COMPANY RESEARCH AND ANALYSIS REPORT

Estore Corporation

4304

TSE JASDAQ

20-Apr.-2020

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Index

Summary — 01

1. Business development in three domains: sales systems, sales promotion services, and sales promotion systems 01
2. Working to strengthen analogue strategy with a focus on customer contact points and marketing 01
3. As a solution to issues with strengthening sales promotion services and building large-scale orders, M&A will bring significant growth in the next fiscal year 01
4. Increased likelihood that FY3/20 operating profit will exceed full-year forecast 02

Business overview — 03

1. Shifting business focus every seven years 03
2. Business structure 05

Medium-term growth strategy — 06

1. Recognition of the business environment and target direction 06
2. The sales systems business growth strategy 07
3. The sales promotion systems business growth strategy 08
4. The sales promotion services business growth strategy 09
5. M&A aimed at bringing in large companies 11
6. Scenario for medium-term growth 12

Results Trends — 13

1. FY3/20 3Q results 13
2. FY3/20 results outlook 14

Shareholder returns — 16

1. Dividend policy 16
2. Shareholder benefits 17

Summary

A comprehensive provider of eCommerce (EC) support services A medium-term strategy of larger-scale orders and strengthened sales promotion services Expectations for significant growth in the next fiscal year through M&A

1. Business development in three domains: sales systems, sales promotion services, and sales promotion systems

Estore Corporation <4304> (the "Company") is a comprehensive provider of e-commerce (EC) support services. Since its founding, it has consistently grown its business in the corporate EC support domain. After starting from the Systems Business, providing ASP services as a framework for EC, the Company has grown by shifting its focus to in response to developments and changes in technology and the EC market, expanding into consulting and outsourced operations management to support revenue growth at client companies. Today, it offers three businesses to support EC, including sales systems, sales promotion services and sales promotion systems.

2. Working to strengthen analogue strategy with a focus on customer contact points and marketing

The Company has established a structure with three businesses as a comprehensive EC support company; however, its business strategy calls for different levels of focus on each business. Looking ahead, the Company is aiming to pursue an analogue strategy, and to strengthen its marketing. Currently, there is an oversupply of information, and the deflationary economy looks set to continue as the population declines going forward. In such an environment, customer contact points are a vital key to effectively selling products, which is to say, the Company recognizes the importance of marketing. Under its business classification, this area comes under the sales promotion services business centered on the human work-force service including consultation and operations management agency businesses. A distinctive characteristic of the Company's operating strategy is that it seeks to attract not only its existing customers (companies that already have Shopserve contracts), but also large-scale orders from other large customers.

3. As a solution to issues with strengthening sales promotion services and building large-scale orders, M&A will bring significant growth in the next fiscal year

In January 2020, the Company made Commerce21 Corporation ("Commerce21") a consolidated subsidiary, followed in March 2020 by WebCrew Agency Inc. ("WebCrew Agency"), which was also made a consolidated subsidiary. Commerce21 provides EC systems for large companies, while WebCrew Agency has a wide-ranging background working primarily with major corporations to develop marketing strategies and branding. These M&As have the potential to solve two issues for the Company: strengthening sales promotion services, and building large-scale orders. Both Commerce21 and WebCrew Agency also present very clear synergies, with expected benefits that include expanded orders for sales promotion services. The Company is thus expected to experience significant growth in FY3/21, and could see annual sales leap to in excess of ¥10,000mn.

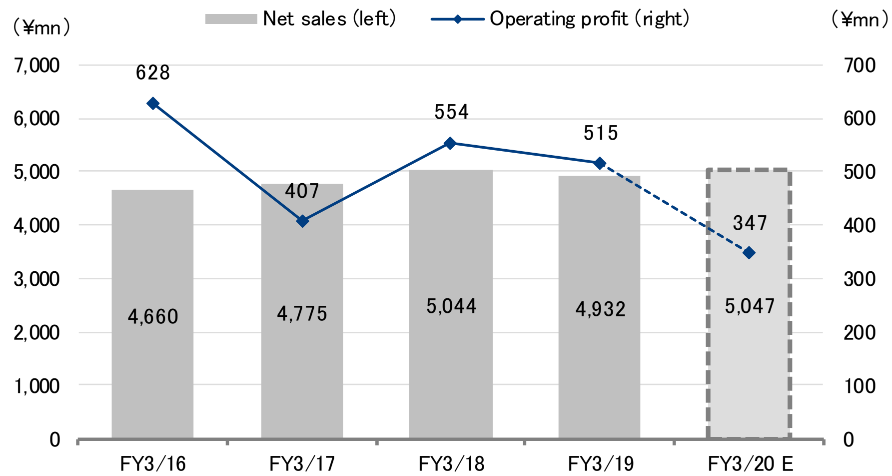
4. Increased likelihood that FY3/20 operating profit will exceed full-year forecast

The Company's results for FY3/20 3Q saw net sales decline 2.3% YoY to ¥3,622mn, with operating profit down 3.8% to ¥378mn. In terms of progress toward the full-year forecast, net sales were at 71.8% (down 3.4 percentage points YoY), while operating profit reached 109.0%, already exceeding budget. This figure also already incorporates the impact of the consumption tax increase and of projects sponsored by the Ministry of Economy, Trade and Industry to provide rebates to consumers for cashless payments, both of which were items of concern. For FY3/20, the Company anticipates net sales of ¥5,047mn, up 2.3% YoY, and operating profit of ¥347mn, a YoY decline of 32.7%, but even if upfront costs should arise for securing consulting personnel for its sales promotion services business, it is increasingly likely that full-year operating profit will end up exceeding this forecast.

