June 7, 2023

Estore Corporation (TSE Standard/4304) UPDATE !

Digital Transformation (DX) is a great business opportunity that is approaching. With an eye to the future, the company is modifying its revenue model from e-commerce support to incubation.
The company is expected to make a big leap in the next fiscal year and beyond.

KAsset Representative
Market analyst

Kenichi Hirano

Corporate profile

Location	Toranomon, Minato-ku, Tokyo
Representatives	Kenichi Ishimura, President and CEO Yoichi Yanagida, President and COO
Established	1999
Capital	768 million yen
Listed	September 19, 2001
URL	https://estore.co.jp/
Business	Information & communication

Stock price data (closing price as of June 5)

Stock price	1,165
Number of shares outstanding	5,636,636 shares
Market cap	6,567 million yen
Dividend per share (est.)	–
PER (est.)	–
Actual PBR	2.1x

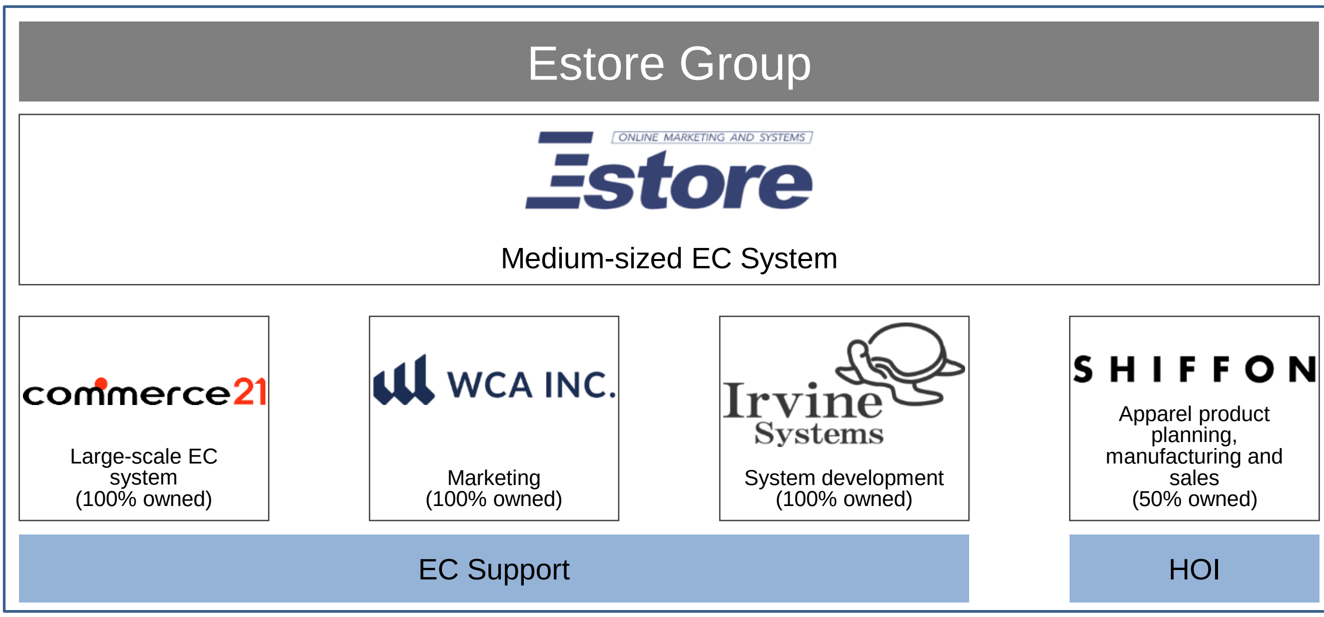
Executive Summary

* In FY 3/2023 the company reported net sales of 9.45 billion yen (up 64.4% YoY) and operating income of 900 million yen (down 14.5% YoY). In addition to steady growth in its existing businesses, M&A in the newly launched HOI (hands-on incubation) business led to a significant increase in sales. On the other hand, income declined due to increased strategic upfront investment aimed at strengthening its existing EC support services.
* The Estore group is a pioneer in EC support, has many national brand companies for clients and boasts the top share in the corporate EC site development market. With increasing its client companies' revenues as its mission, the company has grown by constantly anticipating market changes and providing timely services. It is currently expanding its upfront investment as a great business opportunity.
* The changing work styles and lifestyles brought about by the Covid-19 pandemic have increased the attention given to digital transformation (DX) and companies are eager to invest in DX. While the business environment is favorable, competition is also intensifying. With an eye to the future market, the company has launched an HOI business, which will significantly change its future revenue model. Nevertheless, as incubation is an extension of the EC support that the company has cultivated to date, it is a business in which the company can take advantage of its strengths. The company is aiming for growth in the group as a whole by using the EC support business as a cash cow and redirecting management resources to the HOI business.
