

7618 PC DEPOT Corporation

—Shifting the Business Model to IT Solution Stores that Promise Long-term Relations with Users—

August 22, 2013

JASDAQ

Points

- The Corporation's efforts to turn around its business performance have picked up even more speed. It is evolving its store format from specializing in PCs (Personal Computers) and transforming its business model to an Internet devices service store that combines merchandise and services. It has shifted to a profit structure supported mainly by service sales and has entered a stage where the results of this shift will finally come to fruition. Although it still faces tough price competition for goods sales, the Corporation has succeeded in entering a new phase in which it can overcome the competition, increasing its profitability.
- Looking at its profit structure, sales of PCs 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. "Premium service" means the one that provides convenient contents services and maintenance services to users who purchased a PC or a smartphone, upon payment of certain amount of monthly fees.
- 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 by service sales exceeded the decline in goods sales. Thanks to factors such as the depreciation of the yen, the decline in PC (personal computers) prices slowed down and the Corporation's business performance has entered a recovery stage. It is expected to record ordinary income of 1,800 million yen (up 92.9% YoY) in FY2013 and 2,200 million yen (up 22.2% YoY) in FY2014.
- In order to acquire premium members, the Corporation has pushed forward with developing contents and services, expanding its new services that combine digital magazines and tablet devices. Regarding store formats, the Corporation has launched a service-based Smart Life store, which differs from conventional mass home electronics retailers that display a wide range of products. It will also start to develop new stores.
- The Corporation has turned its profit structure steadily to the one in which profit can be assured by service sales stably. Even though smartphones and tablet devices are going to establish new markets, the Corporation would be able to stimulate demands for various services while placing its base on PCs as the platform. The tables will be turned in the tug of war between the decline in goods' sales prices and the expansion in service sales and the contribution of the latter to the bottom line will become considerably more evident. The Corporation will be able to increase its ROE to 10% in FY2013 or so with its PBR climbing over 1.0, the markets' evaluation of the Corporation will further improve.

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Company rating: B

Stock price (August 21, 2013): 42,000 yen

Market capitalization: 9,500 million yen (225,000 shares)

PBR: 0.91

ROE: 10.7%

PER: 8.5

Dividend yield: 1.7%

(million yen)

Fiscal year end	Net sales	Operating income	Ordinary income	Net income	EPS (yen)	Dividend (yen)
2006.3	45965	1210	1493	981	4501	500
2007.3	42345	839	1112	511	2302	500
2008.3	42439	1229	1340	816	3674	600
2009.3	42899	1259	1429	684	3108	700
2010.3	44740	1226	1306	677	3108	700
2011.3	46912	1368	1509	737	3418	700
2012.3	49693	553	717	280	1275	700
2013.3	51353	876	933	445	2038	700
2014.3 (forecast)	51400	1720	1800	1080	4936	700
2015.3 (forecast)	53000	2120	2200	1320	6033	700

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

Total assets: 22,513 million yen

Net assets: 10,067 million yen

Equity ratio: 44.6%

BPS: 45,926 yen

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

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

Definition of Company rating: Qualitative evaluation with viewpoints on 1) management abilities of the manager; 2) abilities to grow/sustain the business; 3) possibilities of downward amendment to earnings forecasts. It is expressed by four-level rating as A: good; B: some degree of efforts is required; C: considerable improvement is required; and D: being in a quite crucial stage.

1. Characteristics:

Aiming at developing Internet device service stores

Shifting to a New Store Format

The Corporation is aiming to develop IT solution stores with which customers can maintain long relationships. As well as having a PC mass retailer nearby, users can utilize the Corporation to solve the problems they experience when using IT devices and networks.

The digital network market is characterized by the continuous entry of new equipment (devices) and services. Customers will need support in order to maintain an IT environment that enables them to fully utilize the products and services. The Corporation provides services that enable users to make full use of the functions of their PCs, smartphones, and tablet devices (portable multi-function devices). These services provide them with real convenience.

If consumers use products for a long time, they will come to pay fees (charges) to enhance the convenience of using such products, in addition to the profit generated at the time they make the purchase. To realize such a situation, the users must be satisfied with the convenience provided by the service.

The starting point for traditional retailers is the merchandise, but as a retailer/service provider, the starting point for Corporation is its services. The Corporation will offer services relevant to the Internet infrastructure based on devices, which connect customers to the Corporation.

The Corporation's profits can be viewed from three points. It generates profits by first, selling products; second, through technical fees from repairing products; and third, from monthly fees from members to whom it provides continuous support. The support fees from members is a particularly unique source of profits in the retail industry.

The Corporation considers its corporate social responsibility (CSR) to be to reduce the digital divide (information disparity) in society. To a certain extent, a digital divide will be generated between people who can use digital networks and those who cannot. It is not good for society as a whole when people who cannot use these networks find themselves at a disadvantage. The Corporation intends to contribute to greater convenience and enjoyment in these people's lives by supporting them so they can use IT services properly. These types of services will be provided by PC DEPOT, with its stores as the base.

Business started with PC (personal computer)

In the past, president Nojima of PC DEPOT worked at Nojima Co., a mass home electronics retailer (code No. 7419, JASDAQ). First son of the founder of Nojima Co. is the current president of Nojima Co., and president Nojima of PC DEPOT is second son. He was in charge of supervising stores and merchandise at Nojima Co., but at the time when PC became gradually popular, he decided to do business on his own and got independent. While he is still one of the shareholders of Nojima Co., there is no business relationship between PC DEPOT and Nojima Co.

President Nojima was 35 years old when he started his business which is now in its 20th year. At early stage after its incorporation, PCs were on the way to be gradually popular. Many people wanted their own PCs, but PCs were still beyond their reach. In those days, only a limited number of people went all the way to Akihabara to buy PCs. In contrast, president Nojima went into retailing PCs, just like retailers in general deal with some new merchandise. The Corporation successfully raised its performance, and in 1999, five years since its establishment, got listed on JASDAQ.

