

Syuppin Co., Ltd.

3179

Tokyo Stock Exchange First Section

17-Jan.-2018

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■ Summary

Making healthy progress in cultivation of “Syuppin fans,” entering a stage of accelerated earnings growth led by measures to expand sales

Syuppin Co., Ltd. <3179> (hereafter, also “the Company”) is an e-commerce (EC) enterprise specializing in “valuable items,” such as cameras and luxury watches. Making the most of the different customer needs and product characteristics of used and new goods, it has succeeded in creating a virtuous cycle in which both used and new goods reinforce each other to increase sales of both types of goods. In the process, the Company has been rapidly expanding the scope of its business.

1. Upbeat performance with sharply higher sales and earnings, posted all-time high quarterly results in July-September

The Company reported sharply higher sales and earnings in 1H FY3/18 at ¥14,435mn in net sales (+29.3% YoY) and ¥736mn in operating income (+55.8%). Overall performance benefited from healthy growth in the mainstay cameras business, due to a virtuous cycle of increased purchases that lead to higher sales, and a steep rise in sales for the watches business, aided by a proactive inventory strategy and upturn in transaction prices. The SG&A expenses ratio continued to move lower, and this accelerated operating income growth.

2. Advanced to a stage of ambitiously pursuing stronger sales in the growth strategy

We think logical and incremental implementation of growth measures suited to business model attributes has been a key factor in the Company’s success. The Company finally entered a stage of actively expanding sales after completion of a base for increased purchases of used products. Among various measures aimed at boosting sales, one-to-one marketing and EVERYBODY X PHOTOGRAPHER.com deserve close attention and should bring very large benefits.

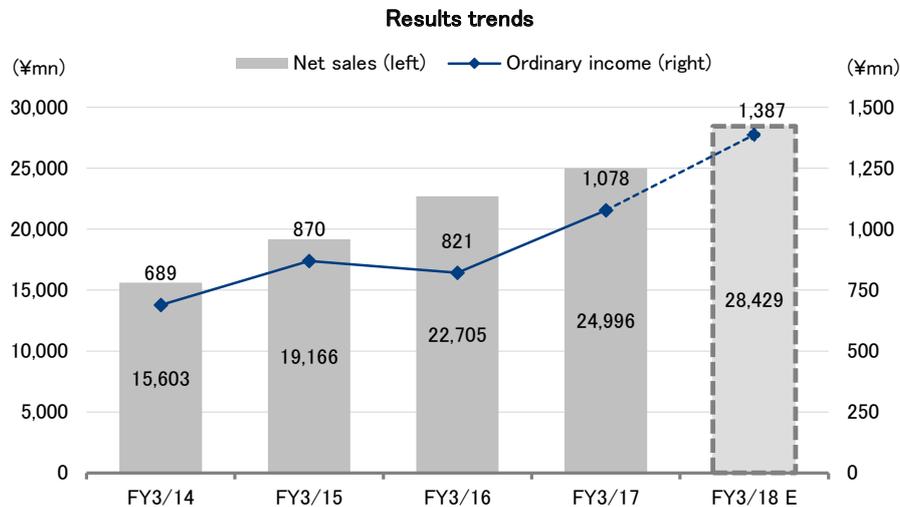
3. Focus on progress with measures and extent of upside in FY3/18

The FY3/18 forecast calls for ¥28,429mn in net sales (+13.7% YoY) and ¥1,402mn in operating income (+27.8%). We believe the forecast is overly cautious and expect stronger results than current targets. This view takes into account the prospect of posting higher sales and earnings for 2H than 1H levels because of occurrence of the main demand period, including the year-end and new-year season, in 2H. We are focusing on the scale of upside, rather than whether or not there is upside.

Key Points

- Larger effect from Phase 2.0 personal requests than anticipated, growing expectations for Phase 3.0 personal recommendations
- EVERYBODY X PHOTOGRAPHER.com offers an opportunity to enjoy cameras after purchases and way of converting camera enjoyment into revenue
- Forecast seems overly cautious; focusing on the scale of upside, rather than whether or not there is upside

Summary



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

Results trends

Very upbeat performance with gains of 30% in sales and 56% in operating income

1. Overview of 1H FY3/18 results

The Company reported sharply higher sales and earnings in 1H FY3/18 at ¥14,435mn in net sales (+29.3% YoY), ¥736mn in operating income (+55.8%), ¥730mn in ordinary income (+56.7%), and ¥503mn in net income (+57.3%). These results were in line with the upwardly revised 1H forecast announced on October 23, 2017.

1H FY3/18 results summary

	FY3/17		FY3/18			(¥mn)
	1H result	Full-year result	1H result	YoY	Vs. initial forecast	Progress rate vs. full-year forecast
Net sales	11,161	24,996	14,435	29.3%	11.8%	50.8%
Gross profit	1,917	4,202	2,418	26.2%	-	-
SG&A expenses	1,444	3,105	1,681	16.4%	-	-
Operating income	472	1,096	736	55.8%	25.7%	52.5%
Operating margin	4.2%	4.4%	5.1%	-	-	-
Ordinary income	466	1,078	730	56.7%	26.1%	52.6%
Net income	319	741	503	57.3%	27.0%	53.0%

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

Results trends

Large sales gains in the mainstay cameras and watches businesses were the direct sources of upbeat 1H FY3/18 performance. Sales rose 23.9% YoY for cameras and 48.7% for watches.