* In FY 3/2024 the company forecasts net sales of 12.50 billion yen (up 32.3% YoY) and operating income of 840 million yen (down 7.2% YoY). Sales are growing steadily on the back of robust EC consumption and active corporate investment in DX. On the other hand, the company will continue to make upfront investments in EC systems to enhance customer convenience, and thus expects to post decline in income for a second consecutive fiscal year. However, this is a strategic investment for growth that is planned to be largely completed in the current fiscal year, and the results of this investment will become apparent from the next fiscal year onward. Operating income for FY 3/2025, the final year of the medium-term management plan, is forecast to be 2.0 billion yen. The company is expected to make great strides in the next fiscal year and beyond by maximizing group synergies and capturing the major trend in DX.

Overview/Financial Summary

■ Overview

The company is a pioneer in EC support. Consisting of Estore, which is a holding company, and four consolidated subsidiaries, the company provides support for "companies' own e-commerce sites" with the mission of increasing clients' income. The services offered are (1) EC systems, (2) payment settlement services, and (3) marketing services. The company's strength lies in its ability to provide one-stop services to increase the competitiveness of customers' own EC sites. In order to increase its own profitability, the company launched a hands-on incubation (HOI) business in 2022.



■ Summary of Financial Results for FY 3/2023

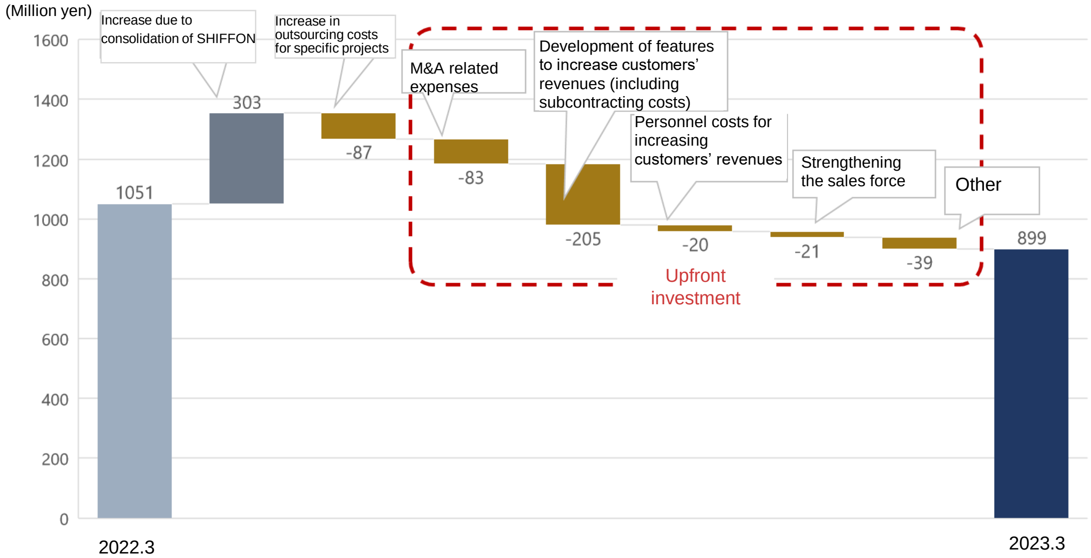
In FY 3/2023 the company reported increased revenue and decreased income, with net sales of 94.5 billion yen (up 64.4% YoY) and operating income of 900 million yen (down 14.5% YoY). Sales grew significantly through making SHIFFON a consolidated subsidiary and the launch of the HOI business in August 2022.

(Million yen)	2019.3	2020.3	2021.3	2022.3	2023.3
Net sales	4,932	4,852	10,504	*5,746	9,449
Operating income	515	478	906	1,051	899
Operating income margin (%)	10.4	9.9	8.6	18.3	9.5
Ordinary income	582	526	1,073	1,078	751
Net income	409	367	482	677	307

＊ Sales for FY 3/2022 appear to be declining due to the change in presentation of transactions from gross to net, but in fact it is up 6%.