As the internet era emerged in 2000, the Corporation entered into its new phase. When having got 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, PC-related products are commonly sold at mass home electronics retailers. Also, there is a wide variety of mass retailers specializing in PC. In the broad sectors of mass electronics and PC retailing, the Corporation ranks 9th in view of sales 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 Corporation seeks to emphasize its uniqueness.

Cooperation with K's Denki

In developing PC DEPOT stores (comprehensive stores specializing in PC), the Corporation made K's Denki stores (operated by K's Holdings Co. (code No. 8282)) its franchisees (FC stores) in the beginning. That is, K's Denki participated in the FC stores of PC DEPOT for the second place. It was beneficial for both of them in that a mass home electronics retailer starts dealing with PCs.

The Corporation does business in cooperation with K's Denki because, president Nojima says, management concepts of the two companies are quite similar and he feels much empathy with Mr. Kato, Chairman and CEO of K's Holdings Co. The Corporation focuses on easy-to-understand management, such as sales in self-service style except for service items, sales with cash discount not dependent on point system, on the basis of chain-store operation.

At the very beginning, Mr Max Co. (comprehensive discount stores) and Kitamura Co. (specializing in cameras) also participated in the FC stores of PC DEPOT. Kitamura adopted a form similar to joint operation, and Mr Max adopted so-called "in-shop" style, namely operation inside PC DEPOT stores. Afterwards, however, major mass home electronics retailers became advantageous and it became hard for discount stores to deal with PCs. FC stores run by Mr Max were taken up by the Corporation as its subsidiaries (current PC DEPOT Stores) by 2010.

Converting FC stores to directly-managed stores

Aside from FC stores of PC DEPOT, other FC stores providing technical services were established as "in-shops" inside some mass home electronics retailers. These were named "PC DEPOT PC Clinic." PC Clinics were successfully operated in many of K's Denki stores, and then expanded.

At present, as PC DEPOT, there are 50 directly-managed stores, 11 stores other than Kanto region run by the subsidiary PC DEPOT Stores Co., and 5 FC stores, for a total of 66 stores. In addition, as PC Clinics, there are 49 directly-managed stores, 1 store run by PC DEPOT Stores, and 7 FC stores, for a total of 57 stores. So, the Corporation now operates 123 stores.

PC Clinics had been operated mainly as FC stores until four years ago, and subsequently these have been converted, at a stretch, to directly-managed. The Corporation and K's Denki agreed that direct-management would be more effective for enhancing service functions, and the former took up FC stores from the latter. Currently, the Corporation operates PC Clinics inside K's Denki stores, as directly-managed stores.

In addition, the Corporation started to deal with TV sets in June, 2010. Even in a wave of digitalization, the Corporation considered the possibilities of connecting TV sets to the internet, and also in the context of eco-point scheme, decided to sell TV sets at PC DEPOT stores.

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Situation of store development

		number of stores (at the end of Mar., 2013)	
PC DEPOT	directly-managed	50	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: FC (franchise chain) stores pay royalties.

Web business is continued

EJWORKS Co., a subsidiary, engages in IT solution business such as internet service provider and creating Web contents. Internet services started to be familiar around 2000. Now such situation is almost peaking and internet service providers are to be selected. The Corporation intends to acquire small-to-midsized providers and continue its own customer services. For customers, continuity would remain since there is no need to change their email address.

Moreover, recently the Corporation has been utilizing this subsidiary as a support team for its development of contents and has been placing more importance on it.

Making effective use of part-time workers

In addition to 674 regular employees, 1,054 part-time workers (on an 8-hour work basis) work for the Corporation. Seven categories of tasks are assigned: operations (cashiers and baggers), attending to customers (attendants) and clinic-related services (defense and offense); workers are trained to handle basic tasks in one category in one week. They carry around portable handhelds with them in the store in order to help each other by sharing information, which allows them to respond to customers at a satisfactory level. There are many part-time workers who have worked for the Corporation over the years. The Corporation gives such contributors a chance to become regular employees.

2. Strength:**Profit structure turned to be contributed by service sales****Specializing in PC-related technical services, keeping the leading position in the industry**

The Corporation is strong in Kanto and its coverage ratio for the population in this region is 90%. Consumers who want support from a PC DEPOT store can access one, even if the store is little way from where they live. If consumers buy PCs and have the routers set up for them at the store, they can start using their PCs as soon as they get home simply by plugging it in, they do not need to do the initial settings themselves. Smartphones also connect to Wi-Fi (high speed wireless LAN). If customers have a problem, they can call the Corporation's call center and get immediate attention. Users can obtain all these services just by paying the monthly fee. This is a genuinely reassuring and convenient service.

The Corporation leads the industry in repairing PCs and providing maintenance services. Moreover, service sales have increased by more than 20% each year, demonstrating its high-rate growth. Although it is at 7th or 8th place in terms of number of PCs sold, service sales are the source of its characteristics.

The Corporation has shown its unique presence in competing with mass home electronics retailers over the past decade. It survived well in localized competitions as specializing in PC, whereas it could not hold against major companies in terms of total volume (sales quantity). Under such circumstances, the Corporation did not try too hard to expand its business by opening new stores. In 2002, it decided, however, to be an IT solution company beneficial for customers, by making efforts to improve its services, rather than by quantitative expansion of sales of hardware, namely PCs. This was the second turning point for the Corporation since its foundation.

Trend in constituent ratios of sales

(%, millions of yen)

	2009.3		2010.3		2011.3		2012.3		2013.3	
	Sales	Constituent ratios	Sales							
Goods sales										
PCs and peripherals	35572	82.4	78.2	75.8	72.3	69.0	66.7	35425		
Accessories, supplies, and software	24375	58.5	56.9	52.0	46.5	46.4	46.4	23788		
Used items and others	6554	14.6	15.0	13.9	12.6	12.1	12.1	6240		
Used items and others	4643	9.3	6.3	9.9	13.2	10.5	10.5	5397		
Used items and others										
Sales from technical services and commissions	11340	17.6	21.8	24.2	27.8	31.0	31.0	15928		
Royalties and other revenue (FC)	8726	10.3	14.4	18.6	23.3	27.3	27.3	14000		
Internet-related businesses	522	1.3	1.3	1.1	0.8	0.3	0.3	170		
Total	46912	100.0	100.0	100.0	100.0	100.0	100.0	51353		

Providing solutions in combination with various services is the key. The Corporation provides telecommunication services on behalf of EMOBILE, as an MVNO (Mobile Virtual Network Operator). Moreover, upon subscribing to the Corporation's premium services, members can get supported in every necessary aspect such as maintenance, call-center service, anti-virus support, and full-installation works when replacing PCs.