While the gross margin dropped by 0.4 percentage point from 17.2% a year ago to 16.8% in 1H, the SG&A expenses ratio fell by 1.2 percentage point from 12.9% to 11.7% and the operating margin climbed from 4.2% to 5.1%. This improvement supported the sharp 55.8% YoY rise in operating income.

The gross margin slipped due to change in sales mix with vibrant watches sales plus the impact of sales promotion outlays to sustain appropriate, fresh inventories in light of stronger purchases of used cameras than anticipated. The Company has done well with product purchases, in contrast to difficulties in procurement of used products at many businesses in the reuse industry. Used product activity occupies an extremely large role in the Company's business model. The Company's ability to reliably purchase used products is vital so we are not concerned about the decline in gross margin in 1H.

SG&A expenses increased 16.4% YoY to ¥1,681mn, but the ratio to sales dropped 1.3 percentage point, as mentioned earlier. Main additions to SG&A expenses were sales promotion costs and commissions paid. These items do not raise concern because they fundamentally increase in correlation with sales gains. It is worth noting that advertising and promotion costs only amount to 0.2% of sales. We believe this attests to establishment of frameworks for purchasing used products and selling these items without much reliance on advertising and promotional costs.

Breakdown of SG&A expenses

(¥mn)

	FY3/17			FY3/18		
	1H	YoY change	Ratio to net sales	1H	YoY change	Ratio to net sales
Personnel expenses	493	1	4.4%	517	24	3.6%
Advertising expenses	32	2	0.3%	26	-6	0.2%
Sales promotion expenses	177	8	1.6%	270	93	1.9%
Outsourcing expenses	67	-15	0.6%	76	8	0.5%
Commissions paid	293	50	2.6%	352	58	2.4%
Depreciation and amortization	97	5	0.9%	94	-3	0.7%
Land rent	105	0	0.9%	105	0	0.7%
Other	176	-27	1.6%	224	47	1.6%
Total	1,444	25	12.9%	1,681	237	11.7%

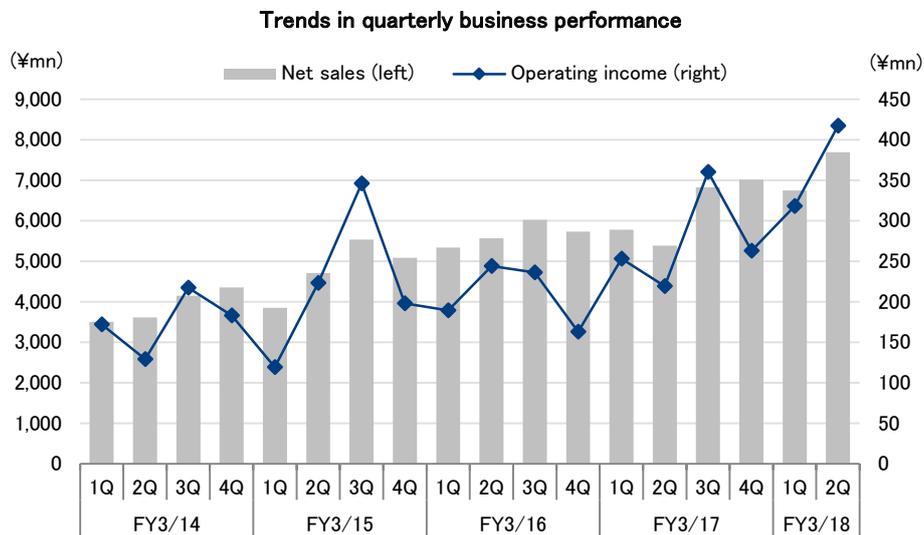
Source: Prepared by FISCO from the Company's results briefing materials

Results trends

Posted all-time high quarterly sales in 2Q (July-September); healthy advances in used product purchases, the used product sales ratio, and other KPI

2. Quarterly results and KPI trends

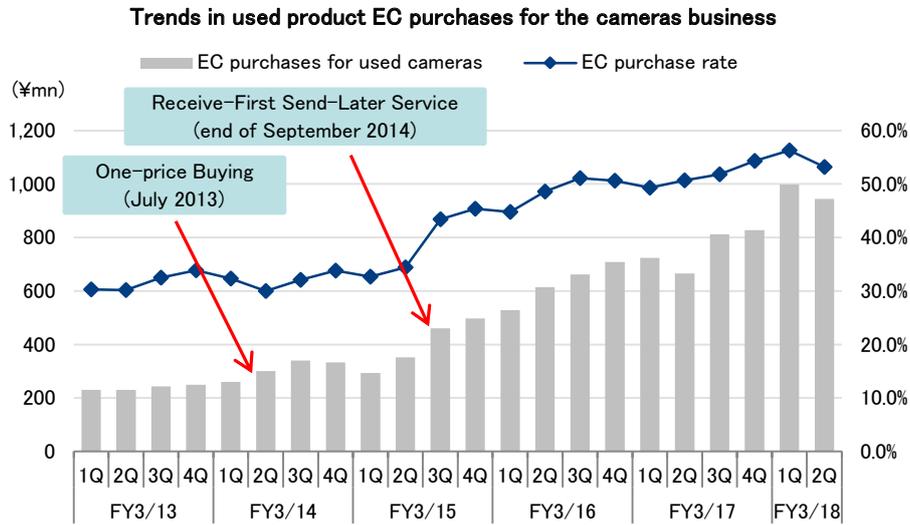
Looking at quarterly trends, net sales expanded 42.9% YoY to ¥7,690mn in 2Q (July-September), exceeding 3Q and 4Q levels from FY3/17. The Company's sales exhibit seasonality of strong growth in 3-4Q that includes year-end and new-year activity and temporary declines in 1-2Q of the next fiscal year. The 2Q FY3/18 result diverged from this pattern. We think the success in one-to-one marketing efforts and expansion of the watches business were leading drivers, as explained previously.



