COMPANY RESEARCH AND ANALYSIS REPORT

Syuppin Co., Ltd.

3179

Tokyo Stock Exchange First Section

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Index

Summary

Shifting to a stage of profit expansion fully utilizing the completed sales growth framework
Beginning new initiatives in ladies business and watches cross-border EC too

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 scale of its business.

1. Posted lower profits on an increase in sales due to weaker margin on used cameras in FY3/19

The Company posted lower profits on an increase in sales in FY3/19 with ¥34,608mn in net sales (+11.9% YoY) and ¥1,444mn in operating profit (-6.0%). While it reduced full-year guidance in January 2019 due to sluggish progress through 3Q, both sales and profits beat revised targets. The main cause of the downward revision was the need to offset weak new product sales in the core camera business with larger used camera sales and resulting setback in gross margin due to sale events and other promotional measures, increased procurement of used cameras, and other actions. Although gross profit climbed YoY to ¥507mn, operating income dropped ¥92mn due to an increase of ¥600mn in SG&A expenses toward measures to strengthen sales. However, we advise against major concern about this outcome. Delay in new products is an issue on the manufacturer side and should be resolved in 2019. The Company has also already resolved its own issues in buying used cameras and sales promotion measures.

2. Highly precise business model, deploying AIMD to improve used camera gross profit in FY3/20

The Company utilizes a unique business model of "selling valuable things (new and used) through the EC channel." It refined the business model by implementing highly precise and logical measures. This is its primary strength and the driving force of longer-term growth. The Company completed the one-to-one marketing system and the platform to expand sales through FY3/19, but continues to make advances. It plans to deploy AIMD (merchandising system that uses AI) to improve gross margin from used cameras. In sales, it wants to employ CGM marketing more extensively. These measures aim to improve top-line growth (net sales growth) and profitability and realize autonomous growth.

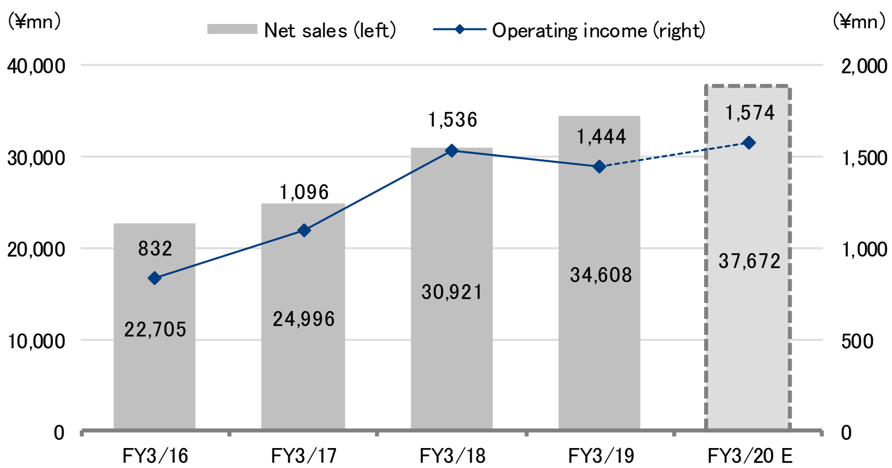
3. Ramping up ladies business and launching a cross-media division in FY3/20

The Company proposed ramp-up of ladies business as a new area in FY3/20. The domestic watches market is worth about ¥820bn (FY3/19), which is roughly four times more than the camera market. While the Company has grown the watches business mainly by selling GMT luxury mechanical watches for men up to now, it decided to launch a ladies division as a spinout from the watches division in light of increase in luxury watches for women it handles and various accumulated knowhow, including for women's watches, in the GMT business. The Company also intends to launch a cross-media division as a specialty group that implements measures to bolster CGM marketing. Overseas initiatives are steadily growing too. While they remain in a trial-and-error phase for future potential, the Company has been steadily expanding customer volume and countries where it operates in the camera business. It has also started cross-border EC for watches from FY3/20.

Key Points

- Adding processes based on various mechanisms to the business model framework is the Company's growth strategy
- Excellent executive team capable of strategically formulating and implementing plans is the primary strength
- Four focus points in FY3/20 – AIMD, enhanced CGM marketing, ladies business, and watch cross-border EC

Results trends



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

Results trends

Profit fell on higher sales on decline in used camera profitability amid speculation about new cameras

1. Overview of FY3/19 results

The Company posted an increase in sales and a decrease in profits in FY3/19, with ¥34,608mn in net sales (+11.9% YoY), ¥1,444mn in operating income (-6.0%), ¥1,433mn (-5.8%) in ordinary income, and ¥982mn (-8.8%) in net income.

The Company lowered FY3/19 guidance on January 8, 2019 when it confirmed 3Q prospects, but ultimately slightly beat revised forecasts.