Key Points

- Aiming for growth with the themes of "analogue strategy" and "marketing"
- Operating profit for FY3/20 3Q has already exceeded the full-year forecast
- Significant growth expected in FY3/21 as M&A strengthen large-scale orders and sales promotion services

Results trends



Note: Transitioned to consolidated results from FY3/19
Source: Prepared by FISCO from the Company's financial results

Business overview

From servers to software, from stock to flow, from systems to services

1. Shifting business focus every seven years

Since its foundation in 1999, the Company has consistently developed EC support-related businesses. However, in this process, it has grown while shifting its business focus roughly every seven years to reflect the changes in the business environment and the growth of the Company itself. As each business hit its stride and reached the stage of establishing an earnings base, the Company would use these earnings to expand into creating a new business to contribute to earnings in a repeated cycle. It can be said that the current year of 2020 is in the period to shift from the third to the fourth cycle.

Estore's history and the shifts in its business development

Date	Event	Business segment
February 1999	Founded Estore	
July 1999	Started providing the shopping cart service storetool	Systems Business
September 1999	Started providing the web hosting service Siteserve	Systems Business
March 2000	Sales partnership with Osaka Yusen Broadcasting Co., Ltd. (currently, USEN Corporation)	Systems Business / OEM subscriptions
June 2000	Sales partnership with Sony Communication Network Corporation (currently, So-net Entertainment Corporation)	Systems Business / OEM subscriptions
July 2004	Business and capital partnership with TELEWAVE, INC. (currently, iFLAG Co., Ltd.)	Systems Business / OEM subscriptions
November 2005	Established a business alliance with Yahoo Japan Corp. <4689>	Systems Business / OEM subscriptions
November 2005	Established a business alliance with Kakaku.com, Inc. <2371>	Systems Business / OEM subscriptions
January 2006	Started providing the Shopserve comprehensive eCommerce support service under its proprietary domain	Systems Business
November 2006	Launched the product search site Shoppingfeed	Systems Business
June 2011	Converted Precision Marketing, Inc. into a consolidated subsidiary	Marketing Business
July 2012	Established the Sapporo Marketing Factory	Marketing Business
October 2012	Established the shopping site PARK, featuring shopping recommendations issued by "curators" in 34 genres	Marketing Business
October 2013	Started providing the Single Hand simple customer acquisition service	Marketing Business
January 2016	Removed Precision Marketing from the scope of consolidation	Marketing Business
April 2016	Strengthened the Promotions Business sales force	EC Business
August 2016	Shopserve is compliant with Amazon Pay	EC Business
March 2017	Shopserve includes bitcoin payments as standard (provided to 12,500 stores)	EC Business
July 2017	Started providing Estore Compare sales promotion system	Marketing Systems
September 2017	Started providing Estore Query sales promotion system	Sales promotion systems
August 2018	Established CrossTrust, Inc. and made it a consolidated subsidiary	EC Business
January 2020	Made Commerce21 Corporation a consolidated subsidiary	Sales systems
March 2020	Made WebCrew Agency Inc. a consolidated subsidiary	Sales promotion services

Note: Segment names are the segment names on the corresponding dates. Currently, the former Systems Business and EC Business have been changed to sales systems business, and the Marketing Business has been changed to the marketing services business.
Source: Prepared by FISCO from Company materials

(1) 1999–around 2006

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

(2) 2006–2012

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

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

(3) 2012–2018

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

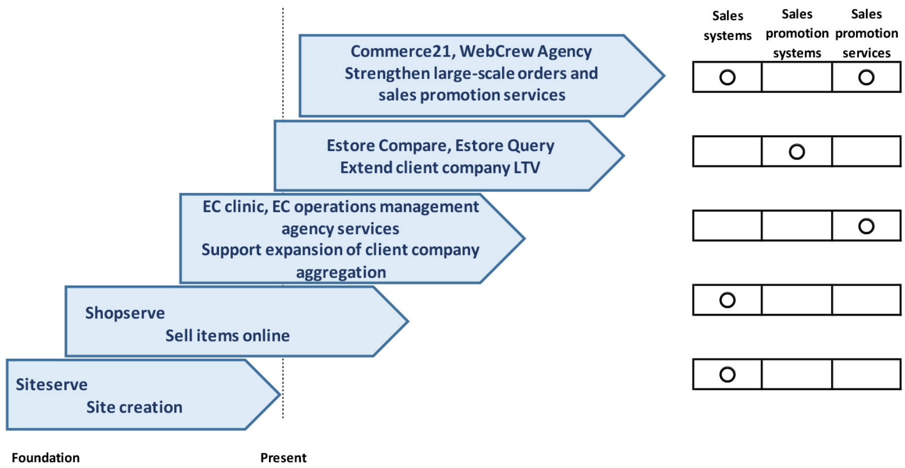
The Marketing Business initially consisted of two businesses, the sales promotions business, which provided consulting and operations management agency services, and the media business, which managed the park EC shopping mall. The Company has positioned the sales promotions business as the business domain it should focus on the most. It distinguishes it from the marketing systems business described below and it currently calls it the sales promotion services business (or marketing services business). Also, it has positioned the media business as a non-focus business, because it has powerful rivals, like Amazon, and it has fulfilled a certain purpose. As a result, the Company ended the media business on September 30, 2018.