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

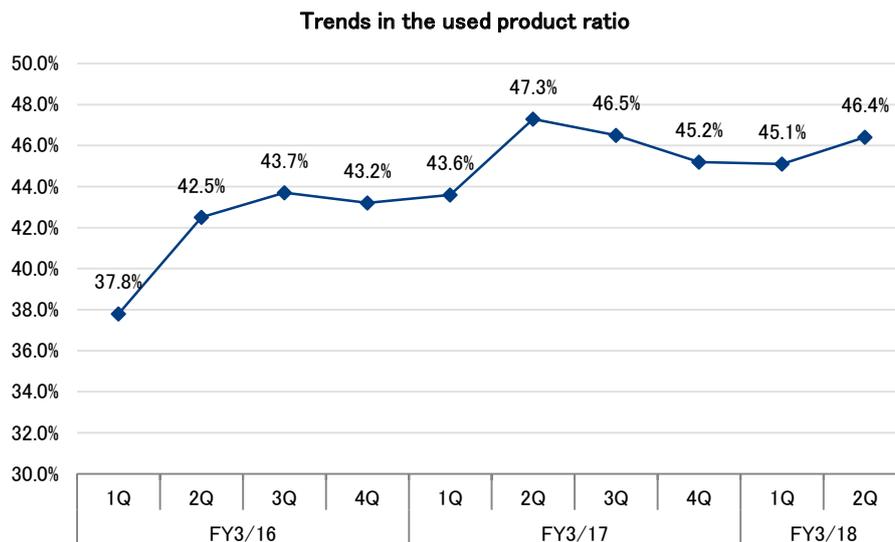
Purchasing used products is a shared top-priority issue for all reuse business operators, including Syuppin. The Company discloses EC purchases in the cameras business as a KPI. Camera purchases increased 27.6% YoY in 1H FY3/18 with the EC portion, which accounts for about 55%, rising 40% to ¥1,942mn. The Company says its service of sending notifications on purchasing price changes by e-mail to members contributed significantly to healthy buying. Smooth purchasing has major implications for the business model because used products serve as a catalyst of growth in new product sales and an extensive inventory is the biggest customer draw.

Results trends



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

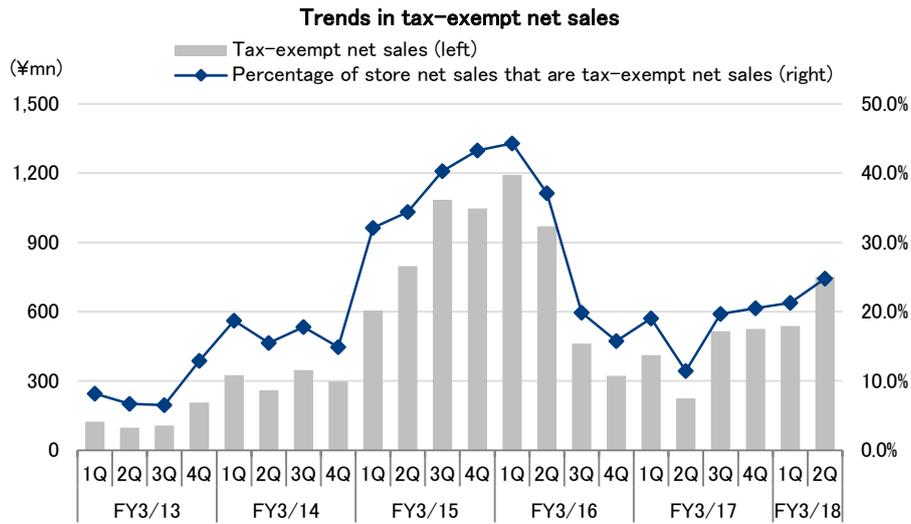
Used product sales have recently been at the upper end of the past range at 45.1% in 1Q and 46.4% in 2Q. While used products generally deliver higher profit margin than new products, new product sales are also an important aspect and a sharp rise in the used product ratio is not necessarily positive. We think gains in new product sales are likely to drive the Company's growth and view expansion of used product transactions (purchases and sales) from the standpoint of being a catalyst for new product sales. The 1H results indicate that the used product ratio is suitable for the Company's current position.



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

Results trends

Tax-exempt net sales rose sharply in 1H with a 102.8% YoY gain to ¥1,290mn. This category expanded sharply during 2H FY3/15 through 1H FY3/16, but its subsequent sudden contraction in 2H FY3/16 and 1H FY3/17 disrupted the Company's results. After this experience, the Company lowered its monthly tax-exempt net sales target in the budget to ¥100-150mn. However, while sales adhered to the plan in 1Q at ¥538mn, they accelerated sharply to ¥752mn in 2Q (July-September). The Company intends to let this business proceed naturally from 3Q too and thus maintained its existing stance. Increase in foreigners visiting Japan, meanwhile, might drive further advances.