The Corporation exerts its strength by originally developing and carrying out these menus. No other PC shop is capable of speedy technical services, especially data recovery, like PC DEPOT. It is too hard for other companies to follow.

The Corporation set its policy towards growing as a store specializing in services, and has strengthened such movement over the internet era. "OZZIO" is a brand name of its private brand (PB) products. Emphasis was also put on PB. Even though accessories and supplies are highly profitable among goods sales, its direction has been towards services.

Earnings by premium service

The Corporation's business model is quite unique, even in overseas. It consists of goods sales, service sales, and MVNO. Members should enter into premium service contract for a term of three years. However, support cost is to be incurred first by the Corporation and to be collected from customers subsequently.

A customer would like to use the PC, tablet device or any others immediately after buying it and returning home. President Nojima was also such a user. After buying, if it takes, for example, 3 hours to

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make various settings such as recovery disc, anti-virus measures, initial settings and password, and then comes to a dead end, the user should ask someone for help. The premium service is a solution to help such users by means of network.

Main menu of the principal premium services

	Nandemo (Anything) support & All wireless for all devices	Nandemo (Anything) support & All wireless for all devices	Gacchiri (Steady) support & All wireless for all devices
Initial setting/support	up to 3 all devices	up to 6 all devices	up to 10 all devices
Wireless internet connection	complete & delivery at store front	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	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 6 Windows PC, Mac or smartphone	up to 10 Windows PC, Mac or smartphone
ozzio email account registration/setting	1 address	1 address	1 address
Explanation on basic operations at store front	up to 3 Windows PC, Mac or smartphone	up to 6 Windows PC, Mac or smartphone	up to 10 Windows PC, Mac or smartphone
OS upgrade & backup	up to 3 all devices	up to 6 all devices	up to 10 all devices
Inspection at store front/periodic backup	up to 3 all devices	up to 6 all devices	up to 10 all devices
Trouble restoration service	up to 3 all devices	up to 6 all devices	up to 10 all devices
Data reconfiguration upon replacement	up to 3 all devices	up to 6 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	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	as many devices as needed
Monthly fee	2450 yen (816 yen per device)	2950 yen (491 yen per device)	3450 yen (345 yen per device)

Suppose a customer brings his/her old PC and member card to a PC DEPOT store, and buys a new PC. Then the store's service staff makes every necessary installation works. The customer takes the new PC to home, and can use it immediately in the same way as before, via the wireless router (PC DEPOT original), with no particular operation required. This is exactly convenient. A system patent for this router was registered in March, 2012. This service is provided upon paying the monthly fee of 2,450 yen (for up to 3 devices), 2,950 yen (for up to 6 devices) or 3,450 yen (for up to 10 devices), together with other services. Furthermore, this service will support cloud computing.

The business model that takes service sales into account has been fully in progress and steadily expanded since November, 2005. Conventionally, various technical services such as adding memories have been provided for a price. Today, members who bought their PCs can borrow wireless routers upon paying certain monthly fees (no additional charge up to 3–10 routers depending on the course), through which they can connect to the internet with no particular operation required.

An MVNO does not have its own mobile communication network, but provides its original brand services by borrowing other major carriers' network. The Corporation provides services to customers as a telecommunications carrier, rather than taking incentives from other carriers. This makes it possible to

provide services that customers may want in just one package, and is quite convenient as premium service. This type of service (EM premium service supporting multiple devices) is provided upon paying monthly fee of 4,750 yen.

For the Corporation, PC Clinics tend to provide only one-time technical services. In order to capture customers to provide them with continuous services for a long time, keeping them as premium service users should be better. Then direct management should make it easier. That is why the Corporation turned its policy to manage PC Clinics directly. Sales amount of technical services and commissions (service sales) include premium service, technical services, communication fees of MVNO and others.

3. Mid-term business plan: Developing contents and services while renewing stores

From PCs to Internet devices

PC sales will decline. Will this be a problem for the Corporation's management? No, because the number of devices each person owns will increase. Replacing PC sales, sales of smartphones and tablet devices will grow. PCs will never entirely disappear and their core functions are absolutely going to survive. As the number of devices owned per person increases, the network environment on which users utilize these devices is always going to be required.

Where will users store their basic data? They will increasingly use cloud services, but there will also remain a strong need from users want to keep their data locally. In this case, PCs will be the core storage device. If we look around us, we cannot as yet find anyone who is saying that PCs are not needed any more. Once smart devices—such as PCs, smartphones, and tablet devices—become diversified, the range of support for them will also widen. This will add value to the services that only PC DEPOT can offer.

The starting point of the Corporation's social mission is helping to solve the digital divide (information disparity). This is likely to considerably expand its business area. Furthermore, it is increasing its added value by connecting with contents. It can be difficult for the elderly and busy people to connect with a network or set up their network environment themselves. In addition, users appreciate getting immediate support when their devices are not working properly.