FY3/19 results summary

(¥mn)

	FY3/18	FY3/19			
	Results	Initial forecast	Revised forecast	Results	YoY
Net sales	30,921	35,381	34,586	34,608	11.9%
Operating income	1,536	1,842	1,410	1,444	-6.0%
Operating margin	5.0%	5.2%	4.1%	4.2%	-
Ordinary income	1,521	1,833	1,400	1,433	-5.8%
Net income	1,077	1,251	955	982	-8.8%

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

Camera business was the main reason for downward revisions. Interchangeable lens cameras, the Company's main business field, are shifting from D-SLRs to full-size mirrorless cameras. Sony <6758> leads in the latter, and the top two D-SLR camera firms (Nikon <7731> and Canon <7751>) released full-sized mirrorless cameras in fall 2018 (announced in spring 2018). Consumers responded with buying hesitancy and wait-and-see attitudes, and this resulted in slower sales of new cameras. In light of this situation, the Company strengthened procurement of used cameras and sales promotions for these products in order to generate revenue by expanding sales of used cameras. The entire industry faced the same circumstances, lifting procurement (purchase) prices of used cameras and thereby pressuring profits. We think this was the background and direct cause of downward revisions.

In net sales, the Company ultimately achieved sales gains (YoY) in three businesses (excluding stationery business) and posted a ¥3,687mn increase. In profits, gross margin slipped by 0.3 percentage points from 16.5% in FY3/18 to 16.2% in FY3/19 and limited the rise in gross profit to ¥507mn. SG&A expenses, meanwhile, increased by ¥600mn due to higher personnel costs, sales promotion costs, and store renewal costs. Operating profit hence was down by ¥92mn YoY to ¥1,444mn.

We do not see any basis for pessimism from the FY3/19 results described above. This takes into account that the main source of downward revisions this time was just a temporary situation, not structural. Furthermore, used camera purchase prices, the direct trigger of earnings pressure, returned from highs in 2Q (Jul-Sep) and 3Q (Oct-Dec) to levels prior to the upswing in 4Q (Jan-Mar). Used camera business margin has recovered to the previous state.

Strong growth in watches business
Sales and profits rising in camera business too after moving past buying hesitancy

2. Trends by business segment

Trends by business segment

(¥mn)

		FY3/17		FY3/18		FY3/19	
		Results	YoY	Results	YoY	Results	YoY
Camera	EC	12,802	20.7%	15,545	21.4%	17,526	12.7%
	Stores	5,328	-10.6%	6,391	19.9%	6,249	-2.2%
	Total net sales	18,131	9.4%	21,937	21.0%	23,776	8.4%
	Segment operating income	1,442	23.4%	1,833	27.1%	1,886	2.8%
	Operating margin	8.0%	-	8.4%	-	7.9%	-
Watches	EC	2,288	22.4%	2,784	21.7%	3,445	23.8%
	Stores	3,725	8.6%	5,190	39.3%	6,414	23.6%
	Total net sales	6,013	13.4%	7,974	32.6%	9,860	23.7%
	Segment operating income	307	33.0%	475	54.5%	543	14.3%
	Operating margin	5.1%	-	6.0%	-	5.5%	-
Stationery	EC	348	11.5%	395	13.7%	351	-11.2%
	Stores	163	2.8%	177	8.9%	140	-21.0%
	Total net sales	511	8.6%	573	12.2%	491	-14.3%
	Segment operating income	46	-14.4%	39	-15.6%	16	-58.2%
	Operating margin	9.2%	-	6.8%	-	3.3%	-
Bicycles	EC	255	6.1%	337	32.1%	385	14.2%
	Stores	83	-29.9%	99	18.0%	95	-3.9%
	Total net sales	339	-5.8%	436	28.6%	480	10.1%
	Segment operating income	-14	-	-4	-	-5	-
	Operating margin	-4.2%	-	-0.9%	-	-1.0%	-
Company-wide	EC	15,694	20.4%	19,062	21.5%	21,709	13.9%
	Stores	9,301	-3.8%	11,858	27.5%	12,899	8.8%
	Total net sales	24,996	10.1%	30,921	23.7%	34,608	11.9%
	Operating income	1,096	31.8%	1,536	40.1%	1,444	-6.0%
	Operating margin	4.4%	-	5.0%	-	4.2%	-

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

(1) Cameras business

The cameras business reported higher sales and profits with ¥23,776mn in net sales (+8.4% YoY) and ¥1,886mn in operating profit (+2.8%). As explained earlier, new camera sales stalled because of buying hesitancy related to new full-size mirrorless camera products planned by Nikon and Canon, but the Company secured higher segment sales by expanding used camera sales. Despite weaker profitability due to increase in procurement prices in the process of expanding used camera sales, the segment still posted higher operating profit. Viewed by channel, EC sales rose 12.7% YoY, while store sales were down 2.2%. We think buying hesitancy was responsible for decline in store sales because inbound sales rose by about 20%.

(2) Watches business

Watches business reported sharply higher sales and profits with ¥9,860mn in net sales (+23.7% YoY) and ¥543mn in operating profit (+14.3%). The Company focused on boosting watches inventory volume and building the strategic line-up from last year, and these efforts paid off. Product introduction video listings, YouTube distributions, and other activities aimed at improving EC sales contributed too. In profits, despite the increase (YoY), operating margin dropped from 6.0% in FY3/18 to 5.5% mainly due to aggressive sale campaigns for the purpose of acquiring new customers, expanding market share, and strengthening EC. However, these outlays were within expectations, and we think the Company sufficiently attained its initial purpose because net sales grew by nearly 25% YoY, as explained above. The Company announced that it intends to begin the ladies business and watch cross-border EC in FY3/20. We believe various measures for the watches business through FY3/19 were also investments anticipating these new businesses.