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

Results trends

Healthy growth in cameras with successful marketing measures, sharp rise in watches sales aided by an expanded product lineup and wealth effect

3. Trends by business segment

Details by business segment

		FY3/17			FY3/18		
		1H	YoY	EC ratio	1H	YoY	EC ratio
		(¥mn)					
Cameras	EC	5,660	23.7%	69.2%	7,140	26.1%	70.4%
	Stores	2,523	-25.9%		2,998	18.8%	
	Total net sales	8,184	2.5%		10,138	23.9%	
	Segment operating income	640	7.8%		821	28.3%	
	Operating margin	7.8%	-		8.1%		
Watches	EC	1,093	34.1%	42.5%	1,397	27.8%	36.6%
	Stores	1,475	-15.5%		2,422	64.2%	
	Total net sales	2,569	0.3%		3,820	48.7%	
	Segment operating income	104	-15.7%		228	118.9%	
	Operating margin	4.1%	-		6.0%		
Stationery	EC	163	17.7%	67.9%	195	19.5%	69.4%
	Stores	77	2.7%		85	10.9%	
	Total net sales	240	12.4%		281	16.7%	
	Segment operating income	24	0.1%		22	-10.0%	
	Operating margin	10.0%	-		7.9%		
Bicycles	EC	124	-1.6%	74.3%	144	15.9%	74.2%
	Stores	42	-43.2%		50	17.6%	
	Total net sales	167	-17.2%		194	16.4%	
	Segment operating income	-5	-		-0		
	Operating margin	-3.0%	-		-0.4%		
Company-wide	EC	7,041	24.5%	63.1%	8,877	26.1%	61.5%
	Stores	4,119	-22.3%		5,557	34.9%	
	Total net sales	11,161	1.8%		14,435	29.3%	
	Segment operating income	472	9.1%		736	55.8%	
	Operating margin	4.2%	-		5.1%		

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

(1) Cameras business

The cameras business posted ¥10,138mn in net sales (+23.9% YoY) and ¥821mn in operating income (+28.3%). Roughly 70% of sales took place through the EC channel with this portion growing by a healthy 26.1%. We see two major sources of the robust trend in the camera sales. One is a substantial rise in used product purchases thanks to the notification service for changes in purchase prices. The other is the one-to-one marketing effect. Personal requests added as Phase 2.0 in FY3/17 have been providing a larger boost than expected. In this service, price and availability updates are transmitted for products that customers put on their "wish list." An improved cycle of "increase in used camera purchases leading to stronger camera sales" supported healthy growth in sales.

Results trends

(2) Watches business

The watches business generated ¥3,820mn in net sales (+48.7% YoY) and ¥228mn in operating income (+118.9%). Sales rose considerably in both EC and store channels. While the store sales ratio tends to be higher with watches because they can be more expensive than cameras, high-priced watch transactions are steadily increasing in the EC channel too. The Company's EC sales have been growing at a 20% annual pace for the past two years and continue to expand in FY3/18. This partly reflects broader acceptance of EC in society and diminished resistance to transactions of high-priced item in this channel. We think the Company's status as a company listed on the TSE First Section is an important factor too. Under the improved business environment, the Company strategically expanded the product lineup and augmented inventories with new and used products, boosting sales. The average sales price in 1H climbed substantially from about ¥700,000 a year ago to around ¥900,000. We believe the wealth effect from higher stock prices contributed to the gain, and this aspect also helped raise sales.

(3) Stationery business

The stationery business recorded ¥281mn in net sales (+16.7% YoY) and ¥22mn in operating income (-10.0%). The Company's KINGDOM NOTE is making healthy inroads in awareness and brand acceptance in the world of high-end stationery. This trend supported upbeat growth in EC sales. We attribute the lower operating income to change in product mix, rather than any particular reason.

(4) Bicycles business

The bicycles business posted ¥194mn in net sales (+16.4% YoY) and a ¥700,000 operating loss (vs. a ¥5mn loss a year earlier). The Company emphasizes an omni strategy (attracting customers through the EC site and strengthening sales at stores). Success in this initiative supported healthy sales growth. The operating loss narrowed considerably too along with increased sales to about a breakeven level.

■ Medium-to long-term growth strategy and the progress made

Finished building the unique business model, advanced to a stage of ambitiously targeting higher sales

1. Overall image of the growth strategy and the rolling medium-term management plan

The Company formulates a medium-term business plan for the next three years that it rolls (updates) annually. It did not make any changes to targets in the medium-term plan announced at the start of the fiscal year. The plan calls for annual growth rates of about 15% in net sales and 25% in operating income. The Company has not revised these fundamental trend targets in the past few years.

Medium-to long-term growth strategy and the progress made

Medium-term management plan: FY3/18–20

(¥mn)

	FY3/17		2017 rolling medium-term plan (FY3/18–20)					
			FY3/18		FY3/19		FY3/20	
	Result	YoY	Forecast	YoY	Forecast	YoY	Forecast	YoY
Net sales	24,996	10.1%	28,429	13.7%	32,620	14.7%	37,575	15.2%
Cameras business	18,131	9.4%	20,400	12.5%	23,654	16.0%	27,517	16.3%
Watches business	6,013	13.4%	7,016	16.7%	7,794	11.1%	8,696	11.6%
Stationery business	511	8.6%	618	20.9%	713	15.3%	825	15.8%
Bicycles business	339	-5.8%	395	16.5%	460	16.4%	537	16.8%
Gross profit	4,202	12.7%	4,930	17.3%	5,671	15.0%	6,548	15.5%
SG&A expenses	3,105	7.2%	3,527	13.6%	3,848	9.1%	4,305	11.9%
Operating income	1,096	31.8%	1,402	27.9%	1,822	30.0%	2,243	23.1%
Ordinary income	1,078	31.3%	1,387	28.7%	1,811	30.6%	2,235	23.4%
Net income	741	32.2%	950	28.2%	1,241	30.6%	1,531	23.4%

Source: Prepared by FISCO from Company materials

We think three main features and strengths in the Company's business model are 1) focus on "valuable items" that are highly specialized in its offerings, 2) utilization of an EC-centric model that limits store openings as few as possible, and 3) pursuit of growth by increasing sales of both used and new products. Reviewing the Company's progress, its implementation of various measures to achieve growth logically and incrementally along a correct path in the proper order has enabled today's success.

