COMPANY RESEARCH AND ANALYSIS REPORT

Syuppin Co., Ltd.

3179

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Index

Summary

In FY3/23, Watches business struggled due to falling prices, but Cameras business steadily grew with help from AI utilization, etc. In FY3/24, the Company expects higher net sales and profits driven by continued brisk EC performance.

Syuppin Co., Ltd. <3179> (hereafter, also "the Company") is an e-commerce (EC) enterprise specializing in "valuable items," such as cameras and luxury watches. Utilizing the different customer needs and product characteristics between used and new items, the Company has realized an expansion of the membership base and results growth, while having used and new items interact to support the other's sales. Recently, it has been working on initiatives including proprietary EC purchases, one-to-one marketing, and the utilization of CGM, and it continues to evolve its platform-type business model. During the past few years, store sales have been lackluster due to the COVID-19 pandemic (hereafter, COVID-19), and the Watches business, which has been engaged in strategic inventory investment, has temporarily lost steam as prices have fallen globally. In contrast, the mainstay Cameras business has been steadily growing led by EC with the introduction of new AI-based features*, etc., so it can be said that the Company has entered a new stage in terms of business model evolution.

* AIMD (merchandising system that uses AI technology), AI-based content recommendations (using an AI engine that analyzes customer preferences and distributes a large number of content articles created and owned by the Company.), etc.

1. Overview of FY3/23 results

In FY3/23, the Company's net sales grew 5.0% year-on-year to ¥45,618mn, whereas operating income declined 21.6% to ¥2,463mn. Although sales rose but profit declined, net sales reached a record high and operating income was the second highest level ever. The core Cameras business expanded sharply as one-to-one marketing utilizing AI was successful and sales of major new products from camera manufacturers invigorated the overall market. However, the Watches business, another mainstay, was lackluster since global prices fell sharply and lockdowns in China and other world affairs led to weak duty-free sales (store sales). That said, the Watches business is apparently recovering now. In terms of profit, the Cameras business maintained a high gross margin, whereas the posting of a loss on the valuation of goods and the sale of goods at a loss squeezed profit in the Watches business. As a result, operating income declined and the operating margin decreased to 5.4% (from 7.2% in the previous fiscal year). In terms of activities, initiatives looking to the future such as strengthening cross-border EC and opening a revamped BRILLER (ladies' brand salon) delivered some results.

2. Outlook for FY3/24

The Company forecasts higher sales and profits in FY3/24, with net sales to rise 9.7% YoY to ¥50,028mn and operating income to grow 26.8% to ¥3,122mn. It assumes the strongly performing Cameras business will continue to drive net sales growth, mainly in EC. For the Watches business, which was weak in the previous fiscal year, the Company envisions slightly lower sales, a conservative level, despite signs of prices improving, and prospects for recovery in inbound demand (duty-free sales). In terms of profit, it expects growth in the Cameras business and earnings improvement in the Watches business to drive profit growth. In particular, it envisions the gross margin making a V-shaped recovery to 18.0% from 17.0% a year earlier, owing to the effects of using AIMD (including upgrades), as well as the erasure of one-offs (sale of goods at a loss, posting of losses on valuation). It also expects a higher gross margin to offset higher SG&A costs accompanying the reinforcement of human capital with an eye to future business expansion and the renewal of mission-critical systems, such that operating income grows and the operating margin improves to 6.2% from 5.4% a year earlier.

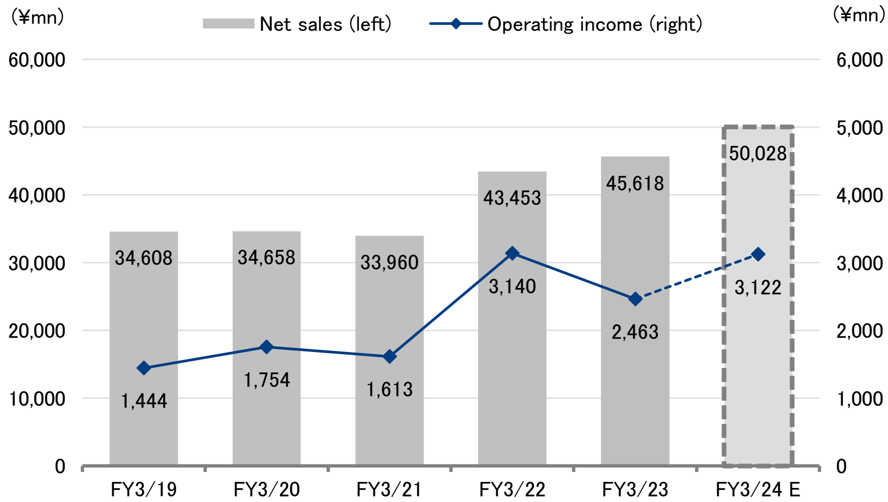
3. Strategy for Future Growth

The Company updates its three-year medium-term management plan annually on a rolling basis, and in May 2023, it announced a new medium-term plan. It intends to continue to further grow its Cameras and Watches businesses and revitalize its global expansion through cross-border EC, etc., positioning sustainable growth in EC sales through expansion of market share as the main driver. The Company also plans to emphasize profit growth over growth in sales by utilizing AI to improve profit margins and reducing its SG&A expense ratio through lean management. For FY3/26, the final year of the current plan, it aims to achieve net sales of ¥63,141mn (a three-year average annual growth rate of 11.4%) and operating income of ¥4,827mn (an operating margin of 7.6%). In FY3/24, the Company intends to improve the inventory turnover rate for cameras by upgrading AIMD, and work on things in the Watches business such as building an AI system to support merchandising to create a framework that is not susceptible to fluctuations in market prices.

Key Points

- In FY3/23, achieved record-high net sales and second-highest level ever of operating income, though sales rose but profit declined
- Watches business was weak due to falling prices worldwide, but is recovering now
- Company expects sales and profits to rise in FY3/24 as Cameras business grows and Watches business earnings improve
- In its medium-term management plan, the Company intends to achieve sustainable growth in EC sales and improve profit margins through AI utilization by working to further grow its Cameras and Watches businesses as well as revitalizing global expansion through cross-border EC

Results trends



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

Business overview

Is developing an EC business specializing in valuable "new and used items," such as cameras and luxury watches. Continued unique evolution through aggressive use of AI technology

The Company is an e-commerce (EC) business specializing in valuable "new and used items." It achieved strong growth by establishing its own business model that harnesses the Internet and its positioning as a business dealing with highly specialized items, capitalizing on the expansion of the EC market. It continues to evolve into a specialist EC site that harnesses the latest technologies by introducing AIMD (merchandising system that uses AI technology) and AI-based content recommendations (using an AI engine, the service automatically distributes recommended articles selected from its broad collection by analyzing customers' preferences).