Financial Summary

On the other hand, income declined because upfront investments in the EC support business were greater than initially planned. The company is strengthening its personnel structure, including system function development and recruitment, with the aim of improving customer convenience.



◻ Business Segments and Sales Trends

With the M&A of "SHIFFON" providing the opportunity to launch the HOI business, the company now consists of two segments, the EC support business and the HOI business. Although sales in the EC support business are growing due to market expansion, the growth rate is slowing due to intensifying competition.

(Million yen)	2020.3	2021.3	YoY(%)	2022.3	YoY(%)	2023.3	YoY(%)
EC Business							
EC Systems	1,935	3,900	101.6	4,293	10.1	4,541	5.8
Payment settlements	582	835	43.5	854	2.3	868	1.6
Marketing	396	678	71.2	599	-11.7	522	-12.9
HOI Business						3,516	-
Total	4,852	5,415	11.6	5,746	6.1	9,446	64.4

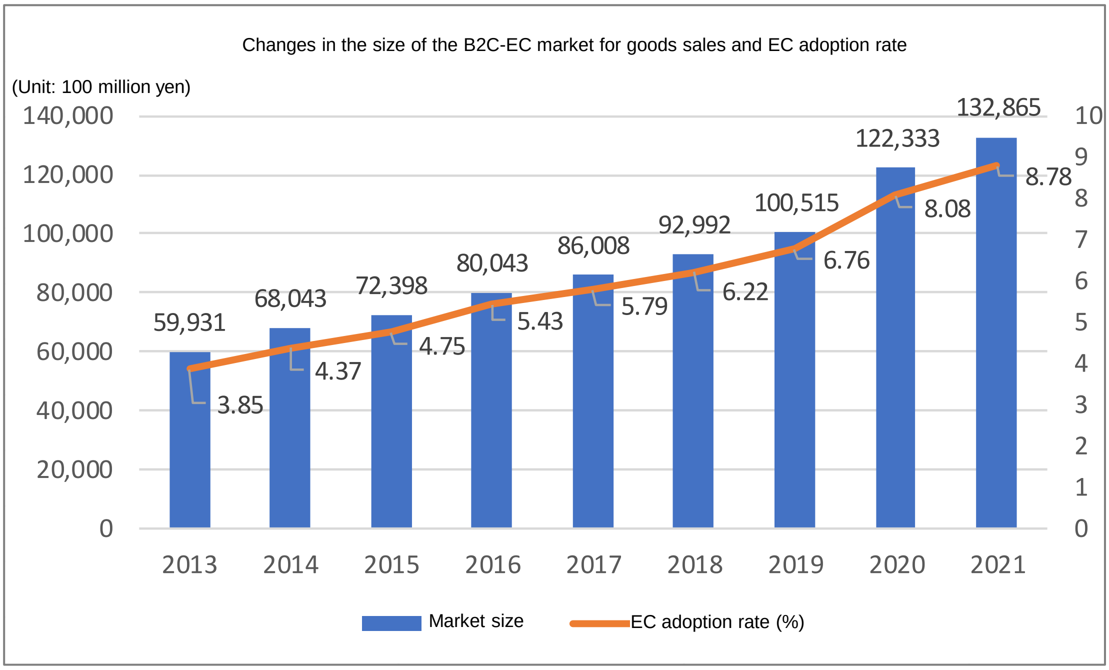
◻ Strengths

In the EC support business, the company has provided EC systems, payment settlement services, sales promotion proposals and sales promotion agency services. By engaging in the development of EC systems, the company can provide a one-stop service from the sales domain, such as market analysis and system development, to the sales promotion domain based on payment and purchasing data analysis. The company's greatest strength is its comprehensive ability to accurately respond to customers' needs to expand revenue.

Position in the Industry

◻ Market Environment and Business Model of the EC Support Business

As shown in the Ministry of Economy, Trade and Industry statistics in the table below, Japan's B2C-EC market grew significantly in 2020, driven by growing demand due to people staying at home during the Covid-19 pandemic, and has steadily expanded since then, with the EC adoption rate rising to the high 8% range. Yet, it still lags far behind the global EC adoption rate of 17.8% (2020). Although EC consumption is becoming more established, it is thought that there is still plenty of room for growth.



