

7618 PC DEPOT Corporation

Shifting to a Business Model of Smart Life Partner (SLP) Stores with Premium Membership Services

March 8, 2014

JASDAQ

Key Points

- PC DEPOT Corporation will start the fully fledged opening its new-format stores by using the equity-based funds it raised in January (2,300 million yen). The Company is shifting its business model to Smart Life Partner (SLP) stores that are based on the provision of services to their premium members. It will increase its number of SLP stores by 12 stores from 4 stores in the term ended March 2014, to 16 stores in the term ending March 2015. It is expected to further increase store numbers in the term ending March 2016.
- The Company's efforts to turn around its business performance have picked up even more speed. It is evolving its store format from specializing in desktop and notebook computers and transforming its business model to a focus on Internet devices service stores that combine merchandise and services. It has moved to a structure of generating profit by service sales and this move is showing positive effects. Although it still faces tough price competition for product sales, the Company has succeeded in taking a new course of action to be the winner in this competition and is significantly improving its profitability.
- A look at the Company's profit structure shows that sales of desktops, notebooks and other hardware represent nearly 70% of its total sales, but this ratio has dropped year after year, while service sales have grown to exceed 30%. Service sales, including technical services and premium services, represent a rapidly growing share of profits. The term "premium service" refers to the provision of convenient content and maintenance services to users who purchased desktops, notebooks or smartphones, upon payment of a fixed monthly fee.
- A cycle of up-front investment associated with new store openings was completed from the second half of the fiscal year ended March 31, 2013 (subsequently FY2012) and the contribution made by service sales exceeded the decline in product sales. Thanks to factors such as the depreciation of the yen, the decline in prices of desktops and notebooks slowed down and the Company's business performance has entered a recovery stage. It is expected to significantly surpass its past record profits, with ordinary income forecast to be 2,000 million yen (up by 2.1 times YoY) in FY2013 and 2,700 million yen (up 35.0% YoY) in FY2014.
- The Company has converted its profit structure successfully into one in which profit is ensured by steady sales of services. The establishment of new markets for smartphones and tablets is continuing, and the Company will be able to stimulate demand for various services while setting PC sales as a platform. Its target is to reach a ratio of ordinary income to net sales of 7% to 8% and ordinary income of from 4,000 million yen to 5,000 million yen, and these targets are within its reach. Even after the equity financing, the Company will see its ROE exceed the 12% level in FY 2014. With its PBR at a level of 1.7, the Company enjoys a good reputation in the market and is expected to pay more dividends in the future.

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Company rating: B

Stock price (March 7, 2014): 812 yen Market capitalization: 21,100 million yen (25.952 million shares)

PBR: 1.66 ROE: 11.4% PER: 15.0 Dividend yield: 1.0%

(except where otherwise indicated, figures are in millions of yen)

Fiscal year end	Net sales	Operating income	Ordinary income	Net income	EPS (in yen)	Dividend (in yen)
Mar. 2006	45,965	1,210	1,493	981	45.0	5.0
Mar. 2007	42,345	839	1,112	511	23.0	5.0
Mar. 2008	42,439	1,229	1,340	816	36.7	6.0
Mar. 2009	42,899	1,259	1,429	684	31.1	7.0
Mar. 2010	44,740	1,226	1,306	677	31.1	7.0
Mar. 2011	46,912	1,368	1,509	737	34.2	7.0
Mar. 2012	49,693	553	717	280	12.8	7.0
Mar. 2013	51,353	876	933	445	20.4	7.0
Mar. 2014 (forecast)	51,400	1,900	2,000	1,220	54.3	8.0
Mar. 2015 (forecast)	53,000	2,600	2,700	1,600	63.2	10.0

* Forecasts are based on financial results as of December, 2013.

Total assets: 26,471 million yen

Net assets: 10,743 million yen

Equity ratio: 40.5%

BPS: 490.2 yen

NOTE: ROE, PER and dividend yield are based on the forecast for FY2012.

On October 1, 2013, the Company carried out a share split at a rate of 1:100. The EPS and dividends for the preceding terms have been revised accordingly.

Analysis by: Yukio Suzuki
(Chief Analyst, Belle Investment Research of Japan)

Definition of Company rating: Qualitative evaluation based on criteria such as 1) management capabilities; 2) abilities to grow/maintain the business; 3) possibilities of downward revisions to earnings forecasts. The Company is expressed as a four-level rating where "A" means good, "B" means some degree of improvement is required, "C" means considerable improvement is required, and "D" means the state of the company is extremely grave.

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1. Characteristics

Objective: developing stores offering Internet device services

Moving to a New Store Format

The Company is aiming to develop IT solution stores known as Smart Life Partner (SLP) stores, with which customers can maintain relationships over the long term. As well as being able to enjoy the convenience of a neighborhood PC superstore, users can have the Company solve the problems they experience when using desktops, notebooks, smartphones, the Internet and more.

The information and communication technology market is characterized by the continuous entry of new devices and services. Customers need support in order to maintain an IT environment that enables them to fully utilize the products and services they use. The Company provides services that enable users to make full use of the features of their desktops, notebooks, smartphones, and tablets and that provide them with real convenience.

If consumers use products over a long period of time, in addition to the profit generated at the time they make the purchase, it is quite likely they will come to pay fees for services that make using such products more convenient. To make this happen, users must be satisfied with the convenience provided by the service.

The starting point for traditional retailers is merchandise, but as the Company is both a retailer and service provider, its starting point is also services. It will offer Internet-related services, mainly for devices, thereby building relations with its customers.

The Company generates profits in three ways: firstly, selling products; secondly, through technical fees for product repairs; and third, from monthly fees paid by members who receive ongoing support from the Company. Especially, the core of the Company's business is the support fees paid by its members, making it unique in the retail industry.

The Company considers its corporate social responsibility (CSR) to be to reduce the digital divide in society. To a certain extent, a digital divide arises between people who can use information and communication technologies, and those who cannot. It is not good for society as a whole when people who cannot use these technologies find themselves at a disadvantage. The Company intends to contribute to more convenient and enjoyable daily lives for these lives by supporting them in making the most of IT services. This support service is being provided by PC DEPOT, with its stores acting as a base for such services.

Business starts with personal computers

Years ago, before Takahisa Nojima became the president of PC DEPOT, he worked at Nojima Co., a consumer electronics superstore (Code No. 7419, JASDAQ). The eldest son of Nojima Co.'s founder is currently president of that company, while Takahisa Nojima, his brother, is president of

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PC DEPOT. He was in charge of supervising stores and merchandise at Nojima Co., but once personal computers began to become popular, he decided to set out on his own and established an independent business. While Nojima is still one of the shareholders of Nojima Co., there is no business relationship between that company and PC DEPOT.

Nojima was 35 years old when he started his business, which is now in its 20th year. Soon after PC DEPOT was incorporated, the gradual rise in the popularity of personal computers began. Many people wanted to own their own desktop or notebook computer, but such hardware was still beyond their reach. In those days, only a limited number of people went all the way to Akihabara, a Tokyo district famous for consumer electronics and Japanese sub-culture, to buy personal computers. In contrast, Nojima went into business selling PCs in the same way that retailers in general deal with new merchandise. The Company performance steadily improved, and in 1999, five years after its establishment, it got listed on JASDAQ.

As the Internet era emerged in 2000, the Company entered into a new phase. At the time it was listed, it operated about a dozen stores with net sales of 15,000 million yen, ordinary income of 800 million yen, and no debt.

At present, desktops, notebooks and related products are commonly sold at consumer electronics superstores. Also, there is a wide variety of specialist computer superstores. In the consumer electronics and computer superstore sectors, the Company ranks 9th in sales terms among the 11 main listed companies, but it exists in a slightly different field and does not compete directly with the biggest companies, such as Yamada Denki, Edion, and K's Denki. It should be noted that the Company seeks to emphasize its uniqueness.