While companies (not only Syuppin) implement a variety of measures, few of these actions have a dramatic impact or provide a significant turning point. One-price Buying was the first measure with a large impact, based on what we know, and next came the Receive-First Send-Later Service. These measures both contributed directly to the goal of increasing purchases of used products. In the Company's business model, used products are a catalyst for boosting sales of new products. The business model might not work unless the Company is capable of obtaining inventories of used products. This provided the motivation for measures to increase purchases. We think the measures not only lifted purchases, as planned, but also contributed substantially to raising recognition and awareness of the Company in the reuse industry.

Now that the Company has used product purchases on track and thereby solidified the base for implementation of its business model, it moved onto measures for full-fledged sales expansion. It is carrying out or planning various measures by type and product category. In particular, we think one-to-one marketing and EVERYBODY X PHOTOGRAPHER.com deserve attention. With the former, the Company has enhanced its existing marketing efforts over the web with AI and other technologies and developed capabilities that can be applied to all products. The latter, meanwhile, focuses on the mainstay cameras business and leverages the Company's in-depth understanding of camera product features.

Medium-to long-term growth strategy and the progress made

Marketing of strategy: Overall progress

	One-to-one marketing	Continue to strengthen the existing online sites	Information marketing	Apps
1H FY3/17	Phase 1.0 Groupings of targets ① Target e-mail distribution specific to each customer group	② Large amount of product information on shopping websites (increased images, etc.) ③ Function of "Comurevi" (user review) list added ④ Launch of "PLUS + 1 STORE," a webpage specializing in camera accessories ⑤ Webpage for watch brand-specific purchases ⑥ Webpage dedicated to women's watches		
2H FY3/17	Phase 2.0 Personal requests ⑦ Notification of arrival email	⑨ Extended warranty service "Itsumademo Anshin Warranty" ⑩ "Kodawari Kensaku (specific search)" installed on websites for watches ⑪ Mitsumori (estimate) SNS Ver.3		
1H FY3/18		⑫ [April] "Kodawari Kensaku (specific search)" installed on websites for stationery ⑬ [August] "Kodawari Kensaku (specific search)" installed on websites for bicycles *Complete deployment on all Syuppin sites ⑮ [August] MapCamera was opened on eBay (overseas mall)	⑭ [April] Established "EVERYBODY x PHOTOGRAPHER.com"	
2H FY3/18	Phase 3.0 Personal recommendations ⑯ [October] AI-based recommendation started on MapCamera	Mitsumori (estimate) SNS Ver.4	Collaboration between "EVExPHOT" and MapCamera. Users can purchase cameras.	· Provision of the MapCamera application · Provision of the GMT application · Provision of the KINGDOME NOTE application · Provision of the CROWN GEARS application · Provision of the EVExPHOT application

Source: The Company's results briefing materials

We expect these two measures to provide substantial benefits (they are already making a difference). If they succeed as planned, purchases of used products should improve and this activity is likely to drive a virtuous cycle of increased purchases of used products lifting sales of new and used products and subsequent further growth in used product purchases. We have already seen evidence of the virtuous cycle, including 1H FY3/18. Our focus is whether these measures accelerate the virtuous cycle and the extent to which it accelerates.

Larger effect from Phase 2.0 personal requests than anticipated, rising expectations for Phase 3.0

2. Progress in one-to-one marketing

The Company ramped up one-to-one marketing from FY3/17 and splits this effort into four phases from Phase 1.0 to Phase 4.0. It began Phases 1.0 and 2.0 during FY3/17 and plans to start Phase 3.0 in FY3/18. (The three-month delay in rolling out Phase 3.0 versus the initial plan prompted revision of the Phase 4.0 timing to FY3/19. Note that the following explanation is based on the original plan.)

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Medium-to long-term growth strategy and the progress made

One-to-one marketing roadmap

Fiscal year ended March 31, 2017		Fiscal year ending March 31, 2018	Fiscal year ending March 31, 2019
Phase 1.0 Groupings of targets	Phase 2.0 Personal requests	Phase 3.0 Personal recommendations	Phase 4.0 Merchandising
Customers are grouped based on big data related to transaction histories. Information on events is sent by e-mail to the groups in accordance with their needs.	Syuppin responds to customers' obvious needs. Syuppin sends them information on products on their wish list, including changes in prices and product arrivals.	Syuppin will respond to customers' potential needs. Syuppin will send information on related products and will recommend popular products to help customers find what they want more easily.	Syuppin will match sellers and buyers. Syuppin will buy out-of-stock items from users and sell them to other users.
Syuppin can send information that customers need instead of e-mailing, without any specific reasons, information in which customers are not very interested. Syuppin can negotiate with manufacturers and strengthen purchases effectively.	Syuppin do not need to conduct excessive sales. When Syuppin purchase products, Syuppin can set fair transaction prices , taking supply and demand relationships into consideration.	Syuppin will display products in accordance with each customer's priority to raise the "conversion ratio."	Syuppin will be able to create transaction opportunities by automatically informing customers with out-of-stock items to purchase from customers having the stock items.