Source: Ministry of Economy, Trade and Industry FY2021 Survey on Electronic Commerce

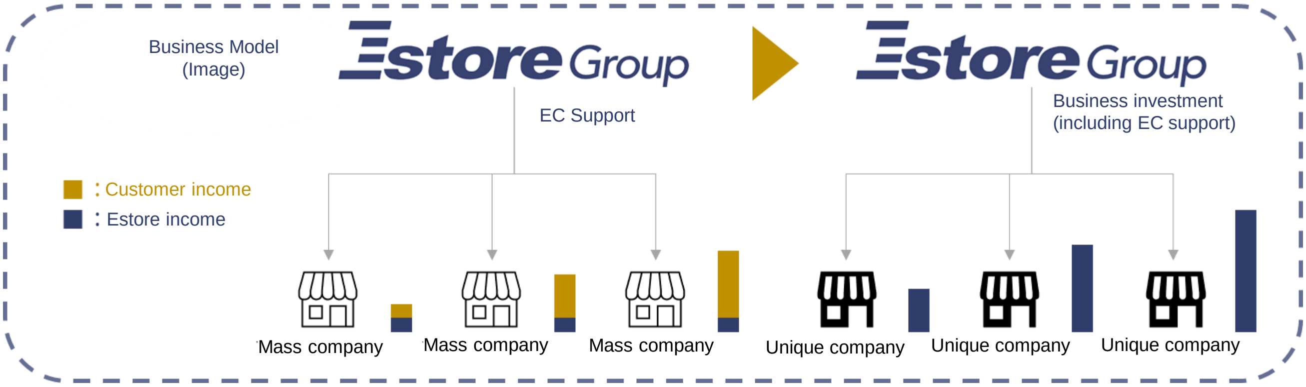
The company has continued to expand the services it offers ahead of market trends. The cross-selling of these products has increased the earnings of customer companies, and the company has also become a top leader in the support of corporate EC site development. As D2C accelerates in the future, "corporate EC" is a promising market. Therefore, competition is intensifying as more and more new participants enter the market. Since the business model was originally low-risk, low-return, it is becoming harder to expect the kind of profit growth that has been seen in the past. The company is modifying its business model in light of these changes in the external environment.

1. As EC support has become a red ocean, the company has decided to focus on serving large, profitable customers. The company has many national brand companies as its main customers, and there is still plenty of growth potential in EC support for large customers. Therefore, the company is currently focusing on the development of systems that are indispensable for customers' to expand their payment settlement revenues (auto-scaling: a system to prevent missed sales during peak periods; CRM: enhanced distribution of email newsletters). While priority has been given to upfront investments in the previous and current fiscal years, the business is expected to become a cash cow from the next fiscal year onward.
2. The company intends to shift the management resources gained from the EC support business to the HOI business and shift its focus in the future. The HOI business will drive future growth by turning companies with promising commercial products into group companies through direct investment such as JVs and M&As, and capturing their business profits.

Business Model

◻ Potential of HOI Business

While the normalization of economic activity has led to increased human flows and consumption, the disparities in income and assets have also widened. In addition, as consumers' values diversify, "premium consumption," in which consumers will pay for what they take an interest in, is expected to expand. In other words, companies must have products that people will find worth buying. Furthermore, even if a company has valuable commercial products, it won't be able to survive if it doesn't have knowledge and financial resources concerning DX. There are many small and medium-sized companies that have valuable products but are unable to promote them on their own EC site. The HOI business is the business of making direct investments in such companies and maximizing earnings by providing the company's accumulated expertise. The company is expected to make a great leap forward with this business model, in which it develops its business as a partner and enjoys business profits together with these companies.



From the company's financial results presentation materials

As mentioned above, the HOI business is a business that uses M&A to acquire companies which are expected to make rapid progress if their EC operations are strengthened, and captures the business income from the increased value. Sourcing ability* is essential, but the company believes it can mitigate risk because of its discerning eye cultivated through EC support and its ability to propose and negotiate income improvement proposals. Furthermore, it can increase corporate value beyond improvements to EC.

* Sourcing = In M&A, selecting and further negotiating with a target company.