Situation of store development

		Number of stores (at the end of Dec., 2013)	
PC DEPOT	Directly-managed (SLP stores included in the above)	50 (2)	PCs and related products for home users; technical support services Kanto region (Kanagawa, Tokyo, Chiba, Saitama, Shizuoka, Gunma, Tochigi and Ibaraki)
	Subsidiaries	11	PC DEPOT Stores (former PC DEPOT Kyushu) (Kyushu, Chubu, Shikoku and Tohoku regions)
	FC	5	Koushinetsu, Shikoku, Chugoku and Kinki regions
	Subtotal	66	
PC DEPOT PC Clinic	Directly-managed	49	Operations inside the premises of other mass home electronics retailers
	Subsidiaries	1	PC technical services/support counter
	FC	7	
	Subtotal	57	
Total		123	

NOTE: SLP stands for PC Depot Smart Life Partner stores, a new type of store, and franchise chain (FC) stores pay royalties.

Cooperation with K's Denki

When developing its PC DEPOT stores, which are comprehensive specialist computer retailers, the Company allowed K's Denki stores, which are operated by K's Holdings Co. (Code No. 8282),

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to become PC DEPOT franchisees. K's Denki was the second PC DEPOT franchisee. It was beneficial for both companies, in that a consumer electronics superstore began to deal with PCs.

The Company does business in cooperation with K's Denki because, according to Takahisa Nojima, management concepts of the two companies are quite similar and he feels much empathy with Shuichi Kato, Chairman and CEO of K's Holdings Co. The Company focuses on basically being a chain store operation that is easy for customers to use, for example, offering self-service sales apart for parts and offering discounts for paying in cash instead of points cards.

From the very start, Mr Max Co. (who run general discount stores) and Kitamura Co. (specializing in cameras) also became PC DEPOT franchisees. Kitamura adopted a business model similar to joint operation, while Mr Max adopted the so-called "retail concession" business model; which involved PC DEPOT outlets operating inside their stores. Afterwards, however, major consumer electronics superstores took the lead, and it became hard for discount stores to handle desktops and notebooks. The franchises run by Mr Max were acquired as subsidiaries (and are currently PC DEPOT Stores) by 2010.

Converting franchises to directly-managed stores

Aside from PC DEPOT franchises, PC DEPOT PC Clinics, which are franchise outlets providing technical services, were established as concessions inside consumer electronics superstores. PC Clinics successfully operated in many of K's Denki stores, and then the franchise was expanded.

At present, there are 50 directly-managed PC DEPOT stores (including four SLP stores), 11 stores outside the Kanto region run by the PC DEPOT Stores Co. subsidiary, and 5 franchise stores, for a total of 66 stores. In addition, there are 49 directly-managed PC Clinics, 1 store run by PC DEPOT Stores, and 7 franchise stores, for a total of 57 stores. As such, the Company currently operates 123 stores.

PC Clinics had been operated mainly as franchises until four years ago, when they were converted in one go into directly-managed stores. The Company and K's Denki agreed that direct management would be more effective for enhancing the service functions of the stores, and so the Company acquired these franchised stores. Currently, the Company operates directly-managed PC Clinics inside K's Denki stores.

Ongoing Web business

EJWORKS Co., a PC DEPOT subsidiary, is engaged in the IT solution business and has lines of business such as internet service provision and Web content creation. The Internet services market started to expand from around 2000 onward. However, this market has matured and a process of natural selection began among internet service providers. The Company is acquiring

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small-to-midsize providers and to maintaining their customer-facing services. Customers would experience a seamless transition as they would keep their original email addresses.

Moreover, the Company has recently been utilizing this subsidiary as a support team for its content development and has come to attach more importance to it. The idea is to position it as a new support base for development.

Deploying part-timers efficiently and flexibly

At the end of December 2013, in addition to 708 regular employees, 1,209 part-timers (on an 8-hour shift basis) were working for the Company. Seven categories of tasks are assigned, including operations (cashiers and baggers), attending to customers (customer-service personnel), and clinic services (preventative and recovery services); workers are trained to handle the basic tasks involved in one category in one week. They carry walkie-talkies with them in the store in order to help each other by sharing information, which allows them to ensure a high level of customer satisfaction. Many part-timers have worked for the Company for years, and they are often given the chance to become full employees.

2. Strength:

Profit structure changed into one where services also generate revenue

Specializing in PC-related technical services, keeping the leading position in the industry

The Company is strong in Japan's Kanto region and covers 90% of the population there. Consumers who want to make use of PC DEPOT support services will find there is one within reasonable travelling distance. Consumers who buy a desktop or notebook can have a Wi-Fi router set up for them at the store, and can start using their new computer as soon as they get home simply by plugging it in. This saves them from having to do the initial setup themselves. Smartphones also can connect to these Wi-Fi routers. If customers have a problem, they can call the Company's call center and get immediate attention. Users can obtain all these services just by paying a monthly fee. This service provides users with genuine reassurance and convenience.

The Company leads the industry in PC repairs and maintenance services. Moreover, the revenue generated by these services has increased by more than 20% annually, and as such are showing rapid growth. Although the Company is in 7th or 8th place in terms of number of PCs sold, it is characterized by its services.

The Company has shown a unique presence in competing with consumer electronics superstores over the past decade. It has survived well in local competition as a computer specialist, although it could not compete against major companies in terms of total sales volume. In these

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circumstances, the Company did not overextend itself when opening new stores. It decided, however, to become a customer-orientated IT solutions company, by striving to improve its services, instead of increasing the sales numbers for desktops, notebooks and other hardware. The Company changed its tack markedly in 2005. This was the second turning point for the Company since it was founded.

Trend in constituent ratios of sales

(%, millions of yen)

	2009.3		2010.3	2011.3	2012.3	2013.3	
	Sales	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Sales
Goods sales	35,572	82.4	78.2	75.8	72.3	69.0	35,425
PCs and peripherals	24,375	58.5	56.9	52.0	46.5	46.4	23,788
Accessories, supplies, and software	6,554	14.6	15.0	13.9	12.6	12.1	6,240
Used items and others	4,643	9.3	6.3	9.9	13.2	10.5	5,397
Used items and others	11,340	17.6	21.8	24.2	27.8	31.0	15,928
Sales from technical services and commissions	8,726	10.3	14.4	18.6	23.3	27.3	14,000
Royalties and other revenue (FC)	522	1.3	1.3	1.1	0.8	0.3	170
Internet-related businesses	2,090	6.0	6.1	4.5	3.7	3.4	1,758
Total	46,912	100.0	100.0	100.0	100.0	100.0	51,353

Providing solutions in combination with various services is key. The Company provides telecommunication services using EMOBILE's network as an MVNO (Mobile Virtual Network Operator). Moreover, when members subscribe to the Company's premium services, they can get support wherever they need it: maintenance, call-center services, anti-virus support, and a "full installation" service for when customers replace an old PC.

One of the Company's strengths is this lineup of original services it has developed and runs. No other PC shop is capable of delivering technical services, especially data recovery, as speedily as PC DEPOT. The competition simply cannot match the level of service that the Company's provides.

The Company set as a policy objective its transformation into a store that specializes in services, and has strengthened its commitment to this policy as it entered the Internet era. The Company has also emphasized the sale of store brand products under the name "OZZIO." However, although OZZIO accessories and supplies are highly profitable when compared with its other retail lines, the Company is moving further toward providing customers with services.

Earnings generated by premium services

The Company's business model is quite unique, even when compared to companies outside of Japan. The model consists of products sales, service sales, and its operation as an MVNO. Members enter into a three-year premium service contract. The company bears the cost of support up front, and then recovers it from the fees paid by members.