Digital-contents services			
Contents (magazines)	Magazines + iPad mini (16GB/ Wi-Fi) Monthly fee	Fixed prices of magazines (yen)	
Weekly Toyo Keizai	1900	690	Weekly
Nikkei Woman	1000	600	Monthly
Nikkei Business Associe	1000	630	Monthly
Nikkei Money	1200	650	Monthly
Nikkei Trendy	1000	550	Monthly
GetNavi	1000	590	Monthly
LEVOLANT (Le Volant)	1200	900	Monthly
Lettuce Club	1000	300	Biweekly
ESSE	1200	500	Monthly
President	1700	690	Monthly
DigiCAPA	1200	840	Monthly
CAPA	1200	680	Monthly
Mac Fan	1000	730	Monthly
Weekly Soccer Digest	1900	450	Weekly
WORLD SOCCER DIGEST	1500	570	Biweekly
Nikkei Health	1000	580	Biweekly
Slugger	1500	860	Monthly
Smash	1200	650	Monthly
dancyu	1200	860	Monthly
DOS/V POWER REPORT	1000	1080	Monthly
Package of three magazines	1900	Woman + Money + Associe	
Package of four magazines	2900	Toyo Keizai + Trendy + Money + Associe	

Independently developing contents and services

For the Corporation's future management policy, we can focus on two points. One is that it is developing contents and services tailored to internet devices and providing them to customers as solutions. The other is that it is developing new stores.

The Corporation has been evolving its business model. Originally, as PCs began to appear, its business model was like that of mass home electronics retailers, consisting of building PC stores and selling PCs. However, in order for users to make full use of their PCs, they needed to be also provided with auxiliary software and hardware products. While offering sophisticated goods and services to satisfy the requirements of PC enthusiasts, as the use of PCs spreads it has also been required to provide services to people who are not familiar with how to use PCs. Its menu of services includes not only repairs, but also services for when customers are buying a replacement and for familiarizing themselves with new models and software on their release. There is nothing more convenient for users than being able to start using their device just by touching its screen.

Today, internet devices have diversified from PCs into smartphones and tablet devices. People will have multiple devices and use them according to their needs and the occasion. A combination of contents and devices meets the needs of today's consumer.

For example, one idea is to install digital versions of specialized magazines onto a tablet device and offer them as a package at a reasonable price. The users have the content that they want immediately, in addition to being able to use the tablet device freely.

Customers can purchase a package of the Lettuce Club (published biweekly at 300 yen per copy) and an iPad mini (16GB/Wi-Fi) for a monthly fee of 1,000 yen. The contract period is three years. If the two are purchased separately over the same time period, the price would be almost 60,000 yen. But with this package, customers pay only about 36,000 yen.

The Corporation aims to package and offer the services that customers want in order to retain their custom for many years to come.

Acquiring members by installing contents on devices

The trend toward offering devices with contents pre-installed is also becoming popular. 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 and anywhere.

Why is the package offered at a lower price? Because the Corporation has a function for services providing packages. If consumers already have iPad minis, they can buy a digital version of this magazine for 800 yen a month. They can of course buy an iPad and the magazine separately, but to do so will cost them more than 1,200 yen a month. The publisher of LEVOLANT could sell this package themselves, but they cannot provide support to readers using the device. The Corporation provides a one-stop service and offers support to users at any time. This service is also convenient for content providers as it helps them to increase their digital audience. As many as 20 types of digital content are currently available for this service.

Services will survive, even if the nature of Internet devices change

In today's digital era, Google, Windows (Microsoft) and Apple are the Big 3. With these Big 3 on center, president Nojima sets his basic policy as helping users' resolve their "troubles."

The Corporation has registered its patent for the original router. This can be used to make earnings with service sales. Currently, goods sales do not make much profit, which is supplemented by service sales. If goods are not sold, services will not be created. The Corporation has not seen profits from services materialize to a sufficient degree because of the decline in goods sales that has continued over the last few years. At last, the Corporation is entering a stage in which it can overcome this difficulty. Some interesting scenario would be anticipated.

A movement has shifted into higher gear where leading player of personal communication is shifted from PC to smartphone. Cloud system as an infrastructure evolves, and air cloud system using wireless communication will be the primary driver.

PCs having been at the center of the internet gives the place over to net devices used anywhere in appliances, cars and homes. Software is required to control such functions, and services to make full use of the software are also required. The Corporation makes pursuit of these services, and aims at adopting a strategy to expand its business to cover internet devices, not limiting its services to those around PCs.

The Corporation's business model is service sales based on goods sales. It sells PCs and proprietary routers and subsequently collects service income. So even when providing services, a certain level of goods sales is needed in order for service sales to be satisfactory.

Service members are increasing, to get helped to resolve their troubles

To maintain relationship with customers for a long time, the Corporation makes its motto that it helps customers resolve their various troubles. For example, when a customer calls to the call center, the line is connected to the staff at the nearest store, thereby enabling conversation among three persons. This system is useful for clarifying what kind of trouble the customer is facing, what is the issue, and how the staff should respond. Sometimes a 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, the service staff responds to the call for help and is able to fix the PC right away. That means quick response. Although it requires some cost, such attitude for preparedness is one of the good points of PC DEPOT.

The Corporation put emphasis on increasing premium members. Detailed data is accumulated and followed for each area, so that as many customers as possible could be premium members when, for example, buying PC, visiting for repair, or replacing PC.

It can be expected that premium members would increase at a considerably high rate. However, that would not make money in a short time. Initial investment is required for the router, and it takes about a year to recover by means of monthly fees for premium service. From the second year, after recovering the initial cost, a certain amount of profit is generated.

Many users of PCs, smartphones and/or tablet devices feel some kind of inconvenience. The strategy is that such users should be provided with the premium service and be premium members.

Increasing number of members is provided with the premium service. Monthly service fees are in the range from 1,000 yen up to 5,000 yen. A call center has been established in order to improve services for members and to respond quickly. The Corporation does not release information on member numbers, but given the variety of services it offers and the increases in its number of services and devices it supports, it is likely that member numbers are increasing by about 20% a year.

Good service is the source of competitiveness. Advantage is also exerted in opening new stores.

60% of visitors to PC Clinics are those who bought products at other stores. That means they want different contact points, not low-price. PC Clinics widely cover products which customers currently own. This brings about significant efficiency to the Corporation.

In considering marginal gains derived from goods sales and from service sales at the stage of operating income, clear-cut separation cannot be done in terms of specific profit level and constitution. The reason is that the Corporation does not operate its business by distinguishing goods sales and service sales. Even though staff members at stores have their own roles, they provide both goods and services. Their duties are not evaluated by distinguishing these sales. One routine is that a customer buys a product and subscribes to a service, thus becoming a regular customer of PC DEPOT, and naturally comes again to buy some other product.