The Company currently has approximately 620,000 web members (as of the end of March 2023). This number has been steadily increasing through the acquisition of over 4,000 new members every month. On the other hand, it has established a physical store network of five stores in the Tokyo metropolitan area, with its basic policy being one store for one item. Stores contribute to results to a certain extent, but their main function is to complement the EC business as bases to disseminate information. Also, the composition of sales broken down by new items and used items is stable at around 1:1, and they each play important roles, generating synergies while mutually interacting to increase the other's sales.

There are four business segments: Cameras business, Watches business, Writing Instruments business, and Bicycles business*. The mainstay Cameras business provides approximately 70% of net sales. Meanwhile, the Watches business is temporarily struggling with impact from falling global prices for luxury watches, but the Company still looks to accelerate growth by strategically enhancing the product lineup, while promoting the creation of a framework that is not susceptible to market prices.

* The Cameras business is conducted under the Map Camera brand, the Watches business under the GMT and BRILLER brands (ladies' brand salon), the Writing Instruments business under the KINGDOM NOTE brand, and the Bicycles business under the CROWN GEARS brand.

The Company's features

Strengths include its proprietary EC purchases, one-to-one marketing, and platform-type business model

1. The growth model

The Company's net sales have grown alongside the increase in the number of web members. In other words, it can be said to have a recurring-revenue business model, in which alongside the acquisition of new customers through effective EC marketing, it captures members and promotes continuous purchases, which leads to sales growth. Therefore, in addition to the number of newly acquired members and the total number of members, the number of purchasing members is an important KPI. Currently, web numbers have grown to approximately 620,000 people, but there remains plenty of room for the number of newly acquired members (and total members) to further increase in the future through its proprietary business model, including strengthening measures for young and female members and expanding its market share in areas outside the Kanto region. Also, increasing the number of purchasing members through raising the active rate* can be expected to be beneficial for improving results and costs. Moreover, the accumulation of "merchandise" (the inventory of used items) is an important KPI that will lead to sales increasing in the future. Unlike other companies in the same industry (such as those involved in reusing and recycling) that collect used items by paying high advertising costs, the Company is focusing on collecting "valuable inventory items," which is its core value, including through its proprietary mechanism for EC purchases and powers of discernment in addition to utilization of AI, and it can be said that this has led to acquisitions of new members and continuous purchases.

* The Company defines the active rate as the number of members who make a purchase in a fiscal quarter (excluding new purchasing members) in relation to the total number of members at the start of that quarter.

2. The Company's features (strengths)

(1) Proprietary model specializing in EC

Since its foundation, the Company has focused on a model specializing in EC that is limited to "valuable items." In other words, it can be said to have established a unique position through specializing in high-value-added items and the convenience of EC. In particular, it is able to respond flexibly to economic fluctuations as it does not incur fixed costs. Additionally, it benefits from having few bottlenecks for increasing sales and from being able to focus on achieving high profitability alongside the growth of sales. Another strength is that the Company has increased the ratio of transactions from its own website to approximately 80% by providing its own services, in contrast to the high dependence of competitors on other companies' malls. This has enabled its platform-type business model, as well as a reduction in the burden of fees. Meanwhile, although stores have been affected by COVID-19 in the past few years, they have been making a certain contribution to business performance and serving as a base for disseminating information, driven by factors including inbound demand (duty-free sales). The Company intends to continue developing its business based around EC, especially by using its own website as a platform.

(2) Synergies between new items and used items

The composition of total net sales provided by new items and used items trend at around 1:1. For the Company, both play important roles and have contributed to expanding its customer base and its results growth, while mutually interacting to boost the other's sales. In other words, compared to used items with high profit margins, for which there are many single items, the significance of handling new items, for which competition is fierce, is not only their contribution to results, but also that they provide opportunities to acquire new members (capture new customers) and amass used items. In particular, when the Company sells a new item, it has a major impact on results and also provides it with the biggest opportunity to acquire a new member. Therefore, the handling of new items functions as a catalyst in order to increase sales of used items. Conversely, for sales of new items as well, the Company is able to differentiate itself through trade-ins of used items owned by customers (by indicating purchase prices that are acceptable to customers), which generates synergies.

(3) Mechanism for collecting "valuable inventory items"

As previously explained, the Company's growth depends on how it collects "valuable inventory items" (used items). Preparing a high-quality inventory not only raises the value of the Company's brand and attracts buyers, it also creates a virtuous cycle through building trust with sellers, which in turn leads to the collection of more high-quality inventory items. It has been able to differentiate itself from other companies by working to enhance functions, including by 1) indicating purchase prices that are acceptable to customers and that correspond to the item's value determined by detailed assessment standards, 2) responding to trade-in needs by handling new items, and 3) enabling estimated purchase prices to be easily obtained on the internet. It is also introducing its own mechanism for EC purchases, including one-price buying*1 and the receive-first, send-later service*2, further raising convenience for the customers to sell, which has led to increases in the EC purchase amount. It also aggressively uses AI, working on improving efficiency (reducing opportunity losses) through a personal identification service using AI facial authentication*3 and development of AIMD*4 and other measures.

*1 A service to guarantee the fixed-price purchase amount of items specified by the Company (launched in July 2013).
*2 A service that enables the customer to receive the item in advance when trading-in (exchanging) a camera that they own and purchasing a new item (launched in September 2014).
*3 The Company previously needed users to mail in a personal identity confirmation document (original certified copy of the resident's certificate) to authenticate their identity, but installation of a system capable of matching the user's face and image on an identification card allows authentication online (an ID and password are sufficient to complete the authentication procedure for second and subsequent purchases).
*4 An automated assist system that utilizes AI for the purchase and sales prices of used cameras. Originally, the Company decided prices manually for all the items its handles, which exceed more than approximately 20,000 items. However, it can conduct timely pricing only for some items, and as a result, there are many cases of opportunity loss. This system will enable fully automated pricing and it is expected to reduce opportunity losses through determining prices appropriately and in a timely manner.

(4) Platform-type business model

Another feature of the Company is that it has built a platform-type business model to encourage continuous purchases by providing valuable information within the sequence of pre-purchase → time of purchase → post-purchase. In other words, its strategy is to create a virtuous cycle of information about enjoying cameras (pre-purchase) → services to make purchases easier (time of purchase) → services to enjoy an item after purchasing (post-purchase). By making this cycle bigger, it can expand and activate its membership base, which in turn leads to further results growth. In particular, for the services at the time of purchase, it realizes one-to-one marketing through the personalization of its EC website (including a wish list, an email notifying of product arrivals, and personal recommendations). Also, with aims including supplementing information and cultivating fans, it is working on utilizing CGM*1 and communication via the Web magazine*2, with the goal of being Japan's largest portal website specializing in cameras. More recently, it continues to evolve in its own way by harnessing AI to introduce unique features such as AIMD and AI-based content recommendations*3.

*1 An abbreviation of Consumer Generated Media, which refers to media with content involving general users, including bulletin boards and word-of mouth websites.
*2 A magazine that can be viewed online. The Company distributes the Web magazine StockShot that brings together 4 types of content, and it has more than 1mn PV per month.
*3 A service that uses as AI engine to analyze customers' browsing and purchase histories to distribute recommended StockShot articles by LINE, e-zine, and push notifications in the app automatically. This gives customers access to information that not only gives them an idea of whether a price is high or low, but also whether it reflects the features, performance, and preferred attributes that they are looking for.