(4) From 2018 to the present day

The sales promotion services business includes a human work-force service that is costly and difficult to operate in general. Therefore, the Company has sought to provide sales promotion services through a system instead as the next growth driver, and has been working to develop this system. As a result, in autumn of 2017, the Company started providing two software packages: Estore Compare and Estore Query (in some cases, they are collectively referred to as the Back Store Group). This sales promotion systems business is called the marketing system business (or the sales promotion systems business), and in 2018 the Company started full-scale efforts to expand sales of the above two software packages.

After passing through the above-described transition, the Company had only one business segment: the EC business. But the Company divided it into three segments according to the target of the service provision ("sales" or "sales promotions") and the provider and the method of provision ("machinery and software" or "work-force services"). These three categories include sales promotion services, sales promotion systems, and sales systems businesses. Also, there is an electronic certification (e-certification) business.

Business shifts and objectives



Source: Prepared by FISCO from Company materials and interviews

Businesses categorized on two axes—sales and sales promotion, and systems and services—function three-dimensionally and in multiple layers according to their relationship with one another

2. Business structure

As noted above, the Company started the sales promotion systems business in 2017, completing a three-business structure comprising the sales system (EC system) business, the marketing services (sales promotion service) business, and the sale promotion system (marketing system) business. These three businesses are presented in three quadrants created from two axes: the sales and sales promotion (marketing) axis and the systems (machinery and software) and work-force services axis.

Business domains so far

	Systems	Services
Sales	Shopping cart business「Shopserve」	
Sales promotion	CRM business（Back Store）	Marketing services EC consultingEC operations management agency services (production, advertising, etc.)

Source: Prepared by FISCO from Company materials and interviews

The Company's growth strategy is, of course, to grow earnings in the three quadrants of the business domains. But the key point is that each of the businesses does not exist separately (independently) from each other on the same plane, but rather they relate to each other in various ways, such as having causal, substitution, and complementary relations, and they have a three-dimensional and multilayered existence according to their relationship with one another. Therefore, in order for the Company to grow earnings, of course the various businesses must work together to pursue synergies, but it is also necessary for the Company to deal with its customers by combining businesses and modifying their relations according to changes in the market environment and the changing times.

Medium-term growth strategy

Respond to a surfeit of information and deflation with a strategy rooted in relationships with existing customers at just the right distance

1. Recognition of the business environment and target direction

After starting with the sales systems business (rental serves, comprehensive EC support service Shopserve, etc.), recently the Company has released its sales promotion systems (E Store Compare and E Store Query) as it makes used of IT and digital technology in its businesses. At the same time, however, the company has positioned its "analogue strategy" at the heart of its growth strategy. This may be out of the blue, but realizing how the Company perceives its own current status is necessary to understand this focus.

The Company's analysis shows that while the march of the IT society will continue unchecked, the demand side (consumers) has become sated (full) with IT (more precisely, with the volume of information provided as a result of the adoption of IT). Given this situation, the Company considers that predicting demand using big data and AI will have only limited effectiveness. By contrast, the Company believes that an analogue strategy of building comfortable relationships with its corporate customers and consumers, with just the right amount of distance, will prove effective.

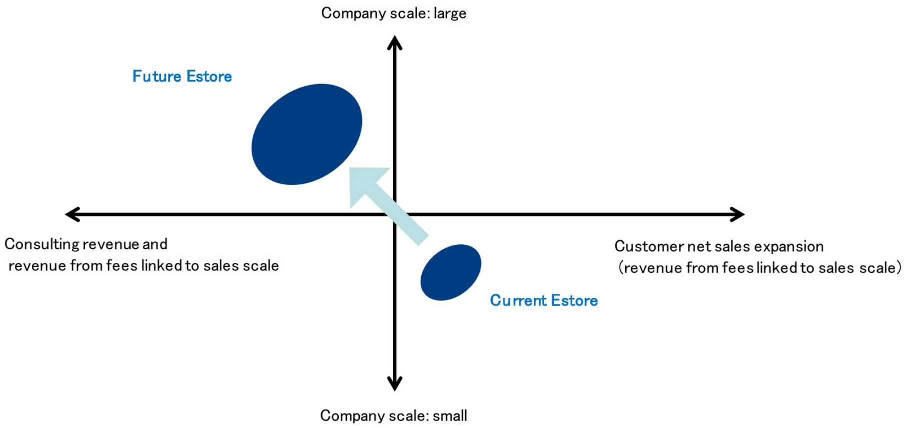
Another very important factor influencing the Company's growth strategy is Japan's deflationary economy. The nation suddenly finds itself a society with a shrinking population, and the generation that experienced the collapse of Japan's asset bubble is rapidly aging. The Company recognizes that the deflationary economy is therefore going to continue. This is expected to propel a transition from a consumer society that consumes physical things, to a sustainable society that makes physical things last longer. Since it is more difficult to sell products in a sustainable society, it will probably be important for the Company to pursue sales strategies based on relationships with existing companies.

The Company also considers that the deflationary economy will put pressure on companies to change their sales methods. To pursue sales strategies based on relationships with existing companies, the Company predicts that companies will need to shift to sales strategies that do not rely on central locations such as malls, that is to say, direct sales.