In considering, subject to a certain prerequisites, marginal gains derived from goods sales and from service sales at the stage of down to operating income, there is no change in the structural outline where profitability of service sales is predominantly stronger.

While other mass home electronics retailers have also moving further to provide similar services, the Corporation provides well-organized services accompanied by 1) services at store front; 2) remote services (by the call center); and 3) services provided by staff visiting by car. No other company has exactly the same business model.

As for movement of merchandise, following the termination of analog terrestrial broadcasting in July, 2011, support for digital terrestrial broadcasting came to an end, resulting in substantial decline in sales of TV sets. Mass home electronics retailers put emphasis on merchandise of higher unit price such as PCs and air-conditioners, causing more severe price competition. Besides, demands for smartphones and tablet

devices have greatly increased. The Corporation deals with smartphones and tablet devices actively, and at the same time, aiming at grabbing demands for services including PCs as its principal merchandise.

In a competition to grab such demands for services, the Corporation has an advantage leveraged by its achievements over the years and human resource. That is, the Corporation has set its core policy for making difference, to provide services taking time and efforts to customers who might need more efforts to make full use of their purchases, not such volatile customers as other companies deemed their main target for just selling goods.

Service menus of PC Clinics (examples)

	(yen)	
	Member	General
Service		
12 tickets for quick lectures	5000	30000
Setting-up		
setting-up a wireless printer	3000	10000
Data		
data HDD back-up	5000	16000
Setting-up an external peripheral device		
setting-up a printer	3000	6000
OS/application configuration		
OS installation	0	10000
Internet/network configuration		
third-party provider email configuration	3000	7000
Smartphones/tablet devices		
Includes a mobile access point to set up Wi-Fi	3000	10000
Data management configuration		
Synchronizing with iTunes and synchronizing with back-up data	3000	6000
Configuration for peripheral devices		
AppleTV configuration	3000	6000
Contents/application configuration		
setting-up for newspaper subscription	1000	4000

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.

Launching of Smart Life stores, a new type of store

The Corporation has been pushing forward with its SLP concept, which stands for "Smart Life Partner," from the current fiscal year. The Corporation installs all necessary software onto hardware devices so that customers can use such devices as soon as they purchase them. People want to use the IT services they need immediately without any inconvenience. Tablets and other devices are provided with content services pre-installed and all necessary setups completed. This convenience allows customers to use the tablets and services without any cumbersome preparation. They neither need to configure initial settings while staring at user guides nor call several call centers to ask for instructions.

The Corporation also advises customers on Internet connections and fees for each PC, smartphone, and tablet device 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.

Another service the Corporation provides to customers is a billing plan, "Smart Pack," which includes a hardware device, software, and Internet connection in a single package. This package allows customers to use hardware along with software and an Internet connection by simply paying a monthly fee instead of buying a hardware device and paying monthly fees for the necessary software and Internet connection. Although this is a type of loan in an amount determined by subtracting the product's estimated residual value at the end of the loan term from the product's sticker price, this type of system is acceptable and convenient for those familiar with cell phone billing plans, which require a two-year subscription. 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. Applicable PCs include the Apple Mac and Sony Vaio. For Sony tablet devices, the monthly fee is set to 2,990 yen, which is a sufficiently reasonable price for enticing use.

The Corporation is innovating with the format of its upcoming stores. The logo of PC DEPOT 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 will be removed from the logo of the new stores.

Smart Life stores will not just sell goods; 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. President Nojima stressed that the approach for Smart Life stores will not be to simply display goods and ask customers to choose the ones they like, but instead they will be offered a one-stop service to provide them with the Internet communications that they want to implement. Consequently, the atmosphere of these stores will be different to that of conventional stores and customer counters will occupy the central place within them.

Inventories of goods will markedly decrease in Smart Life stores. Helping free customers from the burden of choosing goods and services themselves, the stores will function to provide the services needed by customers and as a result, inventories will be reduced. However, a certain 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 contents, with sales being collected in the form of monthly charges.

Store development history of PC DEPOT

(number of stores at the end of each FY)

	1994	1999	2004	2005	2006	2007	2008	2009	2010	2011	2012
PC DEPOT	directly-managed	1	10	28	32	33	34	40	43	44	48
	subsidiaries	0	0	0	0	0	0	4	4	12	11
	FC	0	8	32	24	21	24	21	17	17	5
PC Clinics	directly-managed	0	0	0	0	0	0	0	30	46	49
	subsidiaries	0	0	0	0	0	0	0	0	1	1
	FC	0	0	0	5	14	14	21	24	6	7
Total		1	18	60	61	68	72	82	88	101	119
											123

In recent years, the Corporation has put store openings on hold and pursued management efficiency

PC DEPOT was only able to open one to two stores a year for several years up to FY2010. It planned to open stores in the Tokyo metropolitan area, but was unable to find suitable locations as rents increased. It has delayed store openings as it did not want to force its plan through regardless of circumstances. However, looking at the future, the Corporation has the capacity to open a maximum of 60 PC DEPOT

stores and 120 PC Clinics in Kanto and it is considered that President Nojima wants to achieve these numbers.

When choosing a site to open a new store, the Corporation often competes with other retailers and service providers. The location and costs are important factors when making a decision on sites vacated and left fully furnished by the previous tenant. When building a new store on rented land, it is important that the landowner lives nearby. The quality of PC DEPOT store customers is high so owners can lease their land with peace of mind. More than 80% of the land lots where the Corporation's stores are situated belong to private owners, with nearly 20% being owned by established, medium-sized companies.

PC DEPOT store numbers increased by 3 stores in FY2009, 1 store in FY2010, and 12 stores in FY2011 on a net basis (the 12 stores included 8 newly directly-managed stores that were previously FC stores, meaning there were 4 new stores on a net basis).

The four directly-managed stores in FY2011 were all new stores. In the first half of FY2012, five stores were opened and from the second half of the fiscal year, the pace of the store openings slowed down. In the future, stores vacated and left fully furnished by former tenants will be used for store openings. The financial burden incurred when building a new store is quite heavy, requiring investment in the range of 300 to 400 million yen for a premise of 1,600 to 2,300 m². On the other hand, PC Clinics are opened within existing K's Denki stores.