Summary of results

In FY3/23, achieved high earnings levels as growth in the strongly performing Cameras business offset struggles in the Watches business due to falling prices

1. Summary of the FY3/23 results

(1) Results summary

In the FY3/23 results, net sales increased 5.0% YoY to ¥45,618mn, operating income decreased 21.6% to ¥2,463mn, ordinary income declined 23.5% to ¥2,439mn, and net income decreased 23.1% to ¥1,697mn. Although sales rose but profit fell, the Company achieved record-high net sales and the second-highest level ever of operating income. However, results came in below the Company's initial forecasts due to a weak performance in the Watches business (results were above the Company's revised forecasts announced on February 7, 2023).

The mainstay Cameras business expanded sharply as one-to-one marketing utilizing AI was successful and sales of major new products from camera manufacturers invigorated the overall market. However, overall earnings were below the Company's initial forecasts because of weakness in its other core business, the Watches business. In addition to lackluster duty-free sales (store sales) reflecting the effects of world affairs such as lockdowns in China, a steep decline in market prices globally from 2H FY3/23 resulted in sluggish performance for the segment. Essentially, overall earnings levels remained high as unexpectedly weak results in the Watches business were offset by growth in the Cameras business. Also, the Watches business is apparently recovering now. Further, the Writing Instruments and Bicycles businesses are doing well.

In terms of profit, the Cameras business maintained a high gross margin, whereas the posting of a loss on the valuation of goods and the sale of goods at a loss squeezed profit in the Watches business. As a result, the overall gross margin declined sharply to 17.0% from 18.5% a year earlier. Also, the SG&A expense ratio rose to 11.6% from 11.3% a year earlier, owing to factors such as growth in credit usage fees and personnel expenses accompanying higher basic salaries. As a result, the operating margin decreased to 5.4% from 7.2% a year earlier.

In terms of financial condition, total assets rose 4.6% from the end of FY3/22 to ¥15,066mn, mainly reflecting increases in cash and deposits and merchandise (inventory). Shareholders' equity increased 18.5% from the end of FY3/22 to ¥6,477mn due to higher retained earnings, so the equity ratio improved to 42.9% from 37.9%. Merchandise (inventory) came to ¥8,812mn, up a slight 5.8% from the end of FY3/22 but down sharply from the end of December 2022 (¥11,234mn) when there was a temporary buildup due to the year-end shopping season. Also, purchase costs have apparently fallen due partly to the replacement of inventory.

(2) Gross margin and SG&A expenses conditions

Gross margin (overall) for FY3/23 was 17.0%, significantly lower than the 18.5% of a year earlier. This is because, as previously mentioned, the Cameras business maintained a high gross margin thanks to stable operation of AIMD, but Watches business profit was squeezed by revisions to sales prices in accordance with falling market prices, sales of merchandise at a loss to bring inventory to appropriate levels, and the posting of a loss on the valuation of merchandise inventory. It should be noted that the Company's business model itself has not become less profitable. Accordingly, the Company forecasts the gross margin (overall) will recover again to 18.0% in FY3/24 when inventory level optimization will wind down. As for SG&A expenses, personnel expenses rose accompanying higher basic salaries, and sales-linked promotion expenses, credit usage fees, and operational expenses associated with investing in new system development increased. As a result, the SG&A expense ratio inched up to 11.6% from 11.3% a year earlier, but it is reasonable to view the ratio as under control at the 11% level.

Breakdown of SG&A expenses

(¥mn)

	FY3/22		FY3/23		Change	
	Result	Ratio to net sales	Result	Ratio to net sales	Amount	%
SG&A expenses	4,894	11.3%	5,290	11.6%	396	8.1%
Personnel expenses	1,545	3.6%	1,645	3.6%	100	6.5%
Advertising expenses	47	0.1%	36	0.1%	-11	-23.1%
Promotion expenses	895	2.1%	939	2.1%	44	4.9%
Outsourcing expenses	354	0.8%	370	0.8%	15	4.5%
Commission expenses	1,001	2.3%	1,157	2.5%	156	15.7%
Depreciation	187	0.4%	193	0.4%	6	3.2%
Rent expenses on land and buildings	349	0.8%	352	0.8%	3	0.9%
Other	512	1.2%	593	1.3%	80	15.8%

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

2. Results by business

(1) Cameras business (EC ratio: 86.2%)

Both net sales and profits recorded steady growth, with new record highs of 17.3% YoY in net sales to ¥32,721mn and 20.8% YoY in segment profit to ¥3,810mn. One-to-one marketing utilizing proprietary mechanisms and services that harness AI, such as AIMD and AI-based content recommendations, which the Company has been working on since the previous fiscal year, functioned effectively, and EC sales have been robust. In May 2022, the Company began notifications using LINE (push notifications) in addition to mail and app notifications to make its service more convenient for smartphone users. The brisk performance of the camera market as a whole due to manufacturers releasing new products also contributed to earnings growth. Store sales made a steady recovery too, due in part to the new products effect. In terms of profit, the gross margin for used cameras improved thanks to stable operation of AIMD, which led to a sharp increase in segment profit. The segment profit margin also maintained a high level at 11.7%, up from 11.3% a year earlier.

(2) Watches business (EC ratio: 50.5%)

Net sales declined 19.2% YoY to ¥11,603mn and the segment turned to a loss of ¥191mn from a profit of ¥1,129mn a year earlier. The Company focused on securing one of the largest inventories of Rolex watches in Japan by strengthening purchases of the popular brand as part of strategic efforts to expand the product lineup since the previous fiscal year, and providing a vast product lineup on its EC website. However, the Chinese government's zero-COVID policy led to weak duty-free sales (store sales), and luxury watch prices* declined globally to sharply depress results. In particular, the Company's strategic increase in investments in inventory in preparation for the year-end shopping season dovetailed with a slump in prices, which led it to resort to selling merchandise below cost (at a loss) from December onward to bring inventory to an appropriate level, and post a ¥219mn loss on the valuation of merchandise inventory at the end of FY3/23, which substantially squeezed profit. However, prices in the market have been gradually improving since February 2023, and duty-free sales are recovering along with a resurgence of inbound demand.

* Watch prices dropped sharply during FY3/23, falling over 30% for popular products such as Rolex. They were affected by the aftermath of advancing global inflation alongside fluctuations in commodity prices, dramatic swings in foreign exchange rates due to various countries' monetary policies, and prolonged geopolitical risk in Europe.

(3) Writing Instruments business (EC ratio: 76.9%)

Net sales rose 12.2% YoY to ¥438mn and segment profit grew 593.2% to ¥38mn. The Company increased its sales through the planning and sale of original products in collaboration with manufacturers, enhancing its own product lineup by offering a large selection of rare model fountain pens and other products, and expanding sales of used products by strengthening the purchase of used products. Profit increased substantially, owing to the setting of appropriate sales prices and improved productivity via sales floor remodeling.