Given the above understanding of the situation and the future outlook, it is clear that among its three current business segments, the domain the Company will focus particularly on is the services business. A system-driven approach is of course important, but among sales systems, Shopserve is gradually becoming a non-focus business as it becomes crowded with competition. Sales promotion systems are expected to help make sales promotion services more efficient, and were expected to become a field of focus alongside sales promotion services. However, today the Company's sales promotion systems are often judged to be premature, and the Company appears to have adopted a policy of not pushing them too hard. Meanwhile, it is vital for the Company to expand work-force services on both the sales promotion and sales sides if adding services that involve people better capture the subtleties of consumer needs.

To date, the Company has gradually changed the direction of its own growth to stay aligned with changes in social conditions. Given the above situation, however, the Company is shifting the size of its target companies from the previous focus on small and medium-sized firms to large companies. In addition, in terms of revenue, the Company is also shifting from customer sales corresponding to sales system flow revenue (revenue from fees linked to scale of sales) to fee revenue from consulting in its sales promotion services business. That said, the goal of consulting is to expand customer net sales, ultimately leading to expanded revenue from fees linked to scale of sales, making it possible for the Company to increase customer net sales along with consulting revenue. Meanwhile, because it is difficult to pay consulting fees without a certain scale of business, the strategy of shifting consulting to target large companies makes sense.

Conceptual diagram of growth direction for Estore



Source: Prepared by FISCO from interviews

Switching from recurring revenue to flow revenue by shifting to large customers

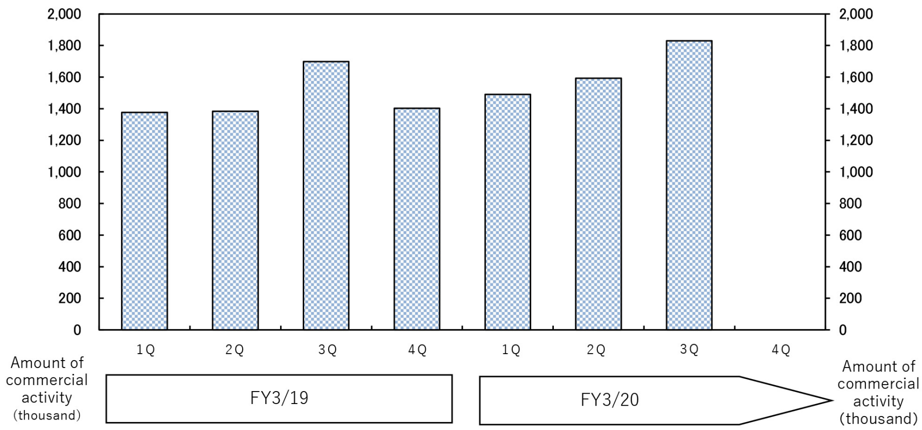
2. The sales systems business growth strategy

As described in the business overview section, the sales systems business revenues are classified into two types. The first is revenue from the Shopserve ASP service, which provides comprehensive EC support. This is a stock-type business model in which the Company receives monthly usage fees. The other type of revenue is collected as a fixed percentage of net sales conducted via Shopserve as a result of supporting for sales expansion of customer companies (revenue from fees linked to sales scale). This is described as a flow-type business model. The Company manages and discloses its recurring revenue and flow revenue separately.

The Company's recurring revenue continues on a declining trend. This is because, as competition grows more intense as the number of companies offering similar services grows, the Company is shifting toward larger customers, even as it maintains its management stance of not pursuing customer numbers. The result is an ongoing situation in which new contract acquisitions fall below the steady rate of contract cancellations (mainly individual stores and small and medium-sized companies acquired in the past). Meanwhile, growth in flow revenue did not continue, and actually dropped in FY3/19. This is because even as new acquisitions of large customers have fallen below plan, the Company has been unable to make up for the impact of a drop in the number of Shopserve contracted customers.

On the other hand, as the Company expected, net sales per store have generally increased. This rise in per-store sales can be divided between an increase in sales among the same customers and a change in customer composition with the shift to large companies. The Company is currently focusing on the latter, and under the slogan of "shift to good products, good stores," it is pushing ahead with that shift to large customers in its acquisition of new contracts. Under the policy of not pursuing customer numbers, acquisition of new large customers will not lead to an increase in recurring revenue. In terms of flow revenue, however, a change in sales composition with the shift to large customers, which have significant per-store sales, is expected to lead to expansion, though currently the effect is limited. This can also be seen as an effort to switch from recurring revenue to flow revenue.

Amount of commercial activity per store



Source: Posted from the Company's financial results

Newly released software has been found to be effective, but many have claimed it to be "premature." For now, the business is expected to continue developing slowly

3. The sales promotion systems business growth strategy

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

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

In the sales promotion systems business, fully fledged sales activities only began from FY3/19. Initial sales targeted existing Shopserve customers, and the Company planned to expand sales to external customers while monitoring the status of the initial sales. However, at this stage, sales have been lower than planned. The main factor appears to be the perception that the product is “premature.” In response to the situation, the Company has been proceeding slowly while reviewing the sales cost and target customers during FY3/20.

As described above, at this stage, the Company has been compelled to review its initial sales strategy. However, we believe there is ample potential to review the efficacy of the strategy over the medium to long term since the Company is confident of its products. In the short term, it seems possible that the sales promotion systems could be used to improve internal productivity in the sales promotion services business, which requires human input. The results could potentially be used to promote the tools and create sales in the future.