Source: The Company's results briefing materials

Phase 2.0, which began in October 2016, realized the anticipated effect in 1H FY3/18. The Company has 337,158 existing members (as of the end of September 2017) and is adding new members at a pace of 3,000 to 3,500 people per month. There are about 60,000 to 70,000 active users, who have engaged in a transaction with the Company over the past year, or roughly 20% of total membership.

Emphasis in the one-to-one marketing strategy goes toward further stimulation of activity among active members, rather than trying to drive activity from stagnant members. Thanks to this appropriate targeting, the Company has recruited more than 20,000 registrants to the "notification mail" service that gives notices of availability and price change information, which is a specific example of Phase 2.0 service. Additionally, registrants have placed a total of 660,000 requests on their wish lists and are increasing list items at a pace of about 40,000 requests for new products.

These numbers exceed the Company's projections and suggest a robust effect from one-to-one marketing. As noted earlier, the Company reported 1H FY3/18 results that surpassed its initial forecast. We think this outcome confirms the existence of benefits from one-to-one marketing.

The Company plans to launch Phase 3.0 of the one-to-one marketing strategy with personal recommendations. This feature recommends products to customers through the accumulation and analysis of customer page views and other information with AI-based machine learning. Provision of information along the lines of "people who purchase this product are also looking at this item" often seen on shopping sites entice customers to make spontaneous purchases by showing related products. Instead, an important characteristic of the Company's recommendation function is the customer service recommendation (similar to advice from a sales staff at a store) that prods customers with the aim of raising the conversion rate.

Medium-to long-term growth strategy and the progress made

MapCamera already started recommendations in the personalized area for members in October 2017, ahead of Phase 3.0's personal recommendations. This is a service that falls between Phases 2.0 and 3.0. While the Company had been initially planning to launch a more generalized and full-fledged service at the end of 1H FY3/18, it delayed the timing to 4Q. We do not see any reason for concern about the delay because the Phase 2.0 effect was stronger than expected, as mentioned earlier, and income is growing at a faster pace than planned. We will closely monitor the effect of personal recommendations that have been sufficiently refined.

Conceptual diagram of one-to-one marketing Phase 3.0 personal recommendations



Source: The Company's results briefing materials

EVERYBODY X PHOTOGRAPHER.com offers an opportunity to enjoy cameras after purchases and is a way of converting camera enjoyment into revenue

3. Significance of EVERYBODY X PHOTOGRAPHER.com and future possibilities

EVERYBODY X PHOTOGRAPHER.com is a dedicated website launched in April 2017 by the Company for camera enthusiasts to upload their creations. While it initially started as an opportunity for the Company's customers to enjoy photos utilizing cameras and lenses they buy from the Company, it has become an independent presence and widely accepts high-level amateur cameramen unrelated to whether they are members.

The Company promotes the EVERYBODY X PHOTOGRAPHER.com website as an opportunity for enjoyment after a camera purchase, but is looking beyond to stimulation of the camera market and increased sales. Uploads to the website totaled about 12,000 photos in the half year through the end of September 2017. The website carries many sophisticated creations by high-level amateurs.

Medium-to long-term growth strategy and the progress made

Positioning of EVERYBODY X PHOTOGRAPHER.com and future development



Source: The Company's results briefing materials

We see a variety of uses of EVERYBODY X PHOTOGRAPHER.com and very robust development potential. The Company currently offers samples of photos by specific models from among the 12,000 photos on MapCamera's pages after identifying camera models from photo data associated with photographs. Customers can select the camera model they want to purchase in light of the numerous sample photos. This service encourages demand for additional purchases and replacements.

The Company also seeks to encourage submissions by periodically holding contests on EVERYBODY X PHOTOGRAPHER.com. Furthermore, it appears to be considering creations of categories by groups due to the wide range of photographic devices actually utilized - from smartphones to SLR cameras. Other opportunities are advertising income from increased page views and stock photo business.

EVERYBODY X PHOTOGRAPHER.com possesses very large potential, in our view, and we think the Company should be capable of realizing promotion of replacement and additional purchases that it anticipates. This might be easier to understand using an example of sports cars and a race track with cameras as the former and EVERYBODY X PHOTOGRAPHER.com as the latter. Driving a sports car at the racetrack and clarifying its strengths and shortcomings promotes replacement and additional purchases as well as new parts (such as lenses).

EVERYBODY X PHOTOGRAPHER.com itself might become a large income source at some point. Once cumulative photos submitted to EVERYBODY X PHOTOGRAPHER.com exceed the 10 million level, the website could constitute a fairly significant stock-photo market. We expect interest in commercial and other uses because it attracts photos with excellent image quality from high-level amateurs. While the stock-photo market has multiple leading companies and it is likely to take some time to accumulate sufficient volume, we think the website has enough potential to develop a business model that differs from existing stock photos by putting emphasis on high quality.