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Customers would like to use the PCs, tablets or other devices they have bought as soon as they get home. Takahisa Nojima remembers what that feels like. If after buying a PC, for example, a user takes 3 hours to do things such as create a recovery disc, set up anti-virus software, configure the initial settings and set a password, and then comes to a dead end, he or she will be stuck without some help. PC DEPOT's premium services are solutions to help such users over the Internet.

Main menu of the principal premium services

	Personal plan	Family plan
Initial setting/support	up to 3 all devices	up to 10 all devices
Wireless internet connection	complete & delivery at store front	complete & delivery at store front
Home wireless connection	setting at store front, free of charge	setting at store front, free of charge
Measures against virus infection/data leakage/entering dangerous sites	up to 3 Windows PC, Mac or smartphone	up to 10 Windows PC, Mac or smartphone
ozzio email account registration/setting	1 address	1 address
Explanation on basic operations at store front	up to 3 Windows PC, Mac or smartphone	up to 10 Windows PC, Mac or smartphone
OS upgrade & backup	up to 3 all devices	up to 10 all devices
Inspection at store front/periodic backup	up to 3 all devices	up to 10 all devices
Trouble restoration service	up to 3 all devices	up to 10 all devices
Data reconfiguration upon replacement	up to 3 all devices	up to 10 all devices
Memories in smart video	Up to 10 video tapes (VHS, 8 mm and/or miniDV), free of charge for 24 months	Up to 10 video tapes (VHS, 8 mm and/or miniDV), free of charge for 24 months
Tethering set-up	as many devices as needed	as many devices as needed
Monthly fee	2450 yen (816 yen per device)	3450 yen (345 yen per device)

Suppose a customer brings his/her old computer and member card to a PC DEPOT store, and buys a new one. The store's service personnel will then carry out all the necessary installations of software for the customer onto his or her new computer. The customer takes the new PC home, and is able to use it immediately in the same way as the old one, via the PC DEPOT-branded wireless router, without having to do anything in particular. This is convenience personified. A patent for this router's systems was registered in March 2012. The above service is provided for a monthly fee of

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2,450 yen (for up to 3 devices) or 3,450 yen (for up to 10 devices), and this fee provides other services, too. Furthermore, this service is evolving to include support for cloud computing.

PC DEPOT's business model, which generate revenue from service sales, was brought fully into operation in November 2005 and has been steadily expanded since. Conventionally, various technical services such as installing additional memory have been provided for a price. Today, members who bought their desktops or notebooks from the Company can rent a wireless router for a fixed monthly fees (depending on the service plan, members can rent from 3 to up to 10 routers with no additional), through which they can connect to the Internet without having to configure the router first.

As mentioned above, PC DEPOT also is an MVNO. An MVNO does not have its own mobile communication network, but provides services under its own brand by renting network space from major carriers. The Company provides services to customers as a telecommunications carrier, rather than acting as an agent for other carriers in exchange for incentives. This makes it possible to provide services that customers may want in a single package, making for a very convenient premium service. This service (an EM premium service supporting all devices—Personal plan) costs 5,750 yen (6,037 yen including tax) a month.

PC Clinics tend to provide only one-off technical services. Making customers into premium service users is a better strategy in order to retain them as members to whom ongoing services can be provided over a long period time. In addition, PC DEPOT's direct running of PC Clinics facilitates the agile management of PC Clinics. That is why the Company changed its policy and began managing PC Clinics directly. A breakdown of the sales figures indicates that the sales for technical services and charges (service sales) include premium services, technical services, and communication charges for PC DEPOT's MVNO services.

3. Medium term business plan:

Fully fledged opening of SLP stores that will open up the content and services markets

Launch of a new type of store: PC DEPOT Smart Life Partner stores (SLP stores)

The Company renovated a PC DEPOT store in Nishimagome, Tokyo into a Smart Life store in August 2013. The Smart Life Nishimagome Store is the first SLP store. The store displays less merchandise than a conventional store. It instead has spacious customer counters. Tablets now occupy more of the display shelves. The store format is based on the Company's new store concept, "providing services that customers need in a single package instead of simply selling products."

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The variety of professional accessories the a store stocks may not satisfy the needs of PC aficionados, but this poses no problems as customers can ask for an item at the store counter and the store will obtain it for them soon after. The name of the counter for responding to customer requests (such as computer repairs) has changed from PC Clinic to Dr. Smart, and staff members now wear a new uniform.

Starting from FY2013, the Company has been pushing forward with its SLP (“Smart Life Partner”) service. People want to use the IT services they need immediately without having to deal with anything inconvenient. Tablets and other devices are provided with content services pre-installed and with all the necessary configuration completed. This convenience allows customers to use their tablets with these services without having to do any cumbersome preparation. The customers neither need to configure the initial settings while staring at user guides nor need to call several call centers asking for help.

The Company also advises customers on Internet connections and fees for each PC, smartphone, and tablet that they are now using, thereby allowing them to lower the fees for all of their devices or to switch to more convenient service packages.

The “Smart Pack” billing plan is also coming into wide use, which includes a hardware device, software, and Internet connection in a single package. This package allows customers to use hardware, software and an Internet connection by simply paying a monthly fee instead of having to buy a hardware device and paying a monthly fee for the necessary software and Internet connection. Although this is a type of loan of an amount determined by subtracting the product’s estimated residual value at the end of the loan term from the product’s sticker price, as customers are familiar with the billing plans of Japanese cell phone carriers, which require a two-year subscription, they find this system both acceptable and convenient. A PC with a data connection via an EMOBILE Wi-Fi router is available for a monthly fee of 4,990 yen. The charge for the hardware is included in this fee. Computers to which Smart Pack can be applied to include the Apple Mac and the Sony Vaio. For Sony tablets, the monthly fee is set to 2,990 yen, which is a sufficiently reasonable price to encourage take-up.

The Company is fully engaged in innovating at its stores. The PC DEPOT logo includes the terms “Low Price” and “The Computer Superstore,” and its image is that of a PC supermarket, but in some areas this image no longer reflects the reality. Therefore, these two terms were removed from the logo of the new stores.

Smart Life stores will not just sell products; they will create packages and provide customers with the solutions that they want. Their customers will become members who will use the services they offer over long periods of time. PC DEPOT’s president, Takahisa Nojima, stressed that the approach for Smart Life stores will not be to simply display products and ask customers to choose the ones they like. Instead they will be offered a one-stop service to provide them with the Internet

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communications that they want. Consequently, the atmosphere of these stores will be different to that of conventional stores and customer counters will be placed centrally within them.

Inventories decrease in Smart Life stores. By helping free customers from the burden of choosing products and services themselves, the role of these stores will be to provide the services needed by customers, as a result reducing inventories. However, a fixed level of account receivables will accumulate on the balance sheet because the merchandise will be in the form of packages made up of hardware, software, and content, with sales being collected in the form of monthly charges.

Launching the second SLP store

The second SLP store was opened in Higashifuchu in November 2013. Again, an existing store was totally renovated to create the SLP store. Investment cost per square meter of an SLP store is small, but personnel expenses are high, because services are provided on a face-to-face basis. Usually, when a new store opens, sales rise immediately after, but then become slightly sluggish three to six months later. The big question is how long the store can stably maintain this business, although it has prospered up to now.

The two SLP stores are well-known and have regular customers because they were both converted existing PC DEPOT stores. The key to their success is how many new service-oriented customers they can acquire. SLP stores can be set up even if the location is less than favorable. Both the Nishimagome and Higashifuchu stores are located on the second floor of a building. Even if they do not have dedicated parking lots, they can still attract customers if there are coin-operated parking lots around the building. As the Company now knows that these stores can be a success, it is expected to increase its opening of SLP stores in FY2014 and beyond.