PC DEPOT stores are operated in residential areas, with relatively small sized premises around 500 to 1,000 m². Regardless of whether it is large-sized or small-sized, operations at the head office can be carried out at the same level. As located in residential areas, many of the customers come by bicycles or by walk. The higher performance of PC, tablet devices and smartphones becomes, the more clinic services will be required, and there will be more rooms for new stores. Besides, a directly-managed store running only PC Clinic has been in operation in Okinawa, which is to be monitored a little longer for more possibilities.

Risk management is important since accounts receivable from new service sales will increase

The Corporation renovated a PC DEPOT store in Nishimagome, Tokyo into a Smart Life store. The new store, which opened in August 2013, has approximately 60% less inventory of goods than the former store; instead, customer counters are quite spacious. Tablet devices occupy a larger portion of the display shelves. The store format is based on the Corporation's new store concept, "providing services that customers may need in a single package instead of simply selling goods."

The new store does not display a lineup of sophisticated accessories on the shelves, which may frustrate PC enthusiasts. But, if they order the goods they want at the store counter, the store can immediately order and obtain them. The name of the counter for responding to requests from customers (such as PC repair) has changed from PC Clinic to Dr. Smart, and staff members now wear a new uniform.

With respect to Apple products, the Corporation handles them with the expectation that they, combined with services, will bring sufficient profits to the Corporation although alone they have low profit margins.

The Corporation has a unique business model with its Smart Life Partner (SLP) concept. Customers face various problems regarding the use of IT services and they want solutions whether they purchase goods and services from other stores or online. If you actually use the services provided by the Corporation, you will become convinced that they are far more convenient and superior to those of competitors.

In the SLP-based business, it takes three years to collect the total amount of sales from goods and services. Goods sales are recorded under accounts receivable. Accounts receivable will increase with a rise

in SLP-based sales, which requires more working capital. An increase in accounts receivable will also require strengthened credit management. For sales at conventional merchandise stores, individual credit risks arising from consumers who paid by credit card are assumed by the credit card companies, but such risks accompanied by sales at Smart Life stores must be taken by the Corporation. In the event that a customer becomes unable to make monthly payments for any reason, the Corporation will have to assume his/her debts.

In principle, the Corporation sells goods and services to individual customers who use the IT products, and therefore performs identification and usage checks with great care prior to sale. Volume sales to corporate customers are outside the scope of its business. In many cases, the Corporation may turn down an offer of bulk purchases even from an individual customer because it is unsure whether such goods and services are for private use. As is obvious from the above, credit risks are well-controlled by stores and therefore there is not a great 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 Corporation's internal funds. Any excess beyond this amount will have to rely on loans.

More Smart Life stores can be opened. A PC DEPOT store costs approximately 300 million yen to open, but a Smart Life store and PC Clinic cost only 50 million yen and 10 million yen, respectively, if premises with existing furnishings are available. As these stores have significantly lower investment costs and inventories, it is easier for the Corporation to open them.

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

Focusing on human resources development

The Corporation 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, and their usage, and it reflects that working at PC DEPOT is worthwhile and fulfilling to women as well as men. Employees receive training and the Corporation is able to staff the PC Clinics that it opens.

The Corporation does not impose any quotas for individual staff's sales and service performance. Instead, everything is dealt with by teams. 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 experiences and thereby raise each other's levels. Employees' attitude and responsiveness to customers is the key. Part-time workers who have worked for the Corporation 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 persons on site and the head office can be connected via voice communication and they can ask each other about anything at any time. Support for services can also be provided from the head office. Alternatively, if a person on site has a problem, another person in the store immediately goes and provides them with support. Being able to respond quickly in this way

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improves service capabilities, while from the customers' viewpoint, they feel they are being dealt with kindly, politely, and quickly at PC DEPOT stores.

Aiming to achieve an ordinary profit rate of 7% to 8% with the new business model

In this way, the Corporation has started to clearly draw a picture of its next business model and the results are starting to come to fruition. This new challenge that the Corporation has taken on deserves attention. Based on long-lasting relationships with users, it is also shifting its profit structure from a flow-type to a stock-type.

By realizing a profit structure reliant on service sales, the Corporation intends to raise its medium-term ordinary profit rate from the current 2% to around 7% or 8%. The Corporation's profit rate when it listed as a mass PC retailer around 2000 was 6% and it is aiming for a level exceeding this with the new business model.

4. Near-term operating results:

Effects from service sales have become apparent, achieving record-high profits

FY2011 was affected by increased cost for new stores and decline in unit prices.

FY2011 has seen substantially lower profit: net sales 49,693 million yen (up 5.9% YoY); operating income 555 million yen (down 59.5% YoY); ordinary income 717 million yen (down 52.5% YoY); and net income 280 million yen (down 62.0% YoY). This is mainly because net sales were up 5.9% YoY, whereas SG&A expenses were up 15.7% YoY.

Among SG&A expenses, especially personnel expenses increased. Opening a lot of new stores since one year ago was expected to have positive effects gradually, but to the contrary, negative effects were greater due to such as more severe PC-related sales competition and undersupply of peripherals affected by the huge flood in Thailand. The Corporation took over 6 FC stores run by OA System Plaza, which also caused short-term monetary burden.

Consolidated number of employees was 487 in FY2009, 533 in FY2010 (+46 YoY), and 656 in FY2011 (+123 YoY).

On the balance sheet of 2012.3, assets increased by about 3,500 million yen, and increase in accounts receivable by 1,100 million yen includes 700 million yen for installment of premium service, and increase in inventories by 1,800 million yen includes 700 million yen corresponding to covering FC stores. Increase in tangible fixed assets by 1,200 million yen is due to opening new stores. Capital investment increased from 1,500 million yen to 1,920 million yen. Out of the 123 stores operated by the Corporation, 96 stores are located in Kanto region. As can be seen, dominance in that area is in progress.