(4) Bicycles business (EC ratio: 63.7%)

Net sales and profit increased YoY. Net sales rose 7.8% to ¥854mn and segment profit grew 36.1% to ¥55mn. Although the one-time demand boost related to the pandemic ran its course, net sales rose in response to sending out information regularly via the Company's smartphone app and the effect of various sales initiatives on its EC website. A boost in demand for duty-free Japanese parts (which are popular worldwide) also contributed to sales growth. Profitability continued to improve steadily as a result of prioritizing efficiency in operations.

3. Global expansion

In cross-border EC, Map Camera (Cameras business) opened a store on eBay, the world's largest online marketplace, in August 2017. GMT (Watches business) also opened a store in May 2019 on Chrono24, a leading global luxury watches marketplace, as well as one on eBay in July 2020 to steadily establish a structure for business expansion. In addition, the Company's emphasis on the quality of service has helped it to establish brand power overseas too, with cross-border EC sales steadily expanding to about ¥2.5bn (roughly 1.6x the year-earlier level) in FY3/23. Notably, Map Camera received the highest award at the eBay Japan Awards 2022. Also, the Company introduced Buyee Connect (a purchase support service for overseas customers)* on November 7, 2022, enabling its approximately 3.30mn web members in 118 countries (regions) to purchase all items listed on its website, including road bikes and writing instruments.

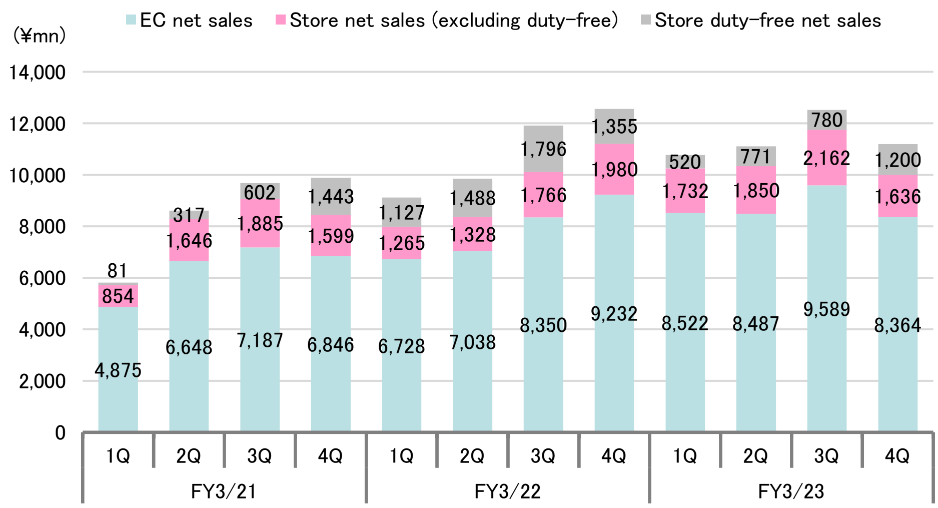
* A purchase support service for overseas customers provided by tenso, inc., a consolidated subsidiary of BEENOS <3328>.

4. Trends in quarterly results and KPI

(1) Trends in quarterly results

Looking at the quarterly trend in net sales from FY3/21, sales fell greatly in the 1Q of FY3/21 due to the pandemic but from 2Q onward, sales benefited from the tailwind of nesting demand and the effect of various measures. Consequently, EC sales were brisk and even exceeded prepandemic levels. In FY3/22, although COVID-19 continued to have an impact, EC sales expanded steadily, while tax-free sales in the Watches business also made a significant contribution due to strategic enhancement of the product lineup. As a result, results in the 4Q set a new record high on a quarterly basis. In FY3/23, the Watches business was weak because duty-free sales were depressed by lockdowns in China and global prices fell sharply, but the Cameras business continued on a growth trajectory, so overall results levels stayed high led by EC sales.

Trend in quarterly net sales

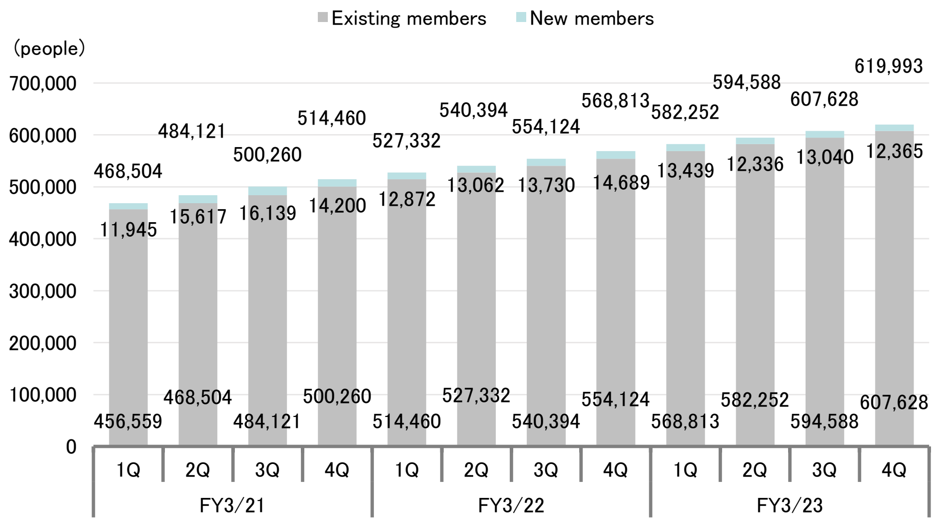


Source: Prepared by FISCO from the Company's results briefing materials

(2) Number of web members

The number of Web members exceeded 600,000 and continued to steadily increase to 619,993 people (up 51,180 people from the end of the previous fiscal year) at the end of March 2023. The factors in the background to this are considered to be that, as a result of stay-at-home orders due to COVID-19, an increasing number of people are purchasing cameras as a hobby that is affordable and familiar, and that in addition, the measures implemented up to the present time to strengthen EC are proving successful and awareness is rising of the Company's brand and the websites it operates. Looking at the percentages of sales by age group, the percentage of the group aged from 10 to 39 is 40.7%, while due to the spread of Instagram and other SNS, the percentage of females aged from 10 to 39 is high in comparison to other age groups at 23.1%, making them a new target group. Also, the percentage of the young generation is increasing, and it can be said that a noticeable trend is that even in this situation, the average use unit price is being maintained.