◻ Future Performance

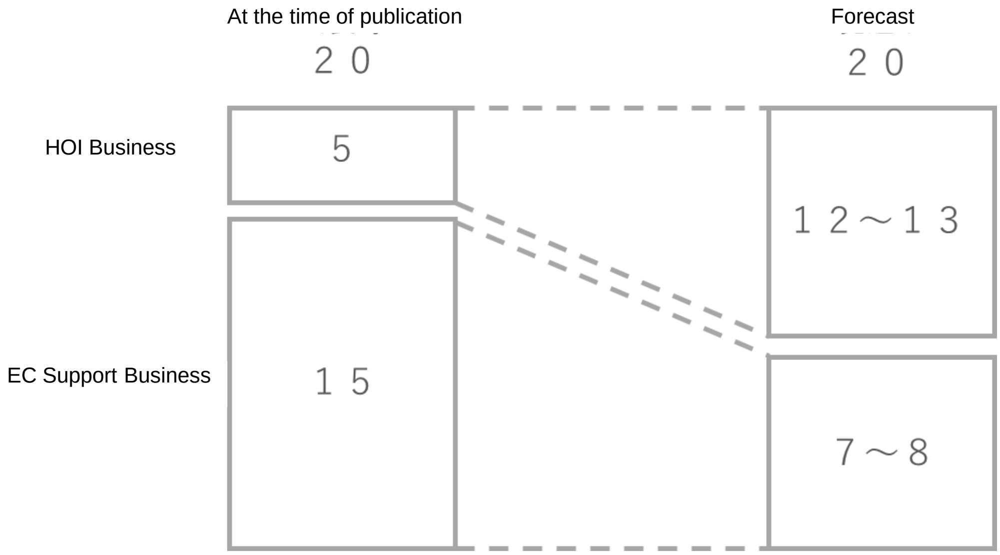
Although income has fluctuated due to development investments and M&A, the company has achieved steady growth over the long term as an industry leader. In FY 3/2024 the company forecasts net sales of 12.50 billion yen (up 32.3% YoY) and operating income of 840 million yen (down 7.2% YoY). Sales are growing steadily on the back of robust EC consumption and active corporate investment in DX. On the other hand, the company will continue to make upfront investments in EC systems to enhance customer convenience, and thus forecasts to post decline in income for a second consecutive fiscal year. However, this is a strategic investment for growth that is planned to be largely completed in the current fiscal year, and the results of this investment will become apparent from the next fiscal year onward.

(Million yen)	2020.3	2021.3	2022.3	2023.3	2024.3 (forecast)
Net sales	4,852	10,504	*5,746	9,449	12,498
Operating income	478	906	1,051	899	835
Operating income margin (%)	9.9	8.6	18.3	9.5	6.7
Ordinary income	526	1,073	1,078	751	–
Net income	367	482	677	307	–

* Sales for FY 3/2022 appear to be declining due to the change in presentation of transactions from gross to net, but in fact it is up 6%.
* Non-operating income/loss has not been disclosed due to the difficulty of reasonably predicting foreign exchange rate fluctuations and other factors at this time.