Such increase in assets has involved increase in loans. Interest-bearing liabilities increased by 2,965 million yen, from 4,463 million yen in FY2010 to 7,428 million yen in FY2011.

Service sales achieved quite good results, up 32.5% YoY. While sales in existing stores were down 3.5%, gross profit rate was slightly raised from 29.1% to 29.7%. During these progress, increase in expenses took the lead, resulting in substantially lower profit. Although cost for opening new stores had been taken into consideration from the early stage, gross profit derived from goods sales was amended downward, due to more severe price competition. In terms of service sales, initial cost takes the lead over

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the early stage since subscription and it should be recovered for a period of 2 or 3 years. So even if service sales increase, profit as a whole cannot be covered so soon because it is accompanied by increase in number of sales persons and in personnel expenses.

Sales of PCs and peripherals experienced very tough situation. Merchandise lineup is completely different between major mass home electronics retailers and the Corporation. The Corporation concentrates on PC-related merchandise. It deals with TV sets, but the share is extremely small. Major mass retailers have inventory guarantee scheme for home electronics such as TV sets, whereas the Corporation adopts complete buy-out scheme, and therefore if sales price fall below the purchase price, the Corporation have to incur the difference.

Another adverse effect was that the huge flood in Thailand caused supply of HDD (hard disc drive) to be significantly difficult. Because of undersupply and higher price of HDD, users who use these peripherals became hesitant to buy them. Accordingly, sales of other peripherals also slowed down.

As can be seen on the balance sheet, inventories increased. It is due to, in addition to opening new stores, taking over more than half stores of OA System Plaza. Following termination of FC contracts, 8 stores were transferred to the Corporation. Two of them were integrated and the remaining six were taken over. Despite initial burden, direct management would be more beneficial for efficient operation and more profit from service sales. Thus, it should be effective sooner or later.

Balance sheets comparison

(million yen, %)

	2010.3	2011.3	2012.3	2013.3	2013.6
Current assets	10511	11678	14185	13991	13861
Cash and deposits	1754	2505	2083	2982	2753
Accounts receivable-trade	2251	2533	3619	4098	4303
Inventories	5316	5500	7285	5986	5807
Fixed assets	7443	8051	9052	8942	8651
Tangible fixed assets	2844	3736	4941	5073	4965
Goodwill	1025	690	406	155	119
Guarantee deposits	1479	1440	1466	1387	1364
Lease deposits	1329	1234	1272	1268	1264
Total assets	17954	19729	23238	22933	22513
Current liabilities	6473	6449	9225	9009	8709
Accounts payable-trade	2764	2421	3506	2087	1907
Short-term loans payable	800	700	2100	2550	2550
Long-term loan payable (within one year)	690	1004	1518	1849	1797
Fixed liabilities	2743	3747	4449	4149	3735
Long-term loans payable	1936	2759	3809	3479	3067
Net assets	8738	9533	9563	9722	10067
Interest-bearing liabilities	3426	4463	7428	7879	7415
Interest-bearing liabilities ratio	19.1	22.6	32.0	34.4	32.9

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

The Corporation 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 Corporation's sales. The growth of service sales

contributed to the overall strong performance despite an increase in the number of stores and service staff and in costs for system development.

On the balance sheet, accounts receivable increased due to the rise in service sales, while efforts were made to reduce inventories. Inventories in existing stores decreased by around 20%. There was an increase in accounts receivable from installment sales of MVNO' communication terminals and from the premium service (a product providing maintenance services for a monthly charge).

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 to the effects of the opening of new stores, the increase in service sales was due to the growth in sales of tablet devices and 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 receive services for all of their devices.

The earnings forecast for FY2012 was downwardly revised on one occasion because performance in the first half of the fiscal year failed to meet the target. However, in the second half of the year the performance was higher than forecast and the initial full-year target was exceeded. Initially, ordinary income of 800 million yen was forecast, but this was downwardly revised to 700 million yen, with ordinary income of 933 million yen ultimately being achieved.

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 stores openings in the second half, which meant no major costs were recorded. Another factor is that a downward trend in the sales prices of goods, including PCs, halted due to a weakening of the yen, with price increases seen in some goods. Gross profit on good sales did not fall and the Corporation exceeded its target.

When the yen is strengthening, price reductions tend to follow soon afterwards. This disadvantage is greater than the advantage provided by a strong yen lowering procurement costs. When the yen becomes weaker, procurement costs increase, but as production bases have been 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 inventories.

Number of stores operating for less than one year

(FY)	2011 2Q	2011 3Q	2011 4Q	2012 1Q	2012 2Q	2012 3Q	2012 4Q	2013 1Q	Total	
									2012 1Q	2013 1Q
PC DEPOT	1	2	4	4	1	0	0	0	11	1
directly-managed subsidiaries	1	1	0	2	1	0	0	0	4	1
—	—	1	4	2	0	0	0	0	7	0
PC Clinic (directly-managed)	4	6	3	1	2	0	0	0	14	2
Total	5	8	7	5	3	0	0	0	25	3

NOTE: The figure in "FY2013 1Q" under "Total" indicates the total number of stores that have been in operation for less than one year for the period from FY2012 2Q to FY2013 1Q.

The figure in "FY2012 1Q" under "Total" indicates the total number of stores that have been in operation for less than one year for the period from FY2011 2Q to FY2012 1Q.

Limiting the number of new stores opened while eagerly waiting for appropriate times

It will take a longer time than usual to recover the costs incurred by the series of large store openings of the past two years. It is difficult for a large store of around 2,600 m² to break-even in two years, with three years normally being required. As the number of service members increases, the balance between expenditures and income will improve. Therefore, the current situation is not a cause for concern, but some time will be required before an improvement is seen.

In the future, it can be said that it will be more efficient for the Corporation to acquire members for stores of around 1,300 m² rather than for large stores. While an investment of 400 to 500 million yen is required for a store of about 2,600 m², a store of about 1,300 m² needs only around 200 million yen.