Store development history of PC DEPOT

(number of stores at the end of each FY)

	1994	1999	2004	2005	2009	2010	2011	2012	2013 (forecast)	2014 (forecast)	2015 (forecast)
PC DEPOT Directly-managed (SLP stores)	1	10	28	32	43	44	48	50	50	52	54
Subsidiaries	0	0	0	0	4	4	12	11	11	11	11
FC	0	8	32	24	17	17	5	5	5	5	5
PC DEPOT Directly-managed	0	0	0	0	0	30	46	49	49	49	49
PC Clinics Subsidiaries	0	0	0	0	0	0	1	1	1	1	1
FC	0	0	0	5	24	6	7	7	7	7	7
Total	1	18	60	61	88	101	119	123	123	125	127

(Note) SLP stores include both new and renovated stores.

It has started opening a large number of stores, but there is a lot of room for store expansion

The Company raised 2,300 million yen through equity finance in January 2014. As the destinations for these funds, the Company plans to allocate 900 million yen to opening new stores, 1,100 million yen to renovating existing stores, and 300 million yen to improving its IT system.

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In terms of new stores, FY2014 will see the opening of two stores, with another two stores scheduled to be opened in FY2015. The Company plans to renovate 15 of its existing stores. The number of SLP stores will increase from two stores at the end of December to four stores at the end of March. The Company plans to open 12 and 5 SLP stores in FY2014 and FY2015 respectively. In total, it intends to open 21 SLP stores, consisting of 4 new stores and 15 renovated stores. Among existing PC DEPOT stores, those stores that (1) are old, (2) have lost their competitiveness and (3) are close to city centers will be chosen for renovation.

The Company has already renovated and reopened two stores and has discovered that professional devices are selling better than it expected, even though these stores put more emphasis on services than selling products. Therefore, the Company has decided to maintain a certain level of inventory at its stores and so it is not necessarily the case that the inventory level of SLP stores will be considerably lower than at conventional PC DEPOT stores.

There remains considerable room for the opening of SLP stores. As a new-type store with emphasis placed on providing services, we can estimate there to be approximately 200 locations where these stores could be opened. The Company will first open stores primarily in the Kanto region to enhance its brand power through providing community-based services.

From PCs to Internet devices

The sales of PCs are declining. Will this be a problem for the Company? No, because the number of devices each person owns will increase. In place of computer sales, sales of smartphones and tablets have been growing. Desktops and notebook computers will never entirely disappear and their role as the core “player” in information technology is of course going to remain. As the number of devices owned per person increases, users will always require a network environment for these devices to use.

Where will users store their basic data? They are increasingly using cloud services, but there will be a big demand from users who want to store their data locally. In such cases, personal computers will be used as the core storage device. Nobody is saying that PCs are not needed any more. Smart devices—desktops, notebooks, smartphones, tablets, and more—are becoming increasingly diverse, increasing the potential for the provision of support services for them. This will add value to the services that only PC DEPOT can offer.

The starting point of the Company’s social mission is helping to resolve the digital divide. Doing this is likely to considerably expand the range of services and products it provides. Furthermore, it is increasing its added value by forming partnerships with content providers. It can be difficult for the elderly or busy people to set up and use an Internet connection themselves. In addition, users appreciate getting immediate support if their devices are not working properly.

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Independently developing content and services and offering 44 kinds of digital content services

The Company has been evolving its business model. At the present time, the Company is focusing on developing content and services that are compatible with Internet devices and providing them to customers as solutions.

Originally, as personal computers began to appear, its business model was similar to that of consumer electronics superstores, consisting of building computer stores and selling desktops and notebooks. However, in order for users to make full use of their computers, they needed to be also provided with software and hardware products together with their personal computers. While offering sophisticated products and services to satisfy the requirements of computer enthusiasts, as personal computers have become more popular services for computer novices have also become required. PC DEPOT's service lineup includes not only repairs, but also services for when customers are buying a replacement computer and that inform them in an easy-to-understand way about new models and software that have been announced. There is nothing more convenient for users than being able to start using their device in a moment.

Today, internet devices have diversified from being personal computers into smartphones and tablets. People have multiple devices and use them according to their needs and the occasion. And the combination of content and device meets the needs of today's consumer.

In fact, one of PC DEPOT's ideas is to install digital versions of specialist magazines onto a tablet and offer them as a package at an affordable price. The users have the content that they want immediately, in addition to being able to use the tablet freely.

Customers can purchase a Lettuce Club package with content published twice monthly at 300 yen per issue and an iPad mini (16 GB Wi-Fi only model) for a monthly fee of 1,000 yen. The contract period is for three years. If a consumer purchased these two items separately and for the same period of time as the contract, it would cost almost 60,000 yen. But with this package, customers pay only about 36,000 yen. The Company aims to package and offer services that customers want in order to retain them as long-term customers.

Acquiring members by installing content on devices

There is an increasing trend toward offering devices with pre-installed content as described above. For instance, LEVOLANT is a specialist, colorful car magazine for motor enthusiasts. The price of the magazine is 900 yen a month, but if readers pay a subscription price of 1,400 yen a month, they can get an iPad mini as well. Books and other publications can be heavy to carry around, but this package allows them to be read casually anywhere.

The reason why this package is being offered at a lower price is because the Company has capabilities in the area of content package services. If consumers already have iPad minis, they can buy the digital version of this magazine for 800 yen a month. They can of course buy an iPad and the

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magazine separately, but doing so will cost them more than 1,200 yen a month. The publisher of LEVOLANT could sell this package themselves, but they are unable to provide users with support until they master their device. On the other hand, the Company provides a one-stop service and offers support to users whenever they need it. This service is also convenient for content providers as it helps them to increase their digital audience. Forty-four types of digital content are currently available for this service.

Digital-contents services (examples)

							(yen)
Contents (magazines)	Magazines + iPad mini	Fixed prices of magazines (yen)		Contents (magazines)	Magazines + iPad mini	Fixed prices of magazines (yen)	
Weekly Toyo Keizai	1,900	690	Weekly	Nikkei PC21	1,200	630	Monthly
Nikkei Woman	1,200	600	Monthly	Mainichi ga Hakken	1,000	—	Monthly
Nikkei Business Associe	1,200	630	Monthly	News Week	1,700	450	Monthly
Nikkei Money	1,200	650	Monthly	PEN	1,400	680	Biweekly
Nikkei Trendy	1,200	550	Monthly	seventeen	1,200	500	Monthly
GetNav!	1,200	590	Monthly	non · no	1,200	630	Monthly
LEVOLANT (Le Volant)	1,400	900	Monthly	MAQUIA	1,200	550	Monthly
Lettuce Club	1,000	300	Biweekly	Marisol	1,200	780	Monthly
ESSE	1,200	500	Monthly	BAILA	1,200	650	Monthly
President	1,700	690	Monthly	eclat	1,200	880	Monthly
DigiCAPA	1,200	840	Monthly	LEE	1,200	650	Monthly
CAPA	1,200	680	Monthly	MEN'S NON · NO	1,200	650	Monthly
Mac Fan	1,200	730	Monthly	Haiku	1,200	890	Monthly
Weekly Soccer Digest	2,000	450	Weekly	Tanka	1,200	890	Monthly
WORLD SOCCER DIGEST	1,900	570	Biweekly	EVEN	1,200	720	Monthly
Nikkei Health	1,200	580	Biweekly				
Slugger	1,500	860	Monthly	Package of two magazines	1,500		
Smash	1,200	650	Monthly	Package of three magazines	2,000		
dancyu	1,200	860	Monthly	Package of four magazines	3,000		
DOS/V POWER REPORT	1,200	1080	Monthly				
Golf Digest	1,700	380	Weekly				
RIDERS CLUB	1,200	800	Monthly				
BiCYCLE CLUB	1,200	700	Monthly				
Discover Japan	1,200	980	Once in two months				
Flick!	1,200	—	Monthly				
Fujingaho	1,200	1,200	Monthly				
ELLE	1,000	690	Monthly				
25ans	1,000	780	Monthly				
MEN'S CLUB	1,000	780	Monthly				

NOTE: The monthly fee indicated is the standard fee; extremely low fees are available depending on the content offered. The iPad mini is the 16 GB/Wi-Fi model.