Quarterly trends in the number of Web members



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

(3) Purchasing numbers and the active rate

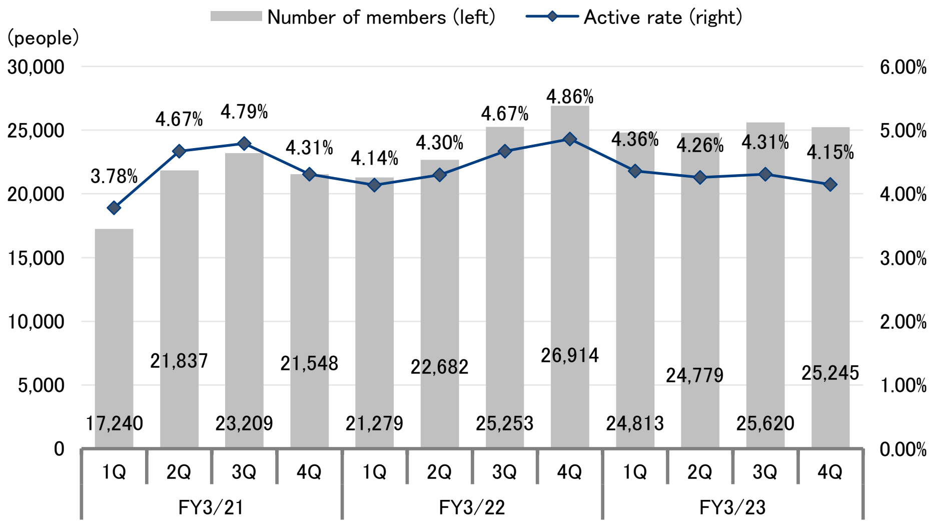
Both the number of purchasing members and the active rate continue to trend strongly, along with a net increase in the number of new members. The number of registrations for wish lists*1 and email notifications of product arrivals are also both growing steadily, and it seems that a factor for this is that these one-to-one marketing measures are maintaining a high active rate. In particular, the Company began providing product arrival notifications using LINE in addition to email and app notifications in May 2022, which resulted in a big increase in the number of communications*2. Further, combining one-to-one marketing, AIMD, and AI-based content recommendations has also increased the number of requests sent out when registered products drop in price*3, which is contributing to the expansion of transaction opportunities.

*1 The number of products registered on wish lists are on an uptrend at 70,000-80,000 items per month lately, and grew to 1,978,392 items at end of FY3/23 (up 276,364 from the end of the previous fiscal year).

*2 The number of registrations for email notifications of product arrivals exceed 120,000 to reach 123,393 (up 21,705 from the end of the previous fiscal year), and the monthly average number of emails sent out amounted to 400,000, contributing to maintaining and improving the active rate.

*3 The Company sends a monthly average of 4.00mn smartphone notifications. Given that the Company's brick-and-mortar store in Shinjuku has a monthly average of 15,000 visitors, this corresponds to the information delivery capability and customer contact points of over 260 stores.

Trends in number of members and active rate

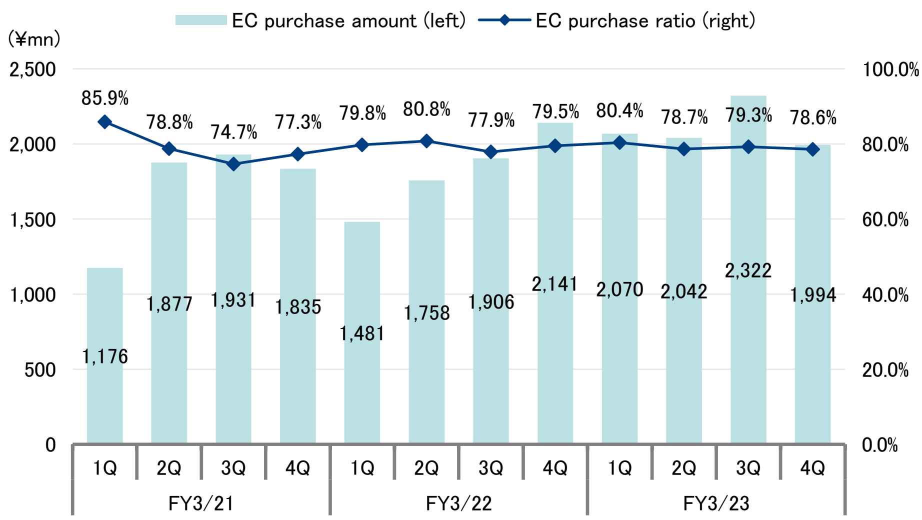


Source: Prepared by FISCO from the Company's results briefing materials

(4) Used cameras purchase amount

For the used cameras purchase amount also, the measures intended to strengthen EC, including introducing an AI facial authentication system (June 2020), AIMD (March 2021), and AI-based content recommendations (March 2022) are proving successful, and the EC purchase ratio is trending at a level close to 80%. The receive-first, send-later service and the trade-in exchange service, which are two of the various differentiation factors, are also both performing well and contributing to the increase in the EC purchase ratio.

Trends in the EC purchase amount and the EC purchase ratio



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

5. Summary of the FY3/23

In summary, the Company's performance in FY3/23 is commendable in that various EC initiatives, including utilizing AI, fueled solid expansion in the Cameras business to deliver high earnings levels, despite unexpected weakness in the Watches business. In particular, the Company has been doing well each quarter on key KPIs, so it is reasonable to conclude that its business model is continuing to steadily evolve. As for the Watches business, which dragged on overall performance, the Company has acted decisively to optimize inventory levels (lower the cost of purchase). FISCO views that positively as a decision targeting a V-shaped recovery. Additionally, the Company's activities looking to the future such as strengthening cross-border EC and opening a revamped BRILLER (ladies' brand salon)* delivered some results.

* On November, 1, 2022, the Company opened BRILLER redefined as a ladies' brand salon. For details, please see the previous FISCO report (published on January 12, 2023).

Business forecasts

Company expects sales and profits to rise in FY3/24 as Cameras business grows and Watches business earnings improve

1. FY3/24 forecasts

The Company forecasts higher sales and profits in FY3/24, with net sales to rise 9.7% YoY to ¥50,028mn, operating income to grow 26.8% to ¥3,122mn, ordinary income to rise 26.8% to ¥3,092mn, and net income to increase 25.7% to ¥2,133mn.

It assumes the strongly performing Cameras business will continue to drive net sales growth, mainly in EC. On the other hand, its initial outlook for the Watches business is conservative calling for slightly lower sales, despite signs of improvement in market prices, which were responsible for the segment's weak performance in FY3/23, and prospects for recovery in inbound demand (duty-free sales). Also, the Company expects ongoing steady growth in the Writing Instruments and Bicycles businesses.

In terms of profit, the Company expects growth in the Cameras business and earnings improvement in the Watches business to drive profit growth. In particular, it envisions the gross margin making a V-shaped recovery to 18.0% from 17.0% a year earlier, owing to the effects of using AIMD (including upgrades), as well as the erasure of one-offs (sale of goods at a loss, posting of losses on valuation, etc.). In addition to an increase in sales-linked expenses such as promotion expenses and credit usage fees, it also expects a higher gross margin to offset higher SG&A costs accompanying the reinforcement of human capital with an eye to future business expansion and the renewal of mission-critical systems, such that operating income grows and the operating margin improves to 6.2% from 5.4% a year earlier.