With regards to cash flows, the Corporation's inventories also increased due to its opening of large stores and the expansion in stores following the withdrawal of franchisees (FC stores). However, for FY2013, free cash flow has become positive due to a reduction of inventories. On the other hand, when service sales grow, more working capital will be needed as accounts receivable increase. Consequently, the Corporation will require some borrowing in FY2013.

President Nojima's policy is that opening new stores should be flexible, taking costs associated with the locations into account. That is, they should be opened during a depression period, and then the cost would be recovered by improved efficiency during a boom period.

Since the second half of FY2012, it has cost more to open new stores in the context of weak yen. Therefore, the Corporation puts emphasis on enhancing efficiency in existing stores, rather than opening new stores which nevertheless might be done if any good premise could be found.

Newly opened stores (results and forecasts)

(number of stores)

		2011.3	2012.3	2013.3	2014.3 (forecast)	2015.3 (forecast)
PC DEPOT	directly-managed	1	4	3	2-3	2-3
	subsidiaries	0	6	2	0	0
	FC	0	-12	0	0	0
PC DEPOT	directly-managed	30	16	3	2-3	2-3
	PC Clinic	0	1	0	0	0
	FC	-18	1	0	0	0

NOTE: forecast by the analyst

During this first half of FY2012, 5 stores were opened: Kannana Okudo store (April), Takamatsu-Higashi By-Pass store (April), Morioka Flagship store (June), Tookaichiba store (June), and Iizuka-akimatsu store (September). Among these, Takamatsu, Morioka and Iizuka-akimatsu are operated by the subsidiary, PC DEPOT Stores Co. PC DEPOT Stores is the former PC DEPOT Kyushu, whose name was changed in April.

In terms of recently opened PC DEPOT stores, Maebashi (2011 summer) and Tsukuba (2011 winter) have been doing well. On the other hand, Tama-Newtown is having a hard time. Material difference is that decline in unit prices of goods sales could be covered by service sales.

Capital investment and cash flow

(million yen)

	2010.3	2011.3	2012.3	2013.3	2014.3 (forecast)	2015.3 (forecast)
Capital investment	1650	1500	1920	1140	800	800
Depreciation	510	600	720	730	750	750
Goodwill amortization	340	330	300	260	150	0
Internal reserve	530	580	120	550	920	1160
Total	1380	1510	1140	1540	1820	1910

NOTE: forecast by the analyst

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

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

There is a view that even if sales of tablet devices increase, it will not lead to an increase in the demand for the services that were created for PCs. This view is not correct. As people expand their fields of view and come to own multiple devices, their demand for 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 Corporation's service all the settings will be done for them. This provides them with a high level of convenience.

Another factor is that Microsoft (MS) will stop its security updates and support for Windows XP in April 2014. Users with PCs installed with Windows XP will no longer be able to use this, because it is extremely likely that they will be infected by viruses. This will create replacement demand, which may

eventually lead to a demand for services provided by the Corporation. There should be many users who 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	44740	46912	49693	51353	51400	53000
Gross profit	11558	13640	14756	16134	17780	18890
ratio to sales	25.8	29.1	29.7	31.4	34.6	35.6
SG&A expenses	10331	12271	14202	15258	16060	16770
ratio to sales	23.1	26.2	28.5	29.7	31.2	31.6
Operating income	1226	1368	553	876	1720	2120
ratio to sales	2.7	2.9	1.1	1.7	3.3	4
Ordinary income	1306	1509	717	933	1800	2200
ratio to sales	2.9	3.2	1.4	1.8	3.5	4.2

A greater contribution from service sales for the current fiscal year, FY2013, and a significant upward revision to profits

In consideration of its business results for the first quarter of FY2013, the Corporation revised its earnings forecast for FY2013 upward; the ordinary income forecast was raised from 1,200 million yen to 1,600 million yen. The decline in PC prices has slowed down and an increase in service sales is making a greater contribution to the bottom line. Brisk performances by existing stores are another major factor behind the upward revision. If such favorable circumstances continue, another upward revision is highly likely. In the analyst forecast, the Corporation will achieve record-high profits for two consecutive years: 1,800 million yen for FY2013 and 2,200 million yen for FY2014 in ordinary income.

In FY2013, the Corporation is expected to post net sales of 51,400 million yen (up 0.1% YoY), operating income of 1,520 million yen (up 73.4% YoY), ordinary income of 1,600 million yen (up 71.5% YoY), and net income of 970 million yen (up 117.5% YoY). Actual results will likely exceed these numbers.

In the original forecast, sales from existing stores were 98% YoY and there was an increase in service sales of 17% YoY. Even if 1,000 million yen is added from the effects of new store openings, net sales will be practically unchanged. Conventional mass retailers cannot increase their gross profit without having high-priced or hit products or by increasing store numbers. But the Corporation has increasingly based its profit structure on services and it is able to increase gross profit by growing its service sales, even if sales at existing stores do not rise.

Due to the weakening of the yen, prices of PCs have risen recently. In the past, the pattern had been for unit prices to decrease, even if the number of units sold increased. But from now on, the trend will be a decline in units sold along with a rise in unit prices.

Two major factors in the first quarter

In the first quarter of FY2013, the price war among merchandise distributors cooled down and the effects from service sales became apparent. This boosted gross profits. On the other hand, SG&A expenses fell below the forecast. There are two major factors behind this performance.

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One factor is that the increase in personnel expenses was small in comparison to the rise in service sales. According to historical results, the number of hours that a staff member spends attending to a customer increases in proportion to the rise in service sales. As more services are provided, personnel expenses are likely to increase since offering such services requires many hours of attending to customers. However, the Corporation successfully improved efficiency. The increase in service sales is due in part to the effects of the accumulated number of existing service members, which also contributed to the curb in growth of personnel expenses. In addition, if existing customers purchase more services and goods, sales increase. Further, the burden of launching new stores was small owing to the limited number of new stores opened.

The other factor is that advertising expenses decreased. The Corporation intentionally reduced such expenses by changing its advertising approach. Simply emphasizing lower merchandise prices was unable to attract as many people as expected. At the same time, if the Corporation arouses more service demand than necessary, visitors to stores will have to wait, