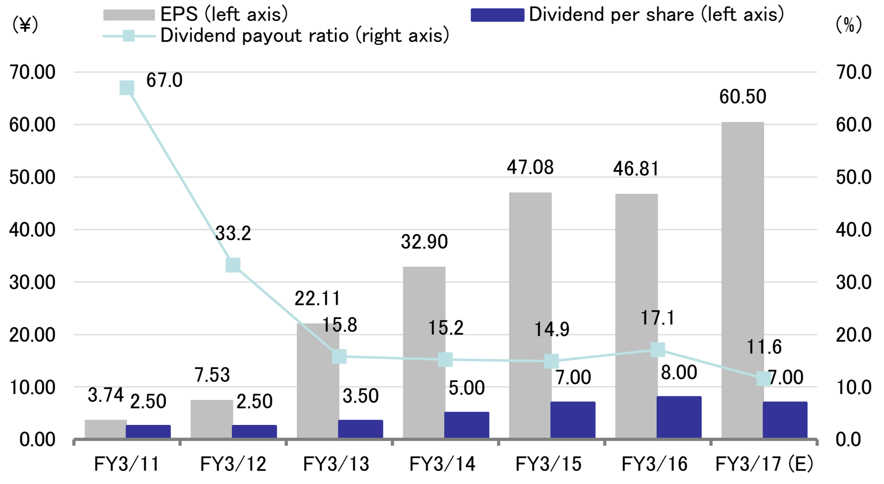
The Company considers returning profits to shareholders to be an important management issue, and its basic policy is to do so through dividends. However, it does not publically set dividend targets, including for the dividend payout ratio, and its approach is to focus on stably and continuously paying dividends while comprehensively taking into account factors such as the results forecasts and the amount required for internal reserves for business expansion.

The Company paid a dividend of ¥8.00 in FY3/16, up ¥1.00 y-o-y. This was comprised of an ordinary dividend of ¥7.00 and a commemorative dividend of ¥1.00 following the Company's transfer to the TSE First Section in December 2015. Earnings per share (EPS) in FY3/16 was ¥46.81, and based on this, the dividend payout ratio was 17.1%.

For FY3/17, the Company is forecasting a dividend of ¥7.00, EPS of ¥60.50, and based on this, a dividend payout ratio of 11.6%. It does not publish a dividend payout ratio target to external audiences but it is aware that it is an important indicator, and at FISCO we expect that if it steadily achieves its results forecasts, the dividend will increase commensurate with the improved results.

■ Returning profits to shareholders

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



Source: prepared by FISCO from the Company's financial results summary

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