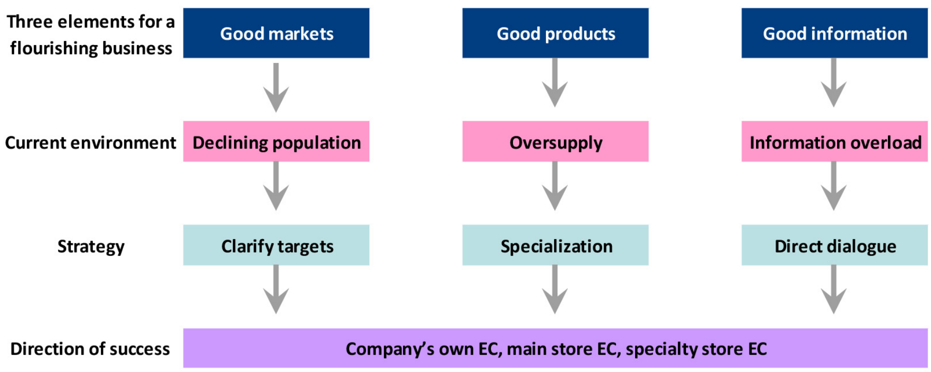
Strengthening consulting and optimizing the distance between customers and consumers

4. The sales promotion services business growth strategy

In the sales promotion services business, the Company provides survey, analysis, consulting, and operations management agency services, among others, to help customers increase their sales. This service is distinguished by its high reliance on the human work force as it requires human input. This has both positive and negative implications, which will be described later.

The Company’s increased focus on strengthening its sales promotion services, in particular consulting, is based on its understanding of social trends, the business environment and other factors. The three elements required for business to succeed are “good products,” “good markets,” and “good information.” However, the current state of these in Japan has degenerated, and we now have “oversupply,” “declining population,” and “information overload,” a situation in which things do not sell. The fundamental strategy for expanding sales in those circumstances is for customers to deal with consumers on a one-to-one basis, becoming specialty stores and optimizing the distance between themselves and consumers. Specifically, it is important to do business as a directly-owned store, through the company’s own EC, its main store EC and through specialty store EC. Supporting those stores’ success will be the Company’s consulting and other sales promotion services.

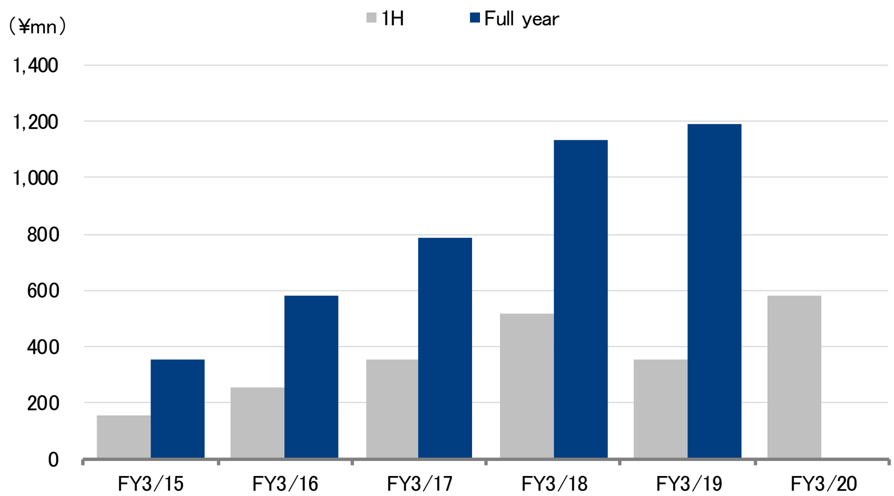
Conceptual diagram of the three elements for a flourishing business and success



Source: Prepared by FISCO from the Company's Shareholders' Letter (2018) and its company brochure

In sales promotion services, net sales grew extremely strongly through FY3/18, but slowed sharply beginning in FY3/19. This reflects factors including stronger seasonal promotions in FY3/18 that led to special demand. It is also possible that sales aimed at acquiring new customers were affected by a large-scale restructuring undertaken with the goal of rejuvenating management positions on a Company-wide basis. While per-order prices have recovered going into FY3/20, current contract growth and scale is still insufficient to increase efficiency in consulting, a service that is highly dependent on a human workforce. The fact that it is taking time to acquire large customers with annual contract amounts in excess of ¥10mn is also a major issue.

Trends in net sales of sales promotion services



Source: Posted from the Company's results briefing materials

There are distinctive positive and negative features in services that rely significantly on the human workforce. On the positive side, it means that the service cannot be easily imitated by other companies. On the negative side, human resources (consultants) require time for acquisition and training, making it difficult to increase capacity. To be precise, the Company makes sufficient budget allowance for human resource investment each year in its business plan. Over the past few years, the Company has not progressed as planned on acquisition and development of consultants, so that expenses have effectively been lower than envisaged. As a result, we are unable to view the higher-than-planned profits in a positive light when considering the situation from a long-term perspective.

From a medium- to long-term perspective, we believe it is actually preferable that the Company spend as planned. The budget calls for an annual increase of 5 to 10 consultants, and if recruitment and training proceed as planned, we believe the Company will be able to establish the team it is aiming for in two to three years. We hope the Company will manage to increase its human resources as quickly as possible while maintaining its selection standards.

Solving medium-term issues by strengthening sales promotion services and building large-scale orders through M&A

5. M&A aimed at bringing in large companies

In January 2020, the Company acquired all of the shares of Commece21 from Z Holdings Corporation (formerly Yahoo! Japan Corporation). In March 2020, it also acquired all of the shares of WebCrew Agency from NFC Holdings, Inc. <7169>, a company owned by Hikari Tsushin, Inc. Both acquisitions were made consolidated subsidiaries. Commerce21 provides a packaged EC integration system that offers a flexible response to the needs of large companies seeking a high degree of scalability. WebCrew Agency is a certified online ad partner of Google, Yahoo and Twitter, and has a record of drafting marketing strategies and providing outsourced management of branding and promotional operations for a wide range of clients, primarily large companies.

These M&As are expected to offer the Company an opportunity to solve two issues—strengthening its sales promotion services and building large-scale orders. In addition, they are also expected to improve cost efficiency by converting outsourcing expenses to internal net sales. By partnering with the Company, both Commerce21 and WebCrew Agency will also be able to offer larger-scale, stronger sales promotion services. As a result, this will enable the Company to provide its customers with a comprehensive set of EC solutions.

Future business domains

	Sales systems	Sales promotion services
Large companies	Commerce 21	WebCrew Agency
SMEs	Shopserve	EC consulting Outsourced EC operations management (creation, customer acquisition, etc.)

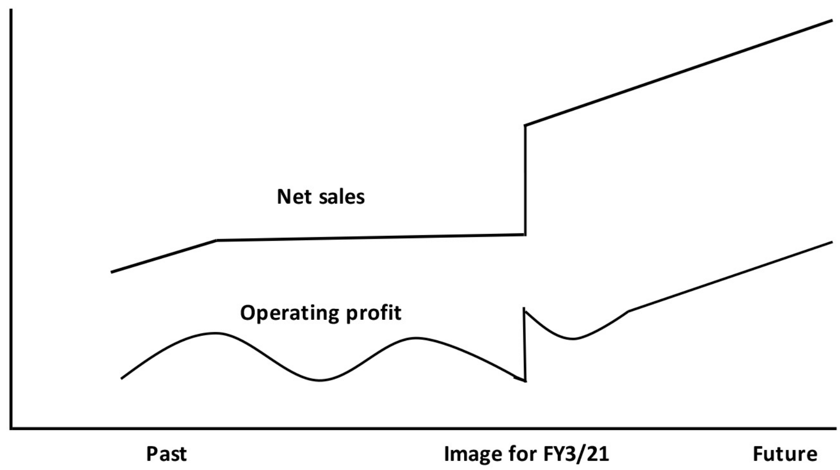
Source: Prepared by FISCO from Company materials and interviews

Next fiscal year will likely see group grow to exceed ¥10,000mn in net sales

6. Scenario for medium-term growth

Here we consider a scenario for medium-term changes in revenue taking into account the M&As involving Commerce21 and WebCrew Agency, and based on the following assumptions: First, in FY3/19, Commerce21 had net sales of ¥2,038mn and operating profit of ¥362mn, while WebCrew Agency posted net sales of ¥3,385mn and operating profit of ¥59mn; next, in FY3/20, the Company forecasts net sales of ¥5,047mn, with net sales for Commerce21 at ¥1,700mn and for WebCrew Agency at ¥3,600mn. We also assumed that the M&As will generate synergies, accelerating large orders for the Company and expanding orders for sales promotion services for Commerce21 and WebCrew Agency. Net sales will rise rapidly in FY3/21 as a result, and will continue to increase at a sharper than usual degree on the basis of these synergies. Profits from the two companies will also be added to total profits, but the transactions will generate amortization of goodwill and other integration costs, so an increase in operating profits will likely follow on a bit later. According to this scenario, there is a strong possibility that the Company will see annual sales leap significantly beyond ¥10,000mn following the consolidations. Incidentally, it appears that resignations at new subsidiaries Commerce21 and WebCrew Agency attributable to the M&A were essentially zero. It seems the transactions were welcomed by the acquired parties both in terms of fit and synergies.

Medium-term growth scenario



Source: Prepared by FISCO from interviews, etc.

Results Trends

While efforts to strengthen human resources are expected to generate upfront costs, FY3/20 3Q results still exceeded the full-year forecast

1. FY3/20 3Q results

In the Company's FY3/20 3Q results, sales and operating profit declined, with net sales of ¥3,622mn (down 2.3% YoY), operating profit of ¥378mn (down 3.8%), recurring profit of ¥448mn (down 3.9%), and profit attributable to owners of parent of ¥321mn (down 3.3%).