(3) Stationery business

Stationery business recorded lower sales and profits at ¥491mn in net sales (-14.3% YoY) and ¥16mn in operating profit (-58.2%). Net sales slipped on lack of recoveries in customer volume and unit prices, despite improvements to EC site capabilities (enhanced search, more listing image, video listings, etc.), collaborative efforts with manufacturers, and additions to original products (fountain pens, ink). Profit fell because of weaker sales and impact from store renovations aimed at boosting work efficiency.

(4) Bicycles business

Bicycles booked ¥480mn in net sales (+10.1% YoY) and a ¥500mn operating loss (vs. a ¥400mn loss in the previous fiscal year). The Company increased product image volume and deployed an information portal site with a smartphone app in FY3/18 and then started video listings in FY3/19. At stores, meanwhile, it promoted an omni strategy of holding periodic consultations and using these events to arrange subsequent sales. These measures generally paid off and sales rose at a double-digit pace. In profits, the operating loss expanded over the previous year because of higher costs associated with the sales increase.

Healthy progress in main KPIs – web member volume, active rate, used camera purchase value

3. KPI trends

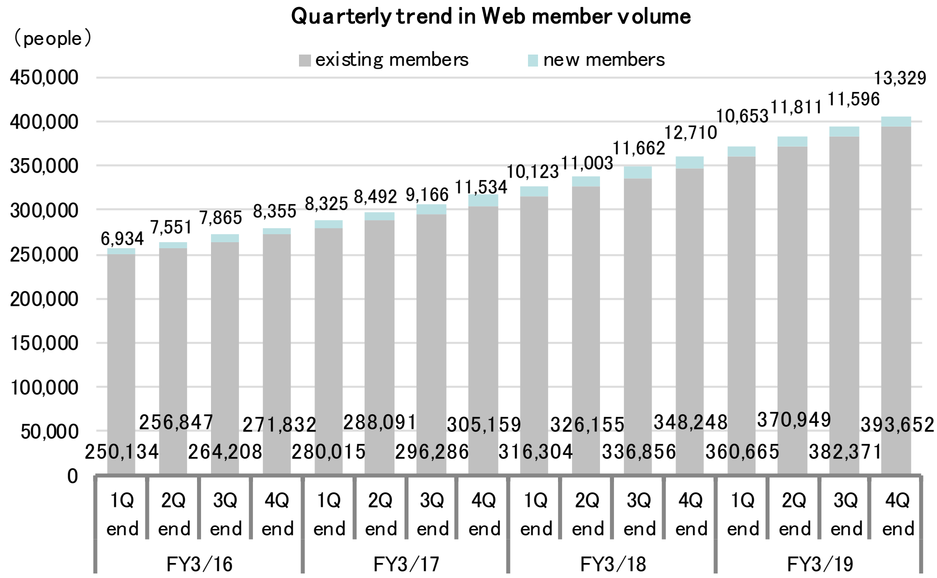
The Company promoted one-to-one market as a way of increasing sales in FY3/17 and FY3/18. This involves “personalization” of marketing activities that are usually conducted uniformly for the general public by providing necessary information tailored to the needs of individuals. It thus requires a mechanism for ascertaining customer needs. The Company spent two years to incrementally build a system. It completed the “personal recommendation” mechanism in FY3/18 and thereby finished the overall one-to-one marketing process (refer to our report issued on January 17, 2019 for details on the Company’s sales expansion platform, including one-to-one marketing).

The platform to expand sales advanced significantly with completion of one-to-one marketing. Key performance indicators (KPI) to monitor the Company’s situation have changed too. We previously focused on the used product ratio and sales channel EC or store) trends. With the more advanced income model, however, we think these values do not have any significance beyond being “results.” We emphasize the following indicators as KPI for effective analysis of current conditions or a source of foresight.

(1) Web member volume

The Company manages customers who make transactions as "web members." We see two important points in the web member volume trend. The first is the trend in new members (in other words, new customer volume). We think this reflects results from sales efforts, such as sale events and other sales promotion measures and development of the EC system format. The other is total (cumulative) member volume. This constitutes an asset accumulated by the Company. Members are grouped into active members who continuously and repeatedly engage in transactions and inactive members who have not conducted a transaction for over a certain amount of time. Total member volume has considerable significance in determining the percentage of total members who are active as a theory.

In FY3/19, the Company steadily added over 10,000 people as new members per quarter and set a quarterly high of over 13,000 people in 4Q. Period-end total member volume hence moved past 400,000 people at 406,981. Recognition and awareness of the Company's brand in various products have risen, thanks to enhanced information on the EC site and measures for CGM marketing explained below, and the increase pace in new members is accelerating.