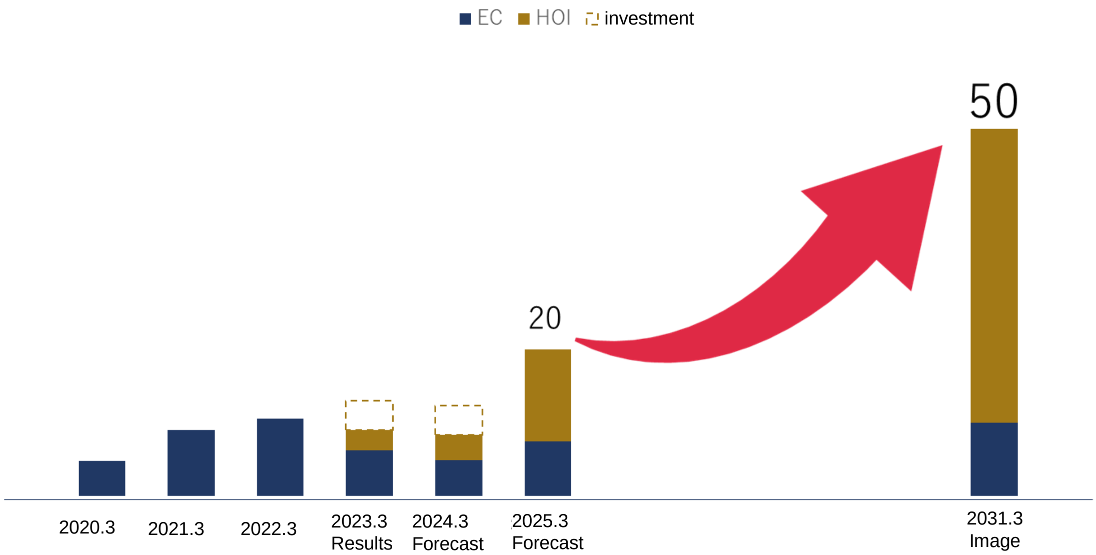
Business Model

Operating income for FY 3/2025, the final year of the medium-term management plan, is forecast to be 2.0 billion yen. While the target figures remain unchanged from the original plan, the income composition of the segments has changed significantly, with the HOI business accounting for 75% and the EC support business accounting for 25%. The EC support segment has almost completed the upfront investment and is growing through services towards large customers. In the HOI segment, SHIFFON's operating income is forecast to be around 600 million yen, and in addition, one or two of the multiple M&A deals currently in progress are expected to be concluded.



From the company's financial results presentation materials

After that, the company plans to expand its operating income to 5 billion yen in FY 3/2031 through the shift to the HOI business.



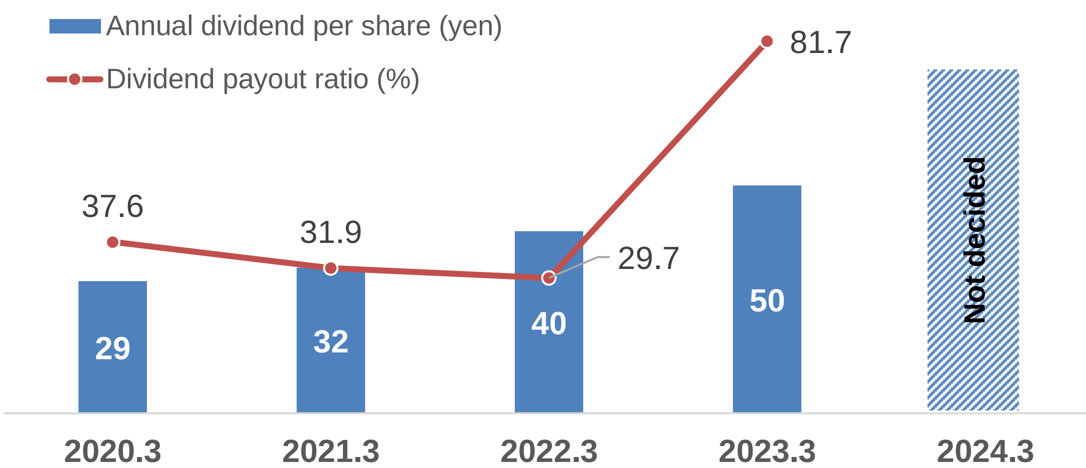
From the company's financial results presentation materials

The DX wave is a great opportunity for growth. The company is actively pursuing business alliances and M&As. By maximizing group synergies, the company aims to make further progress as a total solution company for EC support.

Capital Policy and Shareholder Returns/Challenges and Risks

◻ Capital Policy and Shareholder Returns

Assets and liabilities increased significantly with the consolidation of SHIFFON. The 2022 stock acquisition (50%) was supplemented by bank borrowings, and as the company plans to acquire an additional 20% in June, both short- and long-term borrowings are expected to increase. The company's policy for the moment is to prioritize investment in the HOI business in order to maximize corporate value, but it is open to returning profits to shareholders once it the necessary internal reserves have been secured.



◻ Challenges and Risks

The growth of the EC market will accelerate as society undergoes a rapid paradigm shift and DX becomes inevitable. In the IT market, with its fast rate of technological innovation, system development is a necessity. Securing and developing system engineers and sales personnel is a challenge. Achieving the TSE Prime listing criteria is also a challenge, as is capital policy. If the company is unable to secure and develop sales personnel, or if the results of alliances and M&As are less than expected, the balance sheet will not improve as forecast. The rapidly changing world of IT is a tough world to be in.