FY3/24 forecasts

(¥mn)

	FY3/23		FY3/24		Change	
	Result	%	Forecasts	%	Amount	%
Net sales	45,618		50,028		4,409	9.7%
Cost	37,864	83.0%	41,027	82.0%	3,162	8.4%
Gross profit	7,753	17.0%	9,001	18.0%	1,248	16.1%
SG&A expenses	5,290	11.6%	5,879	11.8%	588	11.1%
Operating income	2,463	5.4%	3,122	6.2%	658	26.8%
Ordinary income	2,439	5.3%	3,092	6.2%	652	26.8%
Net income	1,697	3.7%	2,133	4.3%	435	25.7%

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

2. FISCO's outlook

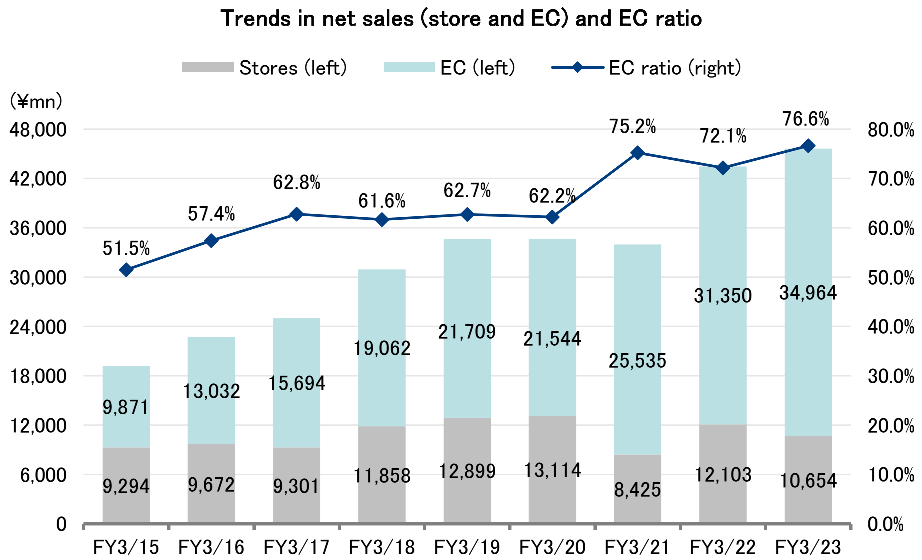
Although impact from things like the unstable economic climate and market fluctuations continue to require attention, FISCO also believes that the Company is fully capable of attaining its forecasts, given that its business model centered on EC is continuing to steadily evolve, and temporary negative factors in the Watches business should drop out. In particular, there is potential for results to top the Company's conservative forecasts if market prices for luxury watches are stable and inbound demand recovers. Points to watch are new measures leveraging technology such as the AIMD upgrade (Cameras business) and AI system to support merchandising (Watches business), and their effects. FISCO will be watching to see how the Company ties further evolution of its business model, starting with its use of AI in the Watches business in light of its reflection upon events in FY3/23, to earnings growth.

Results trends up to the present time

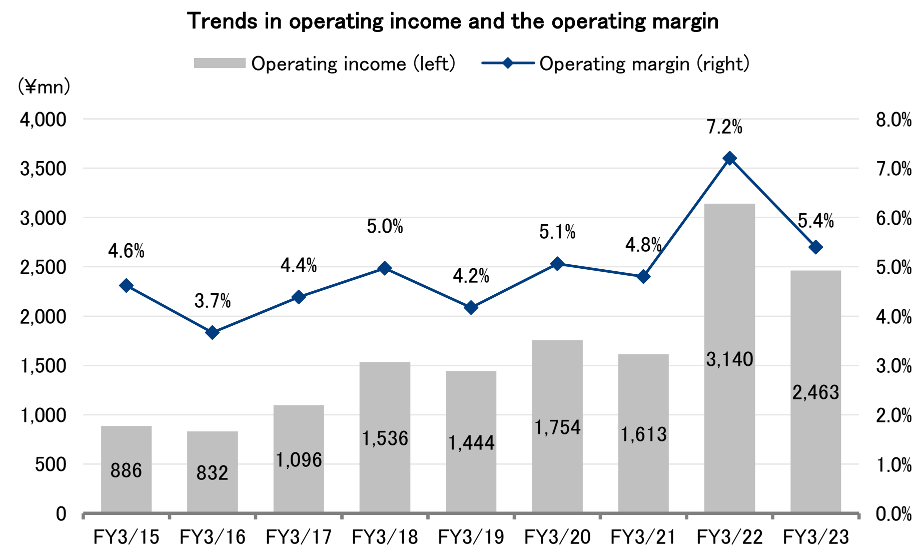
Realized upward growth through the increase in the number of Web members resulting from unique EC initiatives, including those harnessing AI

Looking back at the Company's results through the previous fiscal year, net sales have achieved steady growth along with an increase in web members and growth in EC sales. Although sales growth was sluggish for two consecutive fiscal years from FY3/20 onward due to the Company's focus on improving gross margins over sales growth, the impact of the consumption tax hike, and a drop in store sales due to COVID-19, in FY3/22, the Company achieved a significant increase in sales with the impact of a variety of EC measures (including the introduction of AIMD) and growth in the Watches Business resulting from strategic inventory investments. Average annual growth rate over the nine years from FY3/13, when the Company went public, to FY3/23, is 13.86% (of which the average annual growth rate of EC sales was 18.81%). Profits (operating income) have also generally increased along with sales growth. While operating margin has been in the 4%-5% range for some time, the introduction of AIMD improved gross margins and helped curb SG&A expenses, resulting in a significant improvement in the profit margin in FY3/22. In FY3/23, an operating margin of 5.4% was secured despite a temporary slump in the Watches business, so it can be said that the Company's real earnings capacity has increased.

Results trends up to the present time

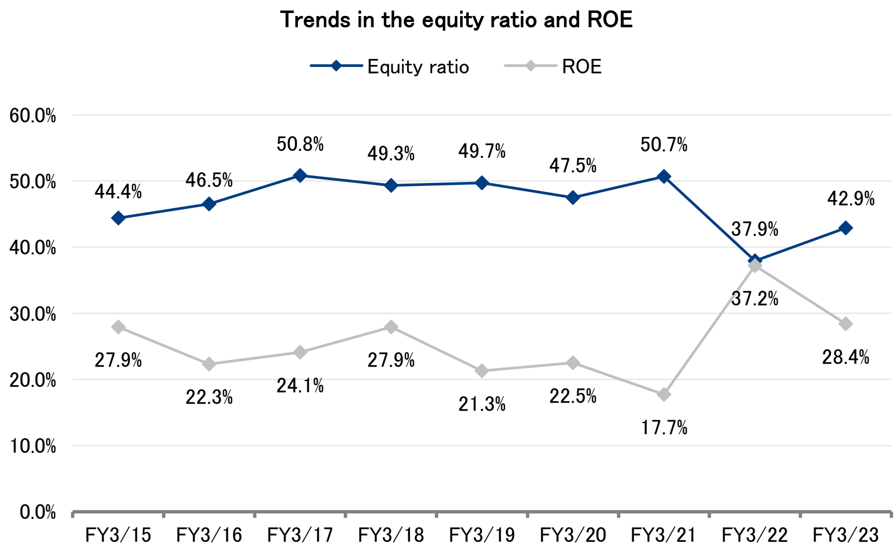


Source: Prepared by FISCO from the Company's results briefing materials



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

Meanwhile, in terms of finances, while the shareholders' equity ratio remained stable at the 50% level for some time, it fell to 37.9% in FY3/22 due to the acquisition of treasury shares from the founder. Nevertheless, ROE, an indicator of capital efficiency, rose to 37.2% and remained close to 30% in FY3/23.