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

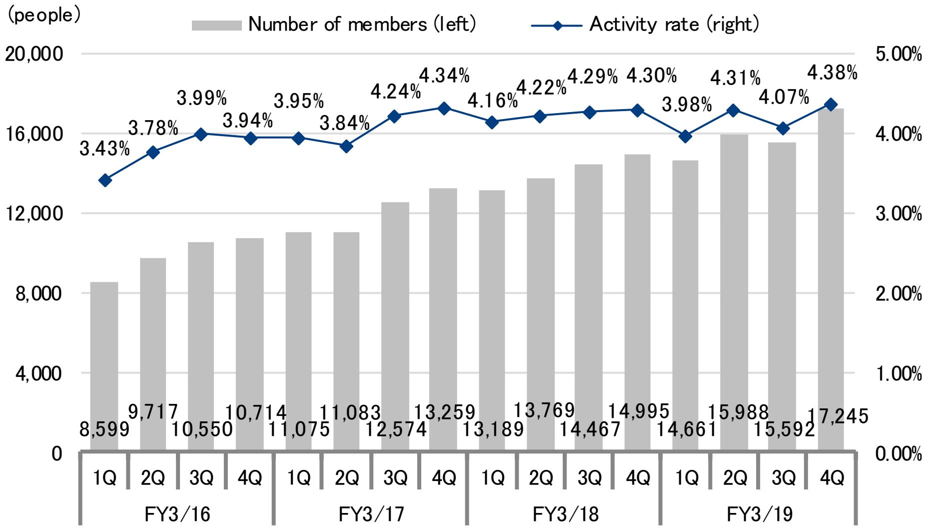
(2) Member numbers and activity rate

Purchase member volume is the number of members who make a purchase on the Company's sites per quarter excluding new members. In other words, this is the number of existing members who made a purchase. The active rate is the percentage of purchase member volume per quarter to member volume at the start of each quarter.

The Company has strong expectations for stimulation of existing members as total member volume expands. This is because of high efficiency. Even though new members are currently joining at a pace in the range of 3,000 people per month, the increase pace is just under 10% a year with total member volume at over 400,000 people (the sales increase rate therefore is also just under 10%). Meanwhile, if active members from the existing membership expand purchases by one time, we estimate a sales boost of 30%. This is why it is meaningful to track purchase member volume and the active rate.

Looking at trends up to now, purchase member volume has been steadily moving upward to the right. The active rate is not as clear as the purchase member volume trend because of increases in total member volume (denominator) as well. Nevertheless, it is staying in the 4% range and we think the trend line is headed upward to the right at a moderate pace.

Trends in members and active rate

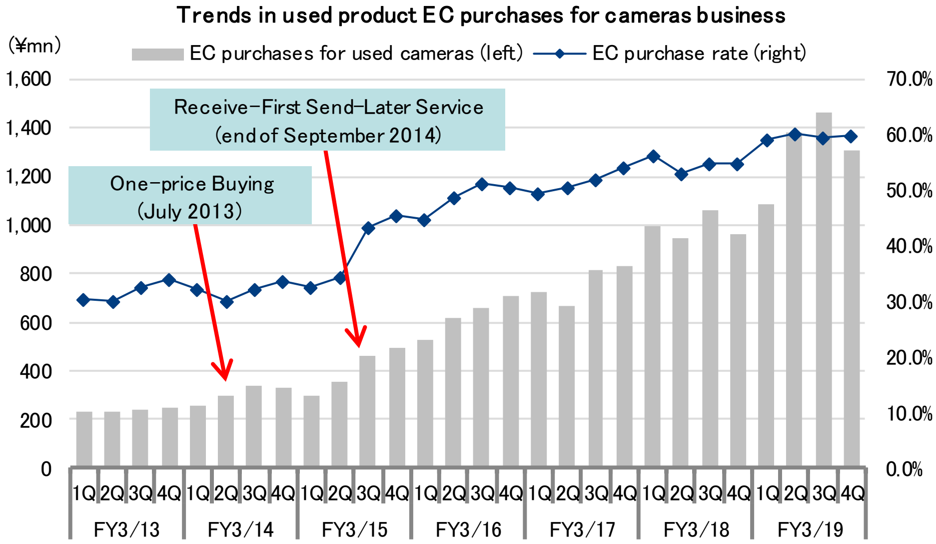


Source: Prepared by FISCO from the Company's results briefing materials

(3) Status of used camera purchases

We believe used camera purchase value is extremely important in assessing trends in the camera business, which is the Company's core business. A key point in the business model is the role of used products as a catalyst for new product sales and expansion of new and used product sales. This pattern applies well to cameras as a pure industrial product.

In FY3/19, the Company focused on buying used cameras to compensate for new camera sluggishness. Specifically, it took steps to raise purchase prices versus previous pricing. This lifted purchase value and purchase volume to desired levels, but it also resulted in weaker profit margin via higher procurement costs. Purchase prices stayed above the normal level in 2-3Q. While purchase value climbed too, this business returned to appropriate levels in 4Q.



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

Medium- to long-term strategy

Growth strategy of adding processes based on various mechanisms to the business model framework

1. Overview of overall medium- to long-term strategies

The Company's business model has two main distinguishing features. One is an EC-based system with one store per product, and the other is handling both new and used products.