Medium-to long-term growth strategy and the progress made

Launching an information portal app with expertise for enthusiasts

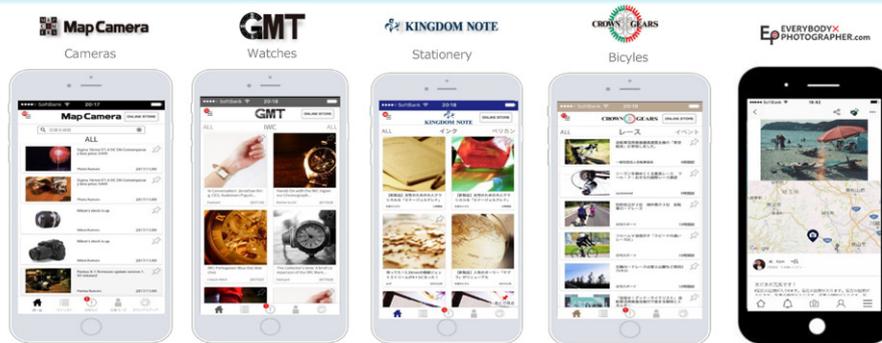
4. Upcoming measure: Release of an information portal app

The Company is preparing to launch an information portal app (smartphone app) as an upcoming measure. The app is divided by product categories. It lets subscribers read compilations of blogs and articles regarding products that are distributed by experts for each category. It thus functions as a curation website that specializes in products. For camera, the app gathers articles from Kasyapa example reports written by employees as well as information from external media. This is a notable feature and strength.

The app is enjoyed by enthusiasts for the customized information for individual customers transmitted on a push basis.

Future actions: Information portal app concept

Apps	<p>Push-based dissemination of information through an information portal application featuring a high level of expertise for experts.</p> <ul style="list-style-type: none"> ▶ Push-based dissemination of various types of information uploaded on the online shopping sites: Information portal application <ul style="list-style-type: none"> • Blogs on products posted by experts for each category. • Photos recently posted on Kasyapa, a photo preview site. • Posting of comprehensive information of outside media. • Provision of the electronic versions of existing membership cards. Points and purchase history will be confirmed. • Push-based dissemination of various types of information and enthusiast-oriented information through the one-to-one marketing approach.
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※The image is an image

Source: The Company's results briefing materials

■ Business outlook

Cautious forecast; focusing on the scale of upside, rather than whether or not there is upside

The FY3/18 forecast calls for ¥28,429mn in net sales (+13.7% YoY), ¥1,402mn in operating income (+27.8%), ¥1,387mn in ordinary income (+28.6%), and ¥950mn in net income (+28.2%). The Company has not changed these values from initial levels because it retained its FY3/18 forecast at the upward revision of the 1H outlook in October 2017.

Outlook for FY3/18

	FY3/17			FY3/18					
	1H result	2H result	Full-year result	1H result	2H		Full year		YoY
					Forecast	YoY	Forecast	YoY	
Net sales	11,161	13,835	24,996	14,435	13,994	1.2%	28,429	13.7%	
Gross profit	1,917	2,285	4,202	2,418	-	-	-	-	
SG&A expenses	1,444	1,661	3,105	1,682	-	-	-	-	
Operating income	472	624	1,096	736	665	6.6%	1,402	27.8%	
Operating margin	4.2%	4.5%	4.4%	5.1%	4.8%	-	4.9%	-	
Ordinary income	466	612	1,078	730	656	7.3%	1,387	28.6%	
Net income	319	421	741	503	446	6.1%	950	28.2%	

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

We believe the forecast is overly cautious and expect stronger results than current targets. The Company explained at the 1H briefing that it needed to increase backyard office space, which had been planned for FY3/19, ahead of time because of stronger growth in purchases and sales than anticipated though the investment cost is not that large. Robust 1H progress toward full-year targets substantially lowered 2H hurdles for attainment of FY3/18 targets. It is possible to reach targets even if 2H sales and profits are lower than 1H. Nevertheless, unless there is a major upheaval we think such declines are unlikely because of the occurrence of the main demand period, including the year-end and new-year season, in 2H in the Company's case with its business that caters to individual consumers.

As explained earlier, the Company implements one-to-one marketing and other measures aimed at sales growth, and these actions are delivering larger benefits than expected. It is also effectively controlling SG&A expenses for costs and has been lowering this ratio vs. sales each period. Earnings should follow as sales grow. We expect shift in investor views to the scale of upside, rather than whether or not there is upside.

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Business outlook

Income statements

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18		
				1H	2H (E)	Full year (E)
Net sales	19,166	22,705	24,996	14,435	13,993	28,429
YoY	22.8%	18.5%	10.1%	29.3%	1.2%	13.7%
Cameras business	13,758	16,572	18,131	10,138	-	-
Watches business	4,680	5,301	6,013	3,820	-	-
Stationery business	363	470	511	281	-	-
Bicycles business	363	360	339	194	-	-
Gross profit	3,348	3,729	4,202	2,418	-	-
Gross margin	17.5%	16.4%	16.8%	16.8%	-	-
SG&A expenses	2,461	2,897	3,105	1,681	-	-
Ratio of SG&A expenses to net sales	12.8%	12.8%	12.4%	11.7%	-	-
Operating income	886	832	1,096	736	665	1,402
YoY	26.4%	-6.1%	31.8%	55.8%	6.6%	27.8%
Operating margin	4.6%	3.7%	4.4%	5.1%	4.8%	4.9%
Ordinary income	870	821	1,078	730	656	1,387
YoY	26.2%	-5.6%	31.3%	56.7%	7.3%	28.6%
Net income	563	560	741	503	446	950
YoY	44.5%	-0.6%	32.2%	57.3%	6.1%	28.2%
After adjustment						
EPS (¥)	23.54	23.41	30.96	21.02	18.67	39.68
DPS (¥)	3.50	4.00	6.00	-	-	9.00
BPS (¥)	94.83	114.74	141.69	-	-	-