Need for specialist services surviving a reinvention of Internet devices

There is an accelerating trend for the position of leading player in personal communication to be shifted from personal computers to smartphones. Cloud systems are evolving as infrastructure, with the primary driver being so-called “air cloud” systems that use Wi-Fi. Computers used to be at the center of the internet, but are now giving way to net devices embedded in appliances, cars and homes, making them useable anywhere. Software is required to control such functions, and services are also required to make full use of this software. The Company is committed to the provision of these services, and has set as its objective the adopting of a strategy to expand its business to cover internet devices, and to not limit its services to computer-orientated ones.

In today’s digital era, Google, Microsoft and Apple are the Big 3. With these three top players at the center, Takahisa Nojima has set the fundamental policy for PC DEPOT as “helping users’ resolve their problems.”

The Company has registered a patent for a proprietary router. This can be used to generate revenue from service sales. Currently, the profit margin on products sales is not good, and is

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supplemented by service sales. But if products are not sold, there will be no demand for services. The Company has not seen sufficient profits generated from services because of the decline in products sales that has continued over the last few years. But the Company has finally overcome this difficulty, opening up a range of interesting new prospects.

Enhanced services

Target devices	Contents of principal services
Windows machine	Initial settings + data recovery disk Data migration + HDD backup Support with a 'one-point quick lecture
iPhone	Synchronizing iPhones and PCs Making reduced-rate telephone calls with an iPhone Listening to radio programs with an iPhone
Nexus 7	E-mail setting + account registration Protecting against viruses and leakage of personal information + 1TB Ground Pack Reading the Asahi Newspaper on the Nexus 7
iPad	Synchronizing iPads and PCs Data sharing with your Mac and iPhone + iPad Watching iPad contents on a large screen

Gaining service members by troubleshooting for our customers

In order to maintain long-lasting customer relationships, the Company has created a motto stating that it helps customers resolve their various problems. For example, when a customer calls the PC DEPOT call center, the call is also connected to the staff at the nearest store, and a three-way conversation begins. This system is useful for clarifying what kind of problem the customer is facing, what is the issue, and how the staff should respond. Sometimes a member of the service staff visits a customer, and sometimes a customer brings his/her PC to a store. The customer comes all the way to the store because he/she wants to get the PC fixed right away. At the store, a member of the service staff responds to the call for help and is able to fix the PC right away. That means a quick response. Although it requires a certain outlay, this attitude of preparedness is one of the PC DEPOT's good points.

The Company is committed to increasing the number of its premium members. Detailed data is collected and tracked for each area, in order to maximize the number of customers who become premium members when, for example, they buy a computer, visit to have a repair done, or replace their PC.

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Premium members are increasing at a very high rate. However, this does not make money in the short term. The Company needs to make an up-front investment for each router which takes a year to recoup from the monthly premium service fees. But once the initial outlay has been covered, profit is generated at a fixed rate from the second year onward.

Many users of computers, smartphones and tablets sometimes find their devices inconvenient. The Company's strategy involves providing such users with premium services and having them become premium members.

The number of members has been continuously increasing. Customers who buy products related to computers, smartphones or tablets are eligible to subscribe to the premium service. Nowadays, each family has several members with digital devices, so a growing number of members are subscribing to services for multiple devices. Various service plans for different numbers of devices are available, for example 2,450 yen for 3 devices and 3,450 yen for 10 devices. This certainly provides customer convenience thanks to the wide variety of services that can be provided. As the monthly fee increases in accordance with the number of devices, the Company's added value also increases.

The sales of services are growing steadily. What this means in practice may be somewhat difficult to understand for people not directly involved; however, the Company's policy is clear. Sales incentives like those given by manufacturers for product sales are included in product sales. Sales from premium services, repair, maintenance, and one-off service plans are classified as service sales. The Company provides such diverse services that it has not reached the point where it can analyze the details of its service sales by disaggregating sales data into the number of service subscribers and the average unit price of services it provides. This is because the number of customer and prices are not the most significant factors in this context.

The Company does not release information on the number of members, but given the variety of services it offers and the increases in the number of services and devices it supports, it is likely that the number of members is increasing by about 20% a year.

Good service leads to competitiveness, while new store openings lead to superiority over rivals

60% of visitors to PC Clinics are those who bought products at other stores. That means they interested in something other than low prices. PC Clinics support a wide-range of products owned by our customers. This brings about significant efficiency to the Company.

When considering the profits generated by products sales and from service sales from a perspective of operating profit levels, it is not possible to create a clear-cut breakdown of levels on classified into products and services. The reason why this cannot be done is that the Company's management does not differentiate products sales and service sales. Even though each staff member at stores has his/her own role, everyone provides both products and services. These sales are not

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differentiated when assessing employee performance. One pattern used involves a customer buying a product and subscribing to a service, thus becoming a regular customer of PC DEPOT, who naturally comes again to buy some other product.

Service menus of PC Clinics (examples)

	(yen)	
	Member	General
Service		
12 tickets for quick lectures	5,000	30,000
Setting-up		
Setting-up a wireless printer	3,000	10,000
Data		
Data restoration service	5,000	16,000
Setting-up an external peripheral device		
Setting-up a printer	3,000	6,000
OS/application configuration		
OS installation	0	10,000
Internet/network configuration		
Third-party provider email configuration	3,000	7,000
Smartphones/tablet devices		
Includes a mobile access point to set up Wi-Fi	3,000	10,000
Data management configuration		
Synchronizing with iTunes and synchronizing with back-up data	3,000	6,000
Configuration for peripheral devices		
AppleTV configuration	3,000	6,000
Contents/application configuration		
Setting-up for newspaper subscription	1,000	4,000

NOTE: "Member" refers to the service member of PC DEPOT; "General" refers to others.

The course means "corresponding to a subscribed course."

Consumption tax is not included, so 5% of these prices will be added as the consumption tax.

20% discount will be applied to seniors 60 years or older.

The profits derived from products sales and from service sales are subject to certain prerequisites, but even when viewed from the perspective of operating income, the structure in which service sales are highly profitable remains unchanged.

While there is an increasing trend among other consumer electronics superstores to provide similar services, the Company provides well-organized services that are accompanied by 1) in-store services; 2) remotely provided services (via a call center); and 3) services provided by staff members who visit members by car. No other company has quite the same business model as PC DEPOT.

As for product trends, following the July 2011 termination of analog terrestrial broadcasting in Japan, we stopped providing support for people switching over to digital terrestrial television, and there was a substantial decline in the sales of TV sets. Consumer electronics superstores emphasized

higher unit merchandise such as PCs and air-conditioners, causing price competition to get fiercer. In

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addition, the demand for smartphones and tablets has greatly increased. The Company deals actively in smartphones and tablets while at the same time capturing the demands for computer-related and other services as a key source of revenue.

In the competition to capture this demand for services, the Company has the advantage that is furthered by its track record over the years and its personnel. That is, the Company has set as its core policy differentiating itself from the competition. It does this by providing services that take time and effort to customers who may need more help to make full use of their purchases. The Company targets this kind of customer rather than those who do not need such services, and it is this latter kind of customer that other companies have set as their main target for their retail-exclusive operations.

Importance of risk management due to increase in accounts receivable caused by new service sales

The Company has a unique business model with its Smart Life Partner (SLP) concept. Customers face various problems when using IT services and they want solutions whether they have purchased the products and services from other stores or online. If you actually try the services provided by the Company for yourself, you will become convinced that they are far more convenient and superior to those of the competition.