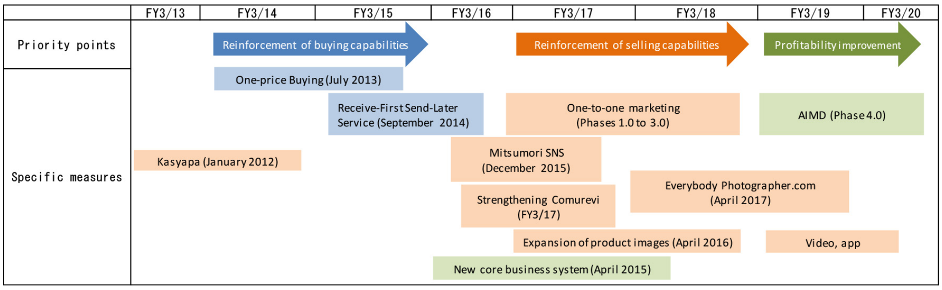
While observers often view the Company as a reuse business because of the focus on handling used products, we think this could lead to misreading of the Company's capabilities and value. Our understanding is that the used products business serves as a catalyst to accelerate new product sales. At the same time, however, used product business is an important income source and growth engine for the Company, along with new product business. Characteristics and income models differ for new product and used product businesses. We find the innovativeness and strength of the Company's business model in its pursuit of organically linking two businesses with completely different profiles (this means the same thing as the catalyst relationship described above) and maximizing income growth as a whole.

This type of business model cannot be built quickly. The Company has carried out various measures since it was founded to reach where it is today. "Measures" in this context refers to building mechanisms for income growth, rather than conducting campaigns of one-time sales promotions. The Company's growth strategy adds various mechanism to expand income to the business model framework of selling 1) valuable things (new and used) via 2) an EC channel.

Some examples are "one-price buying" and "receipt-first exchanges" to strengthen used product purchases (procurement) and "estimate SNS" and "community review" launches to bolster sales capabilities. The Company also adopted precision images, significantly increased the number of images, and listed videos to enhance product images, a vital point in EC business.

In efforts to improve sales capabilities, the Company completed the "personal recommendations" mechanism for one-to-one marketing, the final component of the three phases for this program.

Trends in initiatives for growth at the Company



Source: Prepared by FISCO

The Company decided to mainly pursue the following four points in FY3/20 in light of progress through FY3/19. These are 1) initiatives to expand sales and improve profitability by deploying AIMD, 2) initiatives to stimulate the platform for sales expansion, 3) full-fledged launch of a ladies business (new business), and 4) overseas initiatives.

Below we describe these activities in detail.

Deployment of AI in the purchase and selling price decision process for used cameras aimed at reducing opportunity losses and improving profitability

2. AIMD deployment

AIMD is an automated system for setting purchase and selling prices for used cameras utilizing AI. While the Company had previously referred to this feature as "one-to-one marketing Phase 4.0," it switched to the term AIMD that reflects the actual content. The Company currently decides purchase and selling prices manually. It handles more than 20,000 items, but is only capable of making timely price decisions for some of the items (estimated at about 400-500 items) and this leads to more cases with opportunity losses. AIMD deployment aims to increase the number of items priced in a timely manner by automating the process with AI and thereby reduce opportunity losses.

The Company hopes to improve gross margin as use of AIMD facilitates selling and buying at suitable prices. Other anticipated benefits of conducting transactions at suitable prices are attracting consumers and selection of the most effective sale items, securing sales, and achieving suitable profit margin in sale campaigns and sales promotions.

The Company is beginning AIMD development in FY3/20. We only expect timely price decisions on about 2,000 items even after AIMD deployment because of the need to reach a certain level of transaction cases in order to raise the precision of price decisions. While this is just one-tenth of the total number of items (about 20,000), it is roughly five times more than the current level and should substantially lower opportunity losses, considering actual transaction volume.

Launch of a cross-media division to pursue synergies from organic linkage of CGM-related contents

3. Full-fledged utilization of CGM marketing

The Company refers to the framework for expanding sales as a “platform.” This is a general term for various mechanisms used to attract customers and retain them. In developing mechanisms, the Company encourages consumer participation and extensively applies information provided by consumers in marketing efforts. This marketing technique is known as consumer generated media (CGM) and is very widely employed with smartphone proliferation and expansion of SNS usage.

The Company has released various CGM marketing services and mechanisms for cameras, its main products, and has completed a platform to expand sales that uses these tools. For the pre-purchase stage, it offers a blog that is useful in selecting models (staff blog Map Times), reviews (Kasyapa), and word-of-mouth information. For purchase timing, it supplies estimate SNS, trade-in exchange, and prior-receipt exchange. For the post-purchase stage, it has launched Everybody Photograher.com (abbreviated as “Eve-Photo”) as a venue for uploading photographs taken with the camera. The Eve-Photo service aims to stimulate buying interest in new cameras and interchangeable lens and thereby encourage the next transaction by supporting the enjoyment of uploading their own photos and gaining motivation and new information from others. The platform’s main points are 1) changing customer consumption behavior from a linear trend of “pre-purchase to purchase” to a cycle of “pre-purpose, purchase, post-purchase, pre-purpose, etc.” and 2) generating and retaining consumption cycles in the “Syuppin commercial zone.”