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

Medium- to long-term strategy

Announced a new medium-term management plan (rolling method). No change in the Company's direction of aiming for profit growth through the use of AI and lean management while working toward further growth in Cameras and Watches businesses and on cross-border EC

1. Business environment

(1) Cameras market

The camera market contracted for some years amid the spread of smartphones, but has picked up since FY2020, when the transition to full-size mirrorless cameras began in earnest and companies all began releasing highly anticipated new products, which has been a boon for specialty camera stores. Full-fledged migration to full-size mirrorless cameras is especially expected to gain steam accompanying the resolution of the semiconductor shortages through the first half of 2022. The number of people taking up photography seriously as a hobby and engaging in video-related work is on an upward trend, which has led to a shift in camera buying activity from volume retail stores to specialty camera stores in the quest for more "professional" equipment. The used camera market is also expected to remain brisk for some time, because products that are replaced by the latest model go on sale as used items. The Company estimates that its market share is around 10% in the new camera market and around 20–23% in the used camera market. It is one of the top companies in the used camera market.

(2) Watches market

In 2022, the imported watch market in Japan is estimated to have grown 26% YoY to ¥738.1bn (Japan Clock & Watch Association "January-December 2022 Size of the Japanese Watch Market (Estimated)"). This is partly because there was strong motivation to sell products even if it meant lowering prices amid weak inbound demand (duty-free sales) due to COVID-19 and falling global prices for luxury watches. Since the market remains on a growth trend even excluding impact from temporary market fluctuations, the Company's view that it will continue to be an attractive market in the future is unchanged. It is a market with significant room for growth for the Company, which has a roughly 2% share. The Company has been investing strategically in inventory since announcing in September 2021 its aim to become the top Rolex store in Japan. It expanded its Rolex listings to one of the largest in Japan at the end of 2021 and has worked to further enhance its product lineup, but that proactive approach was affected by falling market prices, which led to temporary struggles. However, market prices stopped declining in January 2023, and duty-free sales swung to sharp recovery in February.

2. Medium-term management plan

Each year, the Company updates its three-year medium-term management plan on a rolling basis, and in May 2023, it announced a new medium-term plan. Since FY3/23 results were below plan due to a slump in the Watches business, the Company revised down* the medium-term management plan it announced in 2022, and established a new plan for FY3/26. However, it expects to sustain strong growth, forecasting an average annual growth rate over the next three years of 11.4% for sales and 25.2% for operating income.

> * Compared to the medium-term management plan announced in 2022, the company has revised its forecast downward. For FY3/24, net sales and operating income will decrease from ¥53,936mn to ¥50,028mn and from ¥4,500mn to ¥3,122mn, respectively; for FY3/25, from ¥60,385mn to ¥56,173mn and from ¥5,091mn to ¥3,893mn, respectively. This is largely due to the revision of the Watches business.

The Company intends to continue to focus on EC by utilizing new technology, further grow its mainstay Cameras business, take its Watches business from recovery to expansion, and to revitalize its global expansion through cross-border EC, etc. It looks to 1) use AI to maximize sales and profits and 2) prioritize profit growth over sales growth by reducing the SG&A expense ratio through lean management. Regarding 1), it will work on improving inventory turnover for cameras by upgrading AIMD, and building an AI system to support merchandising in the Watches business to create a framework that is not susceptible to fluctuations in market prices. Regarding 2), some logistics-related expenses may increase with growth in transaction volume, but the Company plans to curb fixed costs and reduce variable costs by introducing systems and reinforcing data infrastructure to make operations more efficient. Moreover, it targets 1.25-fold increase in net sales per employee by FY3/26 through investments in IT to improve productivity and operating efficiency. As a result, the Company aims to achieve net sales of ¥63,141mn (a three-year average annual growth rate of 11.4%) and operating income of ¥4,827mn (an operating margin of 7.6%) in FY3/26, the final year of the plan.

Overview of the new medium-term management plan

(¥mn)

	FY3/23		FY3/24		FY3/25		FY3/26		Average growth rate
	Result	%	Forecast	%	Forecast	%	Forecast	%	
Net sales	45,618		50,028		56,173		63,141		11.4%
Cameras	37,721	71.7%	37,196	74.3%	41,347	73.6%	45,982	72.8%	6.8%
Watches	11,603	25.4%	11,345	22.7%	13,083	23.3%	15,116	23.9%	9.2%
Writing instruments	438	1.0%	507	1.0%	597	1.1%	705	1.1%	17.2%
Bicycles	854	1.9%	980	2.0%	1,144	2.0%	1,337	2.1%	16.1%
Gross profit	7,753	17.0%	9,001	18.0%	10,160	18.1%	11,461	18.2%	13.9%
SG&A expenses	5,290	11.6%	5,879	11.8%	6,267	11.2%	6,633	10.5%	7.8%
Operating income	2,463	5.4%	3,122	6.2%	3,893	6.9%	4,827	7.6%	25.1%
Ordinary income	2,439	5.3%	3,092	6.2%	3,863	6.9%	4,797	7.6%	25.3%
Net income	1,697	3.7%	2,133	4.3%	2,665	4.7%	3,310	5.2%	24.9%
Number of employees*	263		285		286		287		3.0%
Net sales per employee	176		182		196		220		7.7%

* Includes dispatched and part-time workers
Source: Prepared by FISCO from the Company's financial results and results briefing materials

3. Initiatives in FY3/24

The Company intends to drive forward with the measures below, applying value chain scenario planning from each perspective of the four values* (all known as "shinka" in Japanese, but each expressed with different characters) that it has worked on to date.

* These are: 1) Advancement (value from progressing), 2) Depth (value from deeper understanding), 3) Authenticity (value of being authentic), and 4) Novelty (new value). These values are tied to all of the Company's initiatives and the action goals of all employees. The Company intends to leverage these values in strengthening employee training and engagement and in operational reviews, leading to improved productivity in the form of higher net sales per employee.

(1) Upgrade AIMD (Cameras business)

By increasing the frequency of AIMD price changes, the Company looks to increase its accuracy in finding the sweet spot between itself and customers, prevent unnecessary price reductions and opportunity losses, and further increase sales, turnover rates, and gross profits for used items.