FY3/20 3Q results

(¥mn, %)

	FY3/19 3Q	Vs. sales	Progress vs. full-year	FY3/20 3Q	Vs. sales	Rate of change	Progress vs. forecast
Net sales	3,706	100.0%	75.2	3,622	100.0%	-2.3%	71.8%
Gross profit	1,115	30.1%	74.8	1,138	31.4%	2.1%	-
SG&A expenses	722	19.5%	74.1	760	21.0%	5.3%	-
Operating profit	393	10.6%	76.2	378	10.4%	-3.8%	109.0%
Recurring profit	466	12.6%	80.0	448	12.4%	-3.9%	116.7%
Profit attributable to owners of parent	332	9.0%	81.1	321	8.9%	-3.3%	107.8%

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

In FY3/20 3Q, the Company continued to reduce its reliance on its shopping cart business (sales systems business), which faces intensifying competition due to commoditization. At the same time, it made progress in restructuring to increase the ratio comprising the sales promotion services business, where the market is expanding. While it focused particularly on strengthening large orders and sales promotion services, and saw a rise in rates per order, the Company was late to invest in the sales promotion services business, causing a slight delay in restructuring, and causing it to fall somewhat behind in terms of the rate of progress in net sales versus the same period in the previous year.

Operating profits, meanwhile, fell compared to the same period in the previous year, as the Company reduced its reliance on the shopping cart business (decline in recurring revenue) and increased sales of its sales promotion services. Still, the rate of progress in operating profits has exceeded 100% of the Company’s full-year forecast, a solid result. In part, this was due to the fact that the Company made less progress than expected in new consultant hiring and other human resource investments, which it had planned to pursue aggressively, and curbed the use of sales ads.

Breakdown of net sales by business

(¥mn, %)

	FY3/19 3Q	Vs. sales	FY3/20 3Q	Vs. sales	Rate of change
Sales systems (shopping cart business)	2,826	76.2%	2,716	75.0%	-3.9%
Sales promotion services	850	23.0%	880	24.3%	3.4%
Sales promotion systems	10	0.3%	7	0.2%	-22.1%
Electronic certification (e-certification)	-	-	17	0.5%	-

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

The Company is strengthening consulting in its sales promotion services business and upselling to Shopserve customers is going well. Sales activities aimed at capturing new large orders are showing lead times to capturing actual orders that are longer than planned, and given the time required between the receipt of an order and delivery, the Company is struggling in this respect.

In its sales promotion systems business, the Company has changed how it markets its Estore Compare (AB test tool) and Estore Query (mail marketing tool) systems for sales promotion, disbanding its dedicated sales team and reincorporating the systems as one product handled by the normal sales team. As a result, while the Company views sales promotion systems as a growth market, it currently takes a natural stance toward sales.

In the sales system business, the Company is moving forward with a structural transformation of its Shopserve shopping cart business. By working to gain good stores suited to company-owned EC, rather than intentionally seeking volume, the Company has seen the cumulative number of user stores drop and recurring revenue decline, but per-store commercial activity increased 10% in FY20/3 3Q on a cumulative basis. In addition, the Company's participation in the cashless payment consumer rebate project associated with the increase in the consumption tax brought a rise in the amount of credit card payments handled and in the ratio of credit card settlements, but rules regarding business owner responsibility for cost-related portions resulted in a drop in flow revenue. As a result, recurring revenue was down 3.7% YoY, to ¥1,256mn, while flow revenue fell 4.1% YoY to ¥1,459mn.

The e-certification business was acquired in the previous term (August 2018) with the goal of preventing high-risk sites from being displayed in the browser, and protecting stores against a drop in sales and profits. As that goal has now largely been met, the Company continues to operate the service at a reasonable level, and net sales were generally flat.

FY3/20 operating profits likely to exceed the full-year forecast Will provide momentum for significant growth in FY3/21

2. FY3/20 results outlook

Estore forecasts for a profit decline on increased sales for the full year in FY3/20 with ¥5,047mn in net sales (up 2.3% YoY), ¥347mn in operating profit (down 32.7%), ¥384mn in recurring profit (down 34.1%), and ¥298mn in profit attributable to owners of parent (down 27.2%).

FY3/20 results outlook

(¥mn, %)

	FY3/19	Vs. sales	FY3/20 forecasts	Vs. sales	Rate of change
Net sales	4,932	-	5,047	-	2.3%
Gross profit	1,490	30.2%	-	-	-
SG&A expenses	974	19.8%	-	-	-
Operating profit	515	10.5%	347	6.9%	-32.7%
Recurring profit	582	11.8%	384	7.6%	-34.1%
Profit attributable to owners of parent	409	8.3%	298	5.9%	-27.2%

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

One factor the Company raised at the beginning of the year for a forecasted decline in profits in FY3/20 was upfront costs for acquiring and training consultant resources for its sales promotion services business, a key focus area. Over the past several years, the Company has put together similar budgets for these costs, but failed to make the expected progress in acquiring such personnel, resulting in an ongoing pattern of profits ending up above forecast. A similar pattern is likely to be seen in FY3/20. Still, progress toward operating profit in FY3/20 3Q has already reached 109.0%, exceeding the full-year forecast even accounting for concerns raised with the increase in the consumption tax. Going forward, even if efforts to acquire consultant resources in the sales promotion services business generate upfront costs, there is a greater likelihood that full-year results will end up above the Company's forecast.