In SLP-based businesses, it takes three years to collect the full amount of revenue from products and services. Products sales are recorded under accounts receivable, which increase as SLP-based sales rise, so requiring more working capital. An increase in accounts receivable will also require enhanced credit management. With regard to sales at conventional merchandise stores, the individual credit risks arising from customers paying by credit card are assumed by the credit card companies, but such risks accompanying sales at Smart Life stores must be taken on by the Company. In the event that a customer becomes unable to make monthly payments for any reason, the Company will have to assume his/her debts.

In principle, as the Company sells products and services to individual customers who use IT products, it performs identification and usage checks very carefully before sale. Volume sales to corporate customers are outside the scope of its business. In many cases, the Company may turn down a bulk purchase even from an individual customer because it is unsure whether such products and services are actually for private use. As is obvious from the above, credit risks are well controlled by stores and therefore there is no need to worry about such risks.

To increase the amount of working capital resulting from a rise in accounts receivable, up to approximately 1,000 million yen per year can be covered by the Company's internal funds. Any excess beyond this amount will have to rely on loans.

There is the potential for the additional opening of Smart Life stores. A PC DEPOT store costs approximately 300 million yen to open, but a Smart Life store and PC Clinic cost only from 100 to

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150 million yen and 10 million yen to open, respectively, if premises with existing furnishings are available. As these stores have significantly lower investment costs and inventories, it is easier for the Company to open them.

One issue is how to draw people's attention to the convenience that these types of stores can offer. Stores which open after the refurbishing of existing stores will have no problem obtaining customers since they already have existing customers from the former stores. For new stores, however, the Company must run aggressive promotional campaigns. That said, the SLP concept has boosted the Company's capability to open stores in central Tokyo. Future development is anticipated.

Focusing on human resources development

In terms of human resources, the Company has changed its conventional system of employing new graduates periodically and is inviting current students to work with them as interns or part-timers and then it will recruit some of them as regular employees when they graduate. This enables the Company to steadily attract better workers and motivates part-timers to work harder. The Company has also paid attention to the improvement of working conditions; in July 2013, it raised the base wage rate by two percent.

The Company conducts HR development to support its new-store openings. PC DEPOT has attracted employees who like PCs and moreover, it has many female employees. Its female employees have expertise in hardware, software, as well as in their usage, reflecting that working at PC DEPOT is worthwhile and fulfilling to both women and men. Employees receive training and the Company is able to staff the PC Clinics that it opens.

The Company does not impose any quotas for individual staff's sales and service performance. Instead, everything is handled on a team basis. A team consists of three to five people and, for example, there may be five teams in a store. The management concept behind this is that the team members can share their experience and thereby raise each other's levels of competency. Employees' attitude and responsiveness to customers is the key. Part-time workers who have worked for the Company for a long time are proactively promoted to full-time positions.

Another point is the stores' use of "cyber operations." This was originally a kind of risk management scheme through internal monitoring, by which the on-site staff and the head office can be connected via Internet telephone and they can ask each other about anything at any time. Support for services can also be provided from the head office. If an on-site staff member has a problem, another person in the store can immediately go and provide them with support. Being able to respond quickly in this way improves service capabilities, while customers feel they are being dealt with kindly, politely, and quickly at PC DEPOT stores.

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Response to the rise of internet shopping

There is a concern that internet shopping might be a threat to over-the-counter sales. In fact, some people browse products at stores, but actually buy them online, as the prices.

This scenario is fine for those users who are able to make full use of their newly purchased hardware. However, others are in great need of convenient services in case they do not understand how to use their new hardware fully or are faced with some problem. That is where the Company has a chance to show what it can do. Basic sales of products such as iPhones, iPads, Nexus smartphones/tablets or Kindles do not make much profit. But if customers subscribe to premium services, the relationship with them can be maintained for a long period time, and service sales will contribute to earnings. In that sense, the Company is continuing to handle new products in a proactive way.

Pursuit of lifetime value

“Lifetime value” is a concept in which the time span during which a customer uses a product is considered to be that product’s “lifetime.” The value of the customer to the business in a general sense during the lifetime of that product is raised, allowing the Company to generate sales accordingly during that time.

The Company’s service sales are growing, but in the normal growth pattern for services, they become profitable only in the second or third year of a three-year contract. Service quality should be improved so that members are encouraged to buy more products from the same store. Of course, member numbers are bigger at existing stores than at new stores. New stores have to compete in terms of products sales initially, and then, going forward, they will increase their member numbers. So, if prices go down in due to competitions of products sales, making profit at new stores would be slower than expected. By increasing members, service sales can be raised, leading to additional profits several years later.

President Nojima has set as his basic policy not losing the sales war. By doing this, the Company can obtain a quantitative increase in sales that will in turn lead to income from services. The number of service subscription members is increasing, so “lifetime value” of a particular level can be ensured, depending on the terms of the members’ subscriptions. PC DEPOT is meeting the challenge of expanding a business model that is dependent on a customer base formed of members who are subscribed to its services. The Company operates while carrying out analysis of its service sales.

Since summer 2012, the service subscription term for members has been extended from two to three years. It can be said that the effects of this have come to light during the current fiscal year.

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An ordinary profit rate target of 7 to 8% with the new business model

The success of the Company's business model as described above is also evident in its financial results. Based on its long-lasting relationships with users, it is also changing its profit structure from a flow-type to a stock-type. By realizing a profit structure reliant on service sales, the Company intends to raise its medium-term ordinary profit rate from the current 2% to around 7 to 8%. The Company's profit rate when it listed as a computer superstore around 2000 was 4.4% and it is aiming to exceed this level with its new business model.

The opening of a new SLP store requires an investment of 200 million yen (roughly between 150 and 300 million yen). Assuming 700 to 800 million yen in annual sales, the SLP stores will start contributing to earnings after three years, when their customer base of services is sufficiently expanded. As the stores can be expected to achieve an operating profit rate of 7 to 8%, their contribution to the Company will be considerable.

4. Near-term operating results:

The benefits of service sales have become apparent, and record-high profits have been achieved.

In FY2012, performance started to recover in the second half of the year

The Company achieved a better-than expected recovery in FY2012, with net sales of 51,353 million yen, operating income of 876 million yen (up 58.3% YoY), ordinary income of 933 million yen (up 30.1% YoY), and net income of 445 million yen (up 59.0% YoY).

Although same-store sales declined to 94% of the total of the previous fiscal year, service sales continued to grow, by 21%, accounting for 27% of all the Company's sales. The growth of service sales contributed to the overall strong performance, despite an increase in the number of stores and service staff as well as in system development costs.

On the balance sheet, accounts receivable increased due to the rise in service sales, while efforts were made to reduce inventories. Due to this, inventories in existing stores decreased by around 20%. There was an increase in accounts receivable from installment sales of MVNO communication terminals and from premium services (fixed-monthly-fee maintenance services).

In hardware sales, PC sales increased 2.2% YoY, as although unit prices declined 17.4%, the number of units sold increased 23.8%.

Service sales increased to 14,000 million yen (up 21.1% YoY) and as a percentage of total sales, they increased to as high as 27.3%. Thanks to the increase in service sales, the total gross profit rate improved from 29.7% in the previous fiscal year to 31.4%. In addition being caused by the opening of new stores, the increase in service sales was due to the growth in sales of tablets and

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smartphones, which occurred in conjunction with the increase in the number of Internet devices owned per person. As the number of devices owned per person grows, the service charges paid by members will also rise if they want to benefit from the services with all of their devices.