(2) Build an AI system to support watch merchandising (Watches business)

The Company will use a financial engineering approach to build a system to support merchandising decision-making (plans to conduct pilot operations looking to the December shopping season). By analyzing changes in watch prices by product to estimate and promptly ascertain uptrends and downtrends, it looks to facilitate the optimization of inventory levels and enhancement of profit in the Watches business.

(3) Bolster online purchase estimates (Watches business)

The Company intends to expand the scope of its online purchase estimates to the largest in the industry at 4,000 items (currently 2,600 items) to further promote real-time purchases and replacement purchases (implementation scheduled for 2Q).

(4) Enhance LINE and YouTube content (all businesses)

Especially in the Cameras business, the Company aims to reach Generation Z by establishing a new department devoted to content (Content Creation Department) and actively distributing video content, mainly via YouTube.

(5) Promote collaboration with FUKUI CAMERA SERVICE, Ltd. (Cameras business)

The Company will further advance collaboration with FUKUI CAMERA SERVICE, Ltd., which it concluded a capital and business alliance with on January 26, 2022. Specifically, it looks to improve productivity, enhance camera repair expertise, and secure space for storage in connection with growth in merchandise inventory by newly outsourcing some of the commercialization processes in its operations from purchasing items to listing them online, in addition to operations that it already outsources (repairs, checks of items conditions).

(6) Strengthen data infrastructure (all businesses)

Along with building mission-critical systems, the Company will revamp data warehouses*1 and business intelligence (BI) tools*2, with the aim of improving the productivity of current operations, including merchandising support and head office functions, and contributing to medium- to long-term new service development*3 and operational efficiency enhancement. The Company plans on investing ¥490mn in IT in FY3/24, and making capital investments totaling ¥930mn over three years.

*1 Systems dedicated to data analysis, which excel at large volume data storage, aggregation, and so forth.
*2 Tools for the analysis and visualization of accumulated data
*3 The Company apparently plans to use generative IT and various other AI technologies for things such as externally providing product prices via API, developing new ways of recommending items, and offering real-time online customer services.

4. SDGs initiatives

Regarding SDGs (sustainable development goals) that have been receiving strong interest from investors, the Company wants to leverage initiatives aimed at resolving social issues in boosting its own enterprise value, just as it has done up to now, through "newly created businesses for important products with value" and "development of an easy-to-work environment." In particular, as one concrete example of an effort in "newly created businesses for important products with value," it replaced all the paper used in items like product packaging and name cards with eco-friendly materials. Its policy is also to change the original goods and the novelty goods in consideration of the environment. In addition, the Company enhanced its information disclosure in 2022, including by starting to disclose information based on the recommendations of the Task Force on Climate-related Disclosures (TCFD)*1 and responding to the CDP questionnaire*2. It also concluded an official partner agreement in July 2022 with Shougaisha Jiritsu Suishin Kikou Association*3 to take part in Paralym Art, a program that supports disabled artists. It plans to undertake multifaceted development of SGD initiatives from 2023.

*1 This organization was established by the Financial Stability Board to promote understanding and disclosure of the financial impacts on companies brought about by climate change. It announced recommendations regarding information disclosure in June 2017.
*2 This questionnaire is sent out to obtain companies' environmental information based on requests from major purchasing companies that are enthusiastic about supply chain engagement, institutional investors that make ESG investments, and so forth.
*3 The Association offers the use of art works such as paintings and designs to help disabled artists become financially independent.

5. Medium- to long-term focus points

FISCO thinks the Company's strategy of further boosting its presence in designated areas by using AI, pursuing various types of value, and placing emphasis on profit growth is reasonable. Potential upside drivers, meanwhile, are full-fledged overseas activity, including M&A and business alliances, and creation of new income sources. Regarding overseas efforts in which the Company has already carried out test marketing and increased its visibility centered on the Watches business, the Company has received positive feedback from customers and is likely to establish a new growth pillar through solidification of overseas (local) purchase formats, similar to Japan. In particular, FISCO expects further increase in feasibility from integration of the Company's success model based on collaboration with local companies that possess a customer base. The recent introduction of Buyee Connect is a highly logical strategy, because it will help to expand overseas sales channels thorough its own website, and suggests that the Company intends to prioritize cultivating the market and raising its profile. In creation of new income sources as well (such as the development of paid services that leverage its information capability and membership base and expanding into the media business), the key point is the extent to which the Company is capable monetizing a membership base with high loyalty and enhanced quality and quantity, and a format for gathering content information that is attractive to enthusiasts. FISCO will closely monitor the Company's progress in solidifying a unique business model, including the use of outside resources.

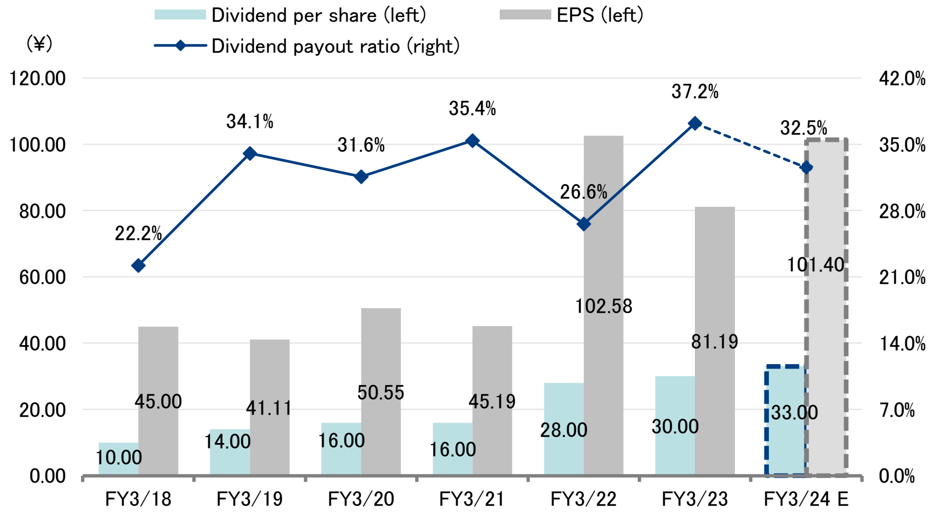
Shareholder returns

Plans to pay an ¥33 dividend in FY3/24 (up ¥3 YoY)

The Company sees shareholder returns as a management issue and has a basic policy of returning profits to shareholders through dividends. Previously, it had continuously paid a stable dividend, but from FY3/17, it changed its dividend policy to being based on the dividend payout ratio. It currently targets a dividend payout ratio in a range of 25% to 35%.

For FY3/23, the Company has decided to pay a year-end dividend of ¥30 per share (a payout ratio of 37.2%), an increase of ¥2 from the previous fiscal year. For FY3/24, the Company plans to pay a dividend of ¥33 per share, an increase of ¥3 from the previous fiscal year. If realized, that would mark the third straight year of dividend growth.

Trends in EPS, the dividend, and dividend payout ratio



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

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