Simplified income statement

(¥mn, %)

	FY3/17 full year	FY3/18 full year	FY3/19 full year	FY3/20 3Q	
				3Q	FY3/20 full year forecasts
Net sales	4,775	5,044	4,932	3,622	5,047
YoY	2.5	5.6	-2.2	-2.3	2.3
Gross profit	1,548	1,449	1,490	1,138	-
Vs. sales	32.4	28.7	30.2	31.4	-
SG&A expenses	1,141	895	974	760	-
Vs. sales	23.9	17.7	19.8	21.0	-
Operating profit	407	554	515	378	347
YoY	-35.2	36.1	-6.9	-3.8	-32.7
Vs. sales	8.5	11.0	10.5	10.4	6.9
Recurring profit	401	582	582	448	384
YoY	-36.1	44.9	0.1	-3.9	-34.1
Profit attributable to owners of parent	285	411	409	321	298
YoY	-32.1	44.1	-0.4	-3.3	-27.2

Note: The Company transitioned to consolidated results from FY3/19, so the growth rates for FY3/19 are reference values
Source: Prepared by FISCO from the Company's financial results

Simplified Balance Sheet

(¥mn)

	FY3/16 full year	FY3/17 full year	FY3/18 full year	FY3/19 full year	FY3/20 3Q
Current assets	3,058	3,012	3,568	3,710	4,716
Cash and deposits	2,385	2,312	2,778	2,977	3,934
Inventories	4	9	7	18	17
Fixed assets	447	480	411	785	846
Tangible fixed assets	82	129	106	106	112
Intangible fixed assets	108	103	74	56	48
Total assets	3,505	3,492	3,979	4,496	5,563
Current liabilities	2,471	2,296	2,490	2,065	2,834
Short-term interest-bearing liabilities	324	-	-	-	-
Fixed liabilities	18	22	26	1,025	1,025
Long-term financial liabilities	-	-	-	-	-
Shareholders' equity	1,012	1,173	1,461	1,402	1,700
Net assets	1,015	1,173	1,462	1,404	1,702

Note: Non-consolidated results for FY3/17 and FY03/18
Source: Prepared by FISCO from the Company's financial results

Cash flow statement

(¥mn)

	FY3/15 full year	FY3/16 full year	FY3/17 full year	FY3/18 full year	FY3/19 full year
Cash flows from operating activities	678	613	465	691	-26
Cash flows from investing activities	-122	-163	-88	-39	-349
Cash flows from financing activities	-252	-376	-449	-124	513
Exchange rate adjustments on cash and cash equivalents	1	0	-0	-0	-0
Net increase (decrease) in cash and cash equivalents	305	74	-72	527	136
Balance of cash and cash equivalents at beginning of year	2,005	2,310	2,385	2,312	2,840
Balance of cash and cash equivalents at end of year	2,310	2,385	2,312	2,840	2,976

Note: Non-consolidated results for FY3/17 and FY03/18
Source: Prepared by FISCO from the Company's financial results

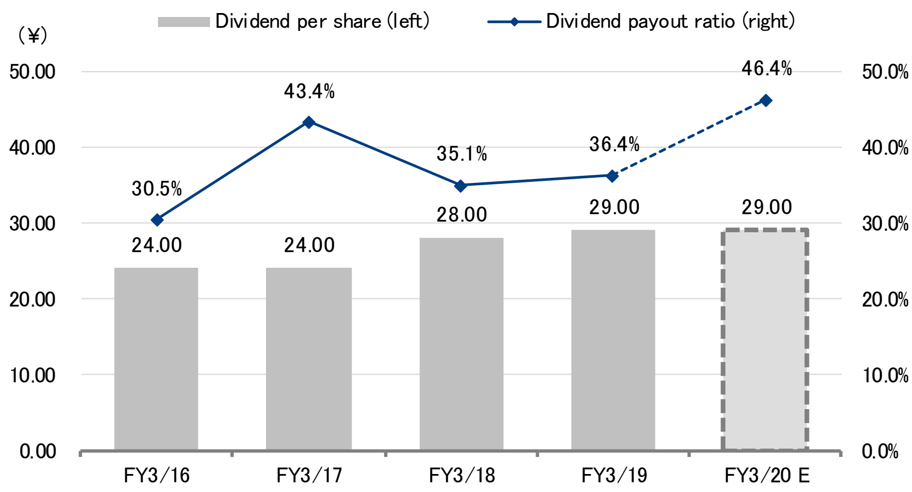
Shareholder returns

FY3/20 dividend expected to be level YoY at ¥29.

1. Dividend policy

The Company basically returns profits to shareholders through dividends. It pays dividends after taking into account a comprehensive range of factors, including business results, financial position, and the need to retain sufficient internal reserves to invest in growth. While it does not formulate an official dividend payout ratio, the foundation of Estore's thinking on the distribution of profits is its basic philosophy of "dividing profits between three groups; shareholders, customers, and staff." In the past also, it has a track record of determining the dividend based on this basic philosophy. The Company has decided on a dividend of ¥29 for FY3/19, an increase of ¥1 from FY3/18. For FY3/20, the Company has announced a dividend of ¥29 (year-end only), level with FY3/19.

Trends in EPS, dividend per share, and dividend payout ratio



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

Shareholder benefits dramatically increased from once-yearly dividend of ¥500 to twice-yearly dividends totaling ¥2,000

2. Shareholder benefits

In addition to cash dividends, the Company also provides a shareholder benefits program. Recently, the Company announced that this program will be enhanced. Up until now, shareholders holding at least one trading unit (100 shares) as of March 31 each year have been gifted a QUO card with ¥500 of value. Now, this gift will be increased to a QUO card with ¥1,000 of value, given twice a year to shareholders as of September 30 and as of March 31. The annual shareholder benefit amount will thus be quadrupled from ¥500 to ¥2,000 per year. This system was applied from September 30, 2019.

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