* Converted to values after the stock split

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

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Business outlook

Balance sheets

	(¥mn)				
	FY3/14	FY3/15	FY3/16	FY3/17	1H FY3/18
Current assets	3,475	4,024	4,905	5,727	6,818
Cash and deposits	441	492	506	644	659
Notes and accounts receivable	1,049	917	1,327	1,612	1,562
Inventories	1,790	2,222	2,757	3,209	4,260
Other	195	393	315	262	337
Non-current assets	787	1,085	1,001	949	923
Property, plant and equipment	101	159	137	123	115
Intangible assets	210	607	530	468	452
Investments and other assets	475	318	333	356	355
Total assets	4,263	5,110	5,907	6,676	7,742
Current liabilities	1,906	2,260	2,585	2,954	2,995
Notes and accounts payable	727	656	940	823	1,041
Short-term loans payable, etc.	650	871	1,215	1,428	1,356
Other	529	733	430	703	598
Non-current liabilities	589	579	568	322	988
Long-term loans payable, bonds payable	584	577	568	322	988
Other	5	2	-	-	-
Shareholders' equity	1,766	2,270	2,746	3,392	3,751
Capital stock	508	508	508	508	508
Capital surplus	408	408	408	408	408
Retained earnings	849	1,352	1,829	2,474	2,834
Treasury shares	1	-	-	-	-0
Subscription rights to shares	-	-	6	6	6
Total net assets	1,766	2,270	2,753	3,399	3,758
Total liabilities and net assets	4,263	5,110	5,907	6,676	7,742

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

Cash flow statements

	(¥mn)				
	FY3/14	FY3/15	FY3/16	FY3/17	1H FY3/18
Cash flows from operating activities	79	157	90	388	-355
Cash flows from investing activities	-225	-262	-333	-122	-80
Cash flows from financing activities	16	154	257	-128	450
Change to cash and deposits at start of period	-130	50	14	137	15
Balance of cash and deposits at start of period	571	441	492	506	644
Balance of cash and deposits at end of period	441	492	506	644	659

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

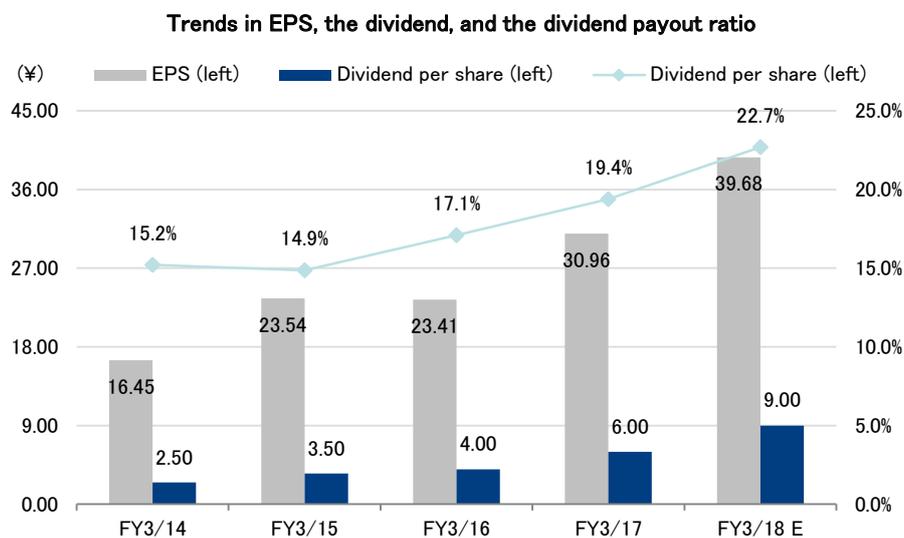
Shareholder returns

Announced a 1-to-2 stock split, planning a ¥9 dividend in FY3/18 (effective hike of ¥3)

The Company addresses shareholder return as an important management topic and adheres to a core policy of return through dividends. It updated the policy on March 14, 2017. The Company switched from a policy of sustaining stable dividends to setting a target dividend payout ratio and paying dividends accordingly to the ratio from FY3/17. It began with a target ratio range of 20-30% in this change and noted plans to ramp up shareholder returns further in the future.

The Company has disclosed that it intends to pay a ¥9 dividend at the end of FY3/18. It began the fiscal year with an announcement of an ¥18 dividend (+¥6 YoY). However, it revised the year-end dividend to ¥9, which factors in a 1-to-2 stock split that takes effect on January 1, 2018 at the 1H disclosure. This level works out to a ¥3 hike effectively since the dividend paid in FY3/17 after adjusting for a stock split works out to ¥6.

We think the FY3/18 forecast is cautious, as noted earlier, and see a possibility of revision to the dividend in accordance with the dividend policy if earnings beat the forecast and the dividend payout ratio drops to less than 20%.



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

■ Information security

Emphasis on suitable management of security software and maintaining the latest version

The Company is highly sensitive to information security as an EC company that caters to a wide spectrum of individual consumers and with a membership of about 340,000 people. It utilizes an external system to settle transactions using credit card information, the riskiest area, and hence does not possess the data and avoids leak risk. Security software is used to manage general personal information, and the Company focuses on maintaining its security systems in a fresh state through updates and preventing gaps in defenses against new attacks.



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