Image of expanding income through completion of the platform

Source: From the Company’s results briefing materials

The FY3/20 initiative focuses on making this platform even more vibrant. The Company believes that the individual mechanisms are currently functioning effectively and achieving initial goals. One example is uploads of over 50,000 photos from ordinary consumers to Eve-Photo and links to respective cameras on the EC site. Users considering a purchase can reach purchase decisions after looking at the actual photos uploaded on Eve-Photo. This is what the Company targeted with Eve-Photo. However, not all of the above-mentioned multiple contents have reached the same level of effective collaboration as Eve-Photo. The Company hopes to harness all of its various contents to efficiently increase customer volume and expand sales. This is the initiative to ramp-up utilization of CGM marketing.

The Company is creating the cross media division as a specialty team. It has started a project team and plans to officially launch a division once the work content and organizational direction have been determined. While it has not clarified the extent of potential effect and timing of realizing it, the Company has delivered anticipated results with various proposed mechanisms and functions on their own in many cases. We focus on the type of chemical reaction that occurs from organic collaboration of these capabilities and whether they help expand profits.

Launching a ladies business as a spinout of business with women from the watches division
Start with watches, also aims to move into precious stones and jewelry

4. Full-fledged ramp-up of a ladies business

The Company intends to begin a full-fledged ladies business that mainly handles watches for women as a spinout of the watches business. It decided to promote this business independent of the GMT brand used by the watches business and with a separate name in light of expansion in both female customer volume and female staff.

While the business mainly handles watches, the Company also plans to broaden coverage to jewelry and precious stones in the ladies business because of the role of luxury watches for women as jewelry too.

The Company has not set an income target for the business in FY3/20, the second fiscal year, it presents a goal of about ¥2bn in FY3/21 (refer to the section on the medium-term management plan for details). The goal seems very aggressive. However, it could be argued that a sharp start is possible in light of the Company's existing track record with women's watches up to now. We intend to monitor developments in this business.

Favorable reaction to camera cross-border EC
Beginning cross-border EC for watches too from FY3/20
Making steady progress in preparations for future full-fledged rollout

5. Global strategy

The global strategy division handles overseas strategy. The Company started cross-broader EC business for cameras in August 2017 as a first step in overseas activity. It opened a store on eBay, an EC mall in North America, and launched business in four countries (United States, Canada, Hong Kong, and Australia). It subsequently added more countries and reached 20 countries at the end of March 2019, including countries from Western Europe, the Near and Middle East, and Southeast Asia. Transaction volume steadily grew with net sales at about ¥480mn in FY3/19.

The Company is introducing cross-border EC business for watches in FY3/20. It plans to open a store on an overseas EC mall, similar to cameras. For watches, it is scheduled to open a store on Chrono 24, one of the world's largest markets for luxury wristwatches worldwide. It will target the United States and Hong Kong initially and then broaden area scope.

The Company's current overseas activities are largely intended as "market research for future full-fledged rollout." It has multiple reasons for not stepping on the accelerator in overseas efforts yet. One is low profitability due to heavy burden from transportation costs and casualty insurance. Another is the need to procure used products locally and thus have local procurement and sales operations in order to fully operate overseas business. While quality used products are likely to continue distribution as quality products in Japan, once they move to overseas markets, these products typically do not return to Japan. Preserving watches in good shape is even more important. Many purposes of cross-border EC at this point are market research as noted above and branding (pursuit of brand inroads) to facilitate smooth business progress once management decides to proceed with a full-fledged launch.

The Company is doing in overseas activities, including receipt of nearly perfect results on eBay evaluations. As mentioned above, it has already expanded the scope to 20 countries. We expect the Company to add more people and strengthen the global strategy division and seek the right timing and markets for full-fledged rollout of overseas business.

The Company aims to reach ¥47,542mn in net sales, ¥2,322mn in operating profit, and ¥2,312mn in ordinary profit by FY3/22.

6. Medium-term management plan

The Company does not officially formulate a three-year medium-term management plan, though it annually discloses medium-term results goals for the next three years.

The results plan disclosed in May 2019 calls for ¥47,542mn in net sales, ¥2,322mn in operating profit, and ¥2,312mn in ordinary profit by FY3/22. Since the Company booked lower profit on increased sales in FY3/19, we think it generally delayed income levels for each of the subject fiscal years by a period of one year compared to the medium-term results plan from a year earlier.