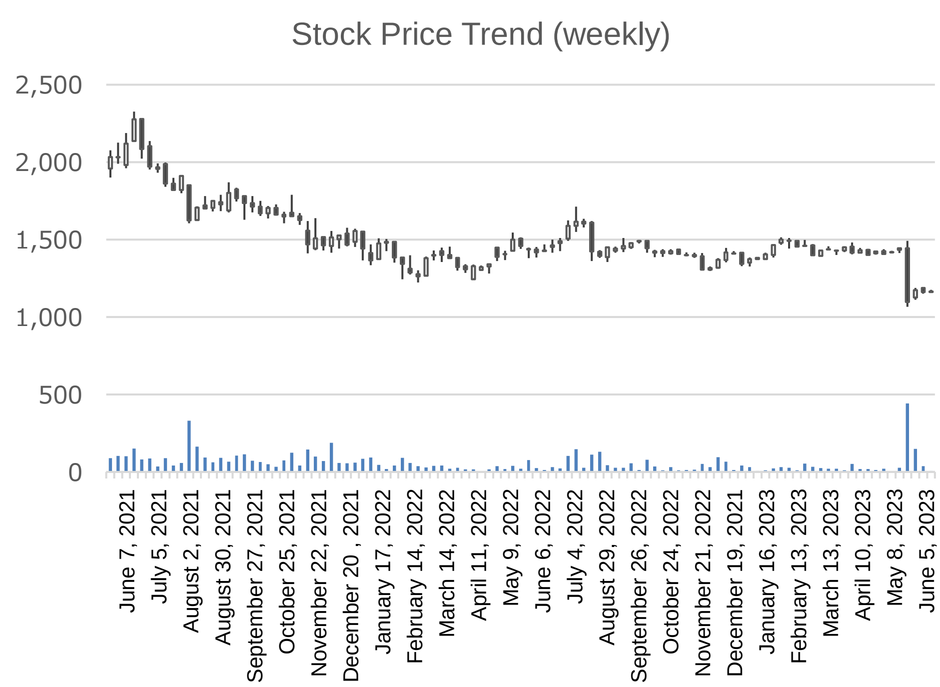
Stock price approach

Foreign investors' view of Japanese stocks has changed dramatically, resulting in large purchases of Japanese stocks. The Nikkei is at its highest level in 33 years, and further upward momentum is expected. However, the large-cap and high-priced stocks bought by foreign investors, as well as index-based stocks, are leading the increases, while small-cap stocks belonging to the standard and growth markets have been relatively sluggish. The stock price of the company, which belongs to the standard market with a market capitalization of 6.5 billion yen, has also been stagnant. However, until now, foreign investors' style of reviewing and buying Japanese stocks has been to buy large-cap and mainstay stocks with large market capitalization and then gradually reach for small-cap growth stocks. On the other hand, individual investors have been accumulating cash on hand by selling to the foreign investors' purchases up to this point, but both domestic and foreign investors are expected to turn their funds towards lagging stocks in the future.

The stock price has fallen sharply since the announcement of the company’s financial results (May 15), as the company's earnings for the fiscal year ended March 2023 was down 14.5% in operating income and 30.3% in ordinary income due to the forward-looking strategic investments. Moreover, while on the surface the company's sales are expected to increase significantly in the fiscal year ending March 2024, income recovery is uncertain and the recovery of the stock price is also sluggish.

However, the upfront investment that is the source of this decline in earnings could significantly change the company's income model going forward, and we believe that this decline in the stock price is a good time for investors to enter the market. More than anything, the company has not reduced its dividend once in the past, which is noteworthy for a company of this type that is usually prone to fluctuations, and the company increased its annual dividend by 10 yen, to 50 yen in the previous fiscal year, even though income had declined. The shift to DX in the corporate sector is expected to accelerate in the future. The trend toward B2C "corporate headquartered EC", which provides customers with all of the necessary EC solutions (systems, marketing, and payment settlements) needed to increase their income, is also expected to increase further. DX has entered the "era of advanced generalization". In the future, the company will shift its focus to the HOI (hands-on incubation) business, where it will make direct investments in companies that provide unique products and services, and capture their entire business income. Will the upfront investment to build the "Estore era" pay off? The future stock price will be the evidence of this, but this may be the place to cast a vote first.

Stock price (historical)	
Year-to-date high	1,513
Year-to-date low	1,066
All-time high	590,000
All-time low	620



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Inquiries about this report:

FinanTec Co., Ltd.
EMail: report@finantec-net.com
4th Floor of Kabutocho Kaisei Bldg. Annex, 13-1 Kabuto-cho, Nihonbashi, Chuo-ku, Tokyo 103-0026
TEL:03-4500-6880 FAX：03-4500-6888