Number of stores operating for less than one year

(FY)	(number of stores)										
	2011	2011	2012	2012	2012	2012	2013	2013	2013	Total	
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	2012 3Q	2013 3Q
PC DEPOT	2	4	4	1	0	0	0	0	0	9	0
Directly-managed	1	0	2	1	0	0	0	0	0	3	0
Subsidiaries	1	4	2	0	0	0	0	0	0	6	0
PC Clinic (directly-managed)	6	3	1	2	0	0	0	0	0	6	0
Total	8	7	5	3	0	0	0	0	0	15	0

NOTE: The figure in "FY2013 3Q" under "Total" indicates the total number of stores that have been in operation for less than one year for the period from FY2012 4Q to FY2013 3Q.

The figure in "FY2012 3Q" under "Total" indicates the total number of stores that have been in operation for less than one year for the period from FY2011 4Q to FY2012 3Q.

The performance for the first half of the fiscal year failed to meet the target, but the initial full-year target was exceeded. There are two factors behind this performance. One is that store openings were concentrated in the first half of the fiscal year and there were no store openings in the second half, which meant no major costs were recorded. Another factor is that the downward trend in the sales prices of products, including computers, halted due to a weakening of the yen, with price increases seen in some product lines. Gross profit on good sales did not fall and the Company exceeded its target.

When the yen starts to strengthen, price reductions tend to follow soon afterwards. This disadvantage outweighs the benefit of a strong yen lowering procurement costs. In cases where the yen weakens, procurement costs increase, but as production sites have shifted overseas it means that procurement costs tend to be reflected in store shelf prices quicker than expected. This situation makes it easier to secure margins, including for inventory.

The Company will continue to post substantial increases in profits

The Company upwardly revised its earnings forecast for FY2013 after the end of the second quarter. The ordinary income forecast was raised from 1,600 million yen to 2,000 million yen. This is because the decline in PC prices has slowed down and the increase in service sales is making a greater contribution to the bottom line. The brisk performance of existing stores is another major factor behind the upward revision. If such favorable circumstances continue, another upward

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revision is highly likely. In the forecast analysis, the Company will achieve record-high profits for two consecutive years: 2,000 million yen for FY2013 and 2,700 million yen for FY2014 in ordinary income.

In FY2013, the Company is expected to post net sales of 51,400 million yen (up 0.1% YoY), operating income of 1,900 million yen (up 116.8% YoY), ordinary income of 2,000 million yen (up 114.3% YoY), and net income of 1,220 million yen (up 173.6% YoY). Sales for existing stores and services are expected to rise by 100% and 25%, respectively.

In the first half of the fiscal year, the Company reduced overall costs by directing advertising and publicity expenses effectively. In the second half, there will be a last-minute rise in demand before the increase in consumption tax. There will also be demand for computers to replace the old XP PCs. In order to meet such demand, the Company is hiring more personnel; it employed 120 part-timers in October and 60 in November. This increased personnel expenses by 200 million yen in the first half of the fiscal year, but they are likely to grow by around 400 million yen in the second half. Even if this is taken into consideration, actual financial results are highly likely to exceed the Company's revised forecast.

As for dividends, the Company aims to return profits to shareholders in a consistent manner over the long term, with a payout target of 20%. Increased dividends can be expected because the Company's performance is brisk.

Focusing on the effects of multiple devices and the end of Windows XP

Demand is being generated by consumers' rush to buy goods before the consumption tax hike. Also, Microsoft's termination of its support for XP is creating demand for replacement of PCs. Such trends will mean that March sales this year will be well above March sales in an average year. On the other hand, from April to June sales are expected to contract as a reaction to this frontloaded demand, and then to return to normal between July and September.

We can focus on two factors in the future market environment. One is that Internet devices, such as smartphones and tablets, will continue to sell well due to the effects of the launch of new models. Potential demand for services provided by the Company is expected to expand.

There is a view that even if sales of tablets increase, it will not lead to an increase in demand for services that were created for PCs. This view is incorrect. As people broaden their point of view and come to own multiple devices, their need for such services will rise. For instance, when a user wants to connect multiple devices and make use of and exchange information, if that person is a member of the Company's service all the settings will be done for them. This is very convenient for them.

Another factor is that Microsoft (MS) will stop providing security updates and other support for Windows XP in April 2014. Users with PCs running Windows XP will no longer be able to use them, because they will be at great risk of being infected by a computer virus if they do. This will create a

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demand for computers to replace the old XP PCs, which may eventually lead to further demand for the support services provided by the Company. There surely are many users who will want to securely transfer the data on their old PCs to their new PCs.

Comparison of earnings forecasts and of profit ratios

(million yen, %)

	2010.3	2011.3	2012.3	2013.3	2014.3 (forecast)	2015.3 (forecast)
Net sales	44,740	46,912	49,693	51,353	51,400	53,000
Gross profit	11,558	13,640	14,756	16,134	17,500	18,700
Ratio to sales	25.8	29.1	29.7	31.4	34.0	35.3
SG&A expenses	10,331	12,271	14,202	15,258	15,600	16,100
Ratio to sales	23.1	26.2	28.5	29.7	30.4	30.3
Operating income	1,226	1,368	553	876	1,900	2,600
Ratio to sales	2.7	2.9	1.1	1.7	3.7	4.9
Ordinary income	1,306	1,509	717	933	2,000	2,700
Ratio to sales	2.9	3.2	1.4	1.8	3.9	5.1

NOTE: forecast by the analyst

Performance will remain strong in FY2014

Earnings in FY2013 will depend on sales in March and are highly likely to exceed the Company's forecast. Earnings are expected to continue to grow significantly in FY2014. The ratio of ordinary income to sales may approach 5%. The Company is expected to achieve its highest ever ordinary income and it is anticipated that it will record 53,000 million yen in sales and 2,700 million yen in ordinary income.

The Company will renovate 10 or so stores. When a store is renovated, it has to stop business for about one month. Because of this, its sales will decrease, but this decrease can be recovered after the new store opens. Therefore, the renovation can be regarded as being more of a positive than as negative.

The impact of the equity finance will increase the Company's net assets to above 13,000 million yen. However, it will be able to maintain ROE in the 12% range in FY2014.

What the figures from existing stores tell us

Cumulative sales at existing stores increased 1.8% up to January 2014. However, the number of store visitors decreased by 17.8%. A simple calculation reveals that sales per customer increased by 19.6% YoY, but this figure does not reveal the truth.

Analysis of the Company's monthly figures is not as simple as that of conventional merchandise stores. This is because the number of service members grows cumulatively, and these members contribute to monthly service sales. However, since products have actually been sold, sales figures cannot be analyzed based simply on member numbers and Average Revenue Per User (ARPU), as is done for service sales of telecommunication carriers. The Company's figures include a mixture of sales from products and monthly fees. That said, it cannot be denied that service sales

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owing to this cumulative effect have made a greater contribution to the Company's favorable performance.

Looking at the quarterly-based sales results posted by the Company in the past, when it engaged mainly in products sales, sales tended to be not bad during the first quarter, decline in the second quarter and become favorable in the third and fourth quarters. This seasonal trend is now disappearing because the Company has shifted its focus from selling products to selling services. Thus, the Company's performance should become more stable.

Newly opened stores (results and forecasts)

		(number of stores)					
		2011.3	2012.3	2013.3	2014.3 (forecast)	2015.3 (forecast)	2016.3 (forecast)
PC DEPOT	Directly-managed	1	4	3	0	2	2
	Subsidiaries	0	6	2	0	0	0
	FC	0	-12	0	0	0	0
PC DEPOT	Directly-managed	30	16	3	0	0	0
PC Clinic	Subsidiaries	0	1	0	0	0	0
	FC	-18	1	0	0	0	0

(Note) New directly-managed stores are SLP stores. PC Clinics depend on projects with partners.

Growth in working capital

The recent noticeable trend is that while the number of visitors to the Company when it engaged mainly in products sales, sales tended to be not bad during the service sales have grown constantly, registering a double-digit increase. The balance sheet has seen inventory assets and accounts receivable-trade increase. As demand is expected to be frontloaded in the period before the consumption tax hike, the Company is increasing inventories toward March 2014.