Medium-term management plan covering FY3/20-22

(¥mn)

		2019 rolling medium-term plan (FY3/20-22)						
	FY3/19 Results	FY3/20 Plan	FY3/20 YoY	FY3/21 Plan	FY3/21 YoY	FY3/22 Plan	FY3/22 YoY	CAGR*
Net sales	34,608	37,673	8.9%	42,359	12.4%	47,542	12.2%	11.2%
Camera business	23,776	25,391	6.8%	28,382	11.7%	32,067	12.9%	10.5%
Watches business	9,860	11,206	13.7%	12,808	14.2%	14,159	10.5%	12.8%
Stationery business	491	530	7.8%	575	8.5%	645	12.2%	9.5%
Bicycles business	480	545	13.3%	594	9.0%	671	13.0%	11.8%
Gross profit	5,612	6,170	9.9%	7,022	13.8%	8,095	15.3%	13.0%
Gross margin	16.2%	16.4%	-	16.6%	-	17.0%	-	-
SG&A expenses	4,168	4,596	10.2%	5,162	12.3%	5,774	11.9%	11.5%
SG&A ratio	12.0%	12.2%	-	12.2%	-	12.1%	-	-
Operational income	1,444	1,574	9.0%	1,860	18.2%	2,322	24.8%	17.2%
Operating margin	4.2%	4.2%	-	4.4%	-	4.9%	-	-
Ordinary income	1,433	1,564	9.2%	1,851	18.3%	2,312	24.9%	17.3%
Net income	982	1,023	4.1%	1,211	18.3%	1,512	24.9%	15.5%
Global strategy division	-	601	-	780	29.7%	1,014	30.0%	-
Ladies business	-	-	-	1,953	-	2,343	20.0%	-

*Note: Average annual growth rate shows the average growth rates for the three years through FY3/22 with the starting point in FY3/19
Source: Prepared by FISCO form the Company's materials

In camera business, the Company targets 10.5% sales CAGR over the three years through FY3/22 with FY3/19 as the standard level. Its cautious view of FY3/20 as a transition phase to full-size mirrorless cameras at the two major firms curtails three-year CAGR. It should be noted that the Company factors in robust sales growth of nearly 30% a year in overseas cross-border EC business.

In watch business, it forecast 12.8% sales CAGR, but this seems conservative in light of the recent growth rate. Planned rapid growth in ladies business in FY3/21 conversely implies sharp slowdown in men's watch business. We expect slightly higher overall growth in combined men's and ladies business because of upbeat growth in watches business over the past few years and the start of overseas initiatives.

In stationery and bicycle businesses, it forecasts sales CAGRs of 9.5% and 11.8% respectively with new customer acquisitions and revitalization of existing customer business. We think this plan is attainable because of steady improvements in recognition and awareness.

Outlook

Projects restoration of sales and profit growth in FY3/20 on removal of one-time factors
Focus on AIMD progress in measures

● Outlook for FY3/20

For FY3/20, the Company forecasts an increase in both sales and profits, with net sales at ¥37,672mn (+8.9% YoY), operating income at ¥1,574mn (+9.0%), ordinary income at ¥1,564mn (+9.2%), and net income at ¥1,023mn (+4.1%).

Outlook for FY3/20

(¥mn)

	FY3/19			FY3/20					
	1H result	2H result	Full-year result	1H forecast	YoY	2H forecast	YoY	Full-year forecast	YoY
Net sales	16,362	18,246	34,608	18,277	11.7%	19,395	6.3%	37,672	8.9%
Operating income	682	761	1,444	741	8.6%	833	9.3%	1,574	9.0%
Operating margin	4.2%	4.2%	4.2%	4.1%	-	4.3%	-	4.2%	-
Ordinary income	679	754	1,433	736	8.4%	828	9.8%	1,564	9.2%
Net income	462	520	982	481	4.1%	542	4.2%	1,023	4.1%

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

We just briefly review FY3/20 points for the breakdown by business segments because of overlap with content covered in the medium-term management plan section.

Sales trends for new products released by Nikon and Canon are a key theme in the camera business. We expect improvements versus FY3/19 since these two companies have presented ILC roadmaps, but advise against excess anticipation because FY3/20 will also be a transition phase to mirrorless products. If the new product market stalls again, we envisage emphasis on used cameras, similar to the previous year. We will look for a profitability boost from using AIMD.

AIMD is often seen as a way of improving work efficiency in procurement of used cameras without a direct connection to top-line growth, but this is not correct. Given the importance of used cameras in the Company's business model, measures that reinforce procurement are obviously vital. We think AIMD contributes to top-line growth too because the Company cannot book sales unless it procures products.

Enhancement of CGM marketing is a key perspective in the camera business too, but this is difficult to assess from outside. We intend to monitor this aspect through quarterly income trends in the camera business.

We see two main themes in the watch business – ladies business and cross-border EC. The Company has not disclosed income targets for ladies business in FY3/20, but we believe it is aiming for a certain amount of first-year sales in light of the roughly ¥2bn goal in FY3/21, the second year. In cross-border EC, our focus is on whether camera-related experience pays off or watches and cameras businesses develop differently. The Company positions this as a test. While it does not seem to be counting on income contributions, we think a healthy start in watches business might affect the decision on full-fledged overseas initiatives (particularly in light of ramp-up in camera business).

In stationery and bicycle businesses, the Company is steadily taking steps to expand income, including photo additions and video distribution. We do not expect rapid income growth because of the narrow market segments where the Company is primarily active ("high-end writing instruments" rather than basic stationery and "road bicycles" rather than ordinary bikes) and instead will focus on steady sales growth and realization of profit contributions.