As service sales grow further, sales of products that combine a subscription to a magazine with a tablet computer are to be reported as installment sales, increasing accounts receivables-trade. Store investments have settled down, but the amount of working capital needs to be increased as service sales grow.

Capital investment and cash flow

		(100 million yen)					
		2010.3	2011.3	2012.3	2013.3	2014.3 (forecast)	2015.3 (forecast)
Capital investment		16.5	15.0	19.2	11.4	7.0	15.0
Depreciation		5.1	6.0	7.2	7.3	7.0	8.0
Goodwill amortization		3.4	3.3	3.0	2.6	1.5	0.0
Internal reserve		5.3	5.8	1.2	5.5	10.2	13.4
Total		13.8	15.1	11.4	15.4	18.7	21.4

The Company is currently increasing software investments, also. This initiative is being taken in order to concentrate the Company at energies on establishing a cloud-computing system of its own, and on building its own proprietary fee-charging system. The Company plans to open a certain

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number of new stores, though it will do so while closely watching market conditions. Furthermore, it will also lay great stress on turning small stores into SLP stores and renewing old ones.

The capital-to-asset ratio at the end of December 2013 declined slightly to 40.5%. However, this is acceptable as long as it remains above 40%.

Balance sheets comparison

	2010.3	2011.3	2012.3	2013.3	2013.12
	(million yen, %)				
Current assets	10,511	11,678	14,185	13,991	17,876
Cash and deposits	1,754	2,505	2,083	2,982	2,401
Accounts receivable-trade	2,251	2,533	3,619	4,098	5,579
Inventories	5,316	5,500	7,285	5,986	8,567
Fixed assets	7,443	8,051	9,052	8,942	8,595
Tangible fixed assets	2,844	3,736	4,941	5,073	4,826
Goodwill	1,025	690	406	155	46
Guarantee deposits	1,479	1,440	1,466	1,387	1,329
Lease deposits	1,329	1,234	1,272	1,268	1,253
Total assets	17,954	19,729	23,238	22,933	26,471
Current liabilities	6,473	6,449	9,225	9,009	12,682
Accounts payable-trade	2,764	2,421	3,506	2,087	5,424
Short-term loans payable	800	700	2,100	2,550	2,900
Long-term loan payable (within one year)	690	1,004	1,518	1,849	1,559
Fixed liabilities	2,743	3,747	4,449	4,149	3,045
Long-term loans payable	1,936	2,759	3,809	3,479	2,376
Net assets	8,738	9,533	9,563	9,722	10,743
Interest-bearing liabilities	3,426	4,463	7,428	7,879	6,835
Interest-bearing liabilities ratio	19.1	22.6	32.0	34.4	25.8

NOTE: December 2013 indicates the end of the third quarter.

Responding to the consumption tax increase: Adoption of tax-exclusive pricing for services

How should the Company respond to the planned increase in Japanese consumption tax? At present, all consumer-electronics superstores displays prices including tax. The consumption tax is not displayed separately, so customers do not understand clearly how much it is.

PC DEPOT is continuing to display prices that include tax with respect to products sales. On the other hand, service prices have been shown excluding tax since November 2012. Essentially, consumers have to pay the consumption tax on top of the displayed price. This is due to the fact that, with respect to services, the Company decided to respond and prepare earlier for the increase in consumption tax.

Entering an upward phase in profitability

For FY 2013, the company is forecasting 51,400 million yen in sales (an increase of 0.1% YoY), 2,000 million yen in ordinary income (up by 2.1 times YoY), and an ordinary income ratio of 3.9%.

President Nojima believes that a ratio of ordinary income to sales in the 4% range is within the

Company's reach thanks to its series of efforts to change business models, and he has become more

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certain than ever that the Company is on track to achieving its medium-term target of 7% to 8% within a few years. He is also confident that the Company will be able to achieve an ordinary profit of an ordinary profit of 7–8%, the medium-term target, within a few years. If net sales reach 50,000 million yen, ordinary income will be 3,500–4,000 million yen, with ROE exceeding 15%.

However, if any major Japanese computer manufacturer stops making PCs, this would affect the lineup of products that the Company handles. As the Company's business model is based on the concept that the demand for services is increased by offering hardware, there is the possibility that a decrease in the number of major products may negatively affect the Company's performance. Close attention must be paid to this risk.

5. Evaluation:

The Company's innovation to change store formats can be highly evaluated.

ROE has improved significantly through the transformation of the profit structure

It was in 2005 that the Company took the decision to shift its revenue source from selling PCs to providing services. In the eight years since this decision, its earnings have been catching up with its change of business models.

Will the Company's business model remain as a niche presence or evolve into a new major move? President Nojima has to decide on which direction the Company should take. He will ponder the next step while aiming to raise profitability to 8% in terms of the ratio of ordinary income to sales, while maintaining the Company's unique position in the industry.

The Company's efforts to shift to a stock-type profit structure based on service sales have evidently borne fruit. And in FY2014, it could see its ROE reach 12%. Although the change of business model has received favorable assessments, the Company is still required to keep up its efforts as it commences its next set of business offensives, such as increasing the number of Smart Life stores. In consideration of this, the Company is rated B. (Please refer to the front page for an explanation of corporate ratings.)

The reorganization of mass home electronics retailers has enabled some of them to benefit from lower procurement costs and thereby reduce their selling prices to customers, affecting the whole market. On the other hand, the Company's business model is to generate service sales in a consistent manner by selling Internet devices and other hardware. President Nojima believes that PC DEPOT stores can coexist alongside big-box home electronics retailers in different market segments, even if they are located in their immediate vicinity.

For example, some customers may prefer PC DEPOT as they can benefit from computer-orientated services for PCs that closely match their needs. PC DEPOT strategy is that such

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users should be retained in a long-term relationship with the Company as premium service members. There is the potential to open Smart Life stores, a new type of store established by PC DEPOT, in central Tokyo as less investment is required to open such stores.

As a measure to improve profitability, the gross profit for products sales should be raised by 2 to 3%. If that happens, the burden caused by the expansion in sales activities for products would grow more slowly, and profits derived from increased service provision would start to be generated. An increase in operating income of 1,000 million yen per year can be anticipated. In addition, if it is possible to increase the unit price of services per person by 500 yen per month, an increase in operating income of 2,000 million yen per year can be anticipated in the medium term. If these two improvements can be successfully maintained, it is forecast that the operating income of the entire Corporation will reach 4,000 million yen per year. The likelihood that the Company will achieve its target—a ratio of operating income to net sales of 8%—is in sight. The Company will very likely meet this expectation. In that case, the Company will be able to establish a unique status as a service company supporting personal communication in a very true sense.

The Company has 2,511 shareholders, which meets TSE's main market listing requirement. PC DEPOT has the chance to explore better financing methods while increasing the liquidity of the Company's shares by selling shares and making a public offering in order to lower the percentage of shares held by the Nojima family. With the rise in profitability, there is a possibility that the Company will change the market it is listed on the JASDAQ to the TSE main market. A requirement for a company to list on the first section of the TSE is that its market capitalization exceeds 25,000 million yen. Depending on how the markets evaluate the Company, PC DEPOT may be able to list on the first section of the TSE in a year or two.

Based on its stock price of March 7 of 812 yen, PC DEPOT has a PBR of 1.66, an ROE of 11.4%, and a PER of 15.0, with a dividend yield of 1.0%. But, there are questions to be asked: What kind of era will follow the current PC era? Will the Company be able to compete against consumer electronics superstores? With regards to this competition, the Company can demonstrate a unique presence. Meanwhile, its strategy of making profits through providing IT solution services and positioning its stores in a market segment to coexist alongside mass home electronics retailers has started to contribute to earnings. Against this background, more and more market players will upwardly reevaluate the Company's corporate value as its earnings grow.

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