Income statements

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20 E
Net sales	22,705	24,996	30,921	34,608	37,672
YoY	18.5%	10.1%	23.7%	11.9%	8.9%
Cameras business	16,572	18,131	21,937	23,776	25,391
Watches business	5,301	6,013	7,974	9,860	11,206
Stationery business	470	511	573	491	530
Bicycles business	360	339	436	480	545
Gross profit	3,729	4,202	5,105	5,612	6,170
Gross margin	16.4%	16.8%	16.5%	16.2%	16.4%
SG&A expenses	2,897	3,105	3,568	4,168	4596
SG&A ratio	12.8%	12.4%	11.5%	12.0%	12.2%
Operating income	832	1,096	1,536	1,444	1,574
YoY	-6.1%	31.8%	40.1%	-6.0%	9.0%
Operating margin	3.7%	4.4%	5.0%	4.2%	4.2%
Ordinary income	821	1,078	1,521	1,433	1,564
YoY	-5.6%	31.3%	41.1%	-5.8%	9.2%
Net income	560	741	1,077	982	1,023
YoY	-0.6%	32.3%	45.4%	-8.8%	4.1%
After adjustment					
EPS (¥)	23.41	30.96	45.00	41.11	43.34
DPS (¥)	4.00	6.00	10.00	14.00	14.00
BPS (¥)	114.74	141.69	180.68	206.90	-

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

Balance sheets

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19
Current assets	4,024	4,905	5,727	7,692	8,656
Cash and deposits	492	506	644	1,268	1,403
Notes and accounts receivable	917	1,327	1,612	1,851	1,916
Inventories	2,222	2,757	3,209	4,194	4,781
Non-current assets	1,085	1,001	949	1,088	1,214
Property, plant and equipment	159	137	123	136	156
Intangible assets	607	530	468	443	377
Investments and other assets	318	333	356	508	680
Total assets	5,110	5,907	6,676	8,780	9,871
Current liabilities	2,260	2,585	2,954	3,353	3,943
Notes and accounts payable	656	940	823	1,045	1,206
Short-term loans payable, etc.	871	1,215	1,428	1,474	1,831
Non-current liabilities	579	568	322	1,095	1,018
Long-term loans payable, bonds payable	577	568	322	1,095	1,018
Shareholders' equity	2,270	2,746	3,392	4,325	4,903
Capital stock	508	508	508	508	513
Capital surplus	408	408	408	408	413
Retained earnings	1,352	1,829	2,474	3,408	4,151
Treasury shares	-	-	-	-0	-175
Subscription rights to shares	-	6	6	5	5
Total net assets	2,270	2,753	3,399	4,331	4,909
Total liabilities and net assets	5,110	5,907	6,676	8,780	9,871

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

Cash flow statements

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19
Cash flows from operating activities	157	90	388	134	689
Cash flows from investing activities	-262	-333	-122	-184	-419
Cash flows from financing activities	154	257	-128	675	-135
Balance of cash and deposits at start of period	441	492	506	644	1,268
Balance of cash and deposits at end of period	492	506	644	1,268	1,403

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

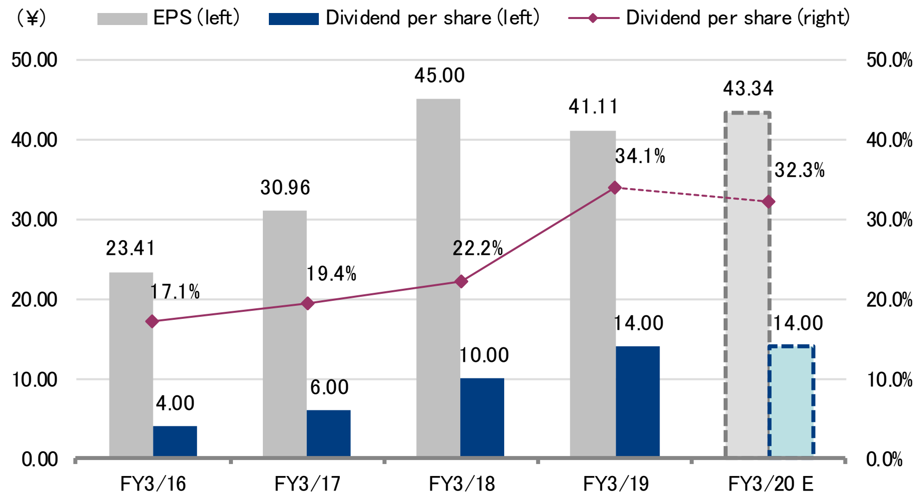
Shareholder returns

The Company announced a dividend forecast of ¥14 for FY3/20 on par with the previous fiscal year

The Company sees shareholder return as an important management issue and has a basic policy of return with dividends. It previously adhered to a stable and continuous dividend policy, but switched to setting a dividend payout target and paying a dividend in line with the target from FY3/17. It currently targets "25-35% dividend payout."

In FY3/19, the Company decided to pay a ¥14 dividend (+¥4 YoY), on track with the period-start outlook. While it lowered the profit outlook during the period, the dividend stayed at the initial level. This result put the dividend payout ratio at 34.1%. The Company has disclosed a ¥14 dividend target (unchanged YoY) for FY3/20, which comes to a 32.3% payout ratio based on ¥43.44 in estimated net profit per share.

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



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

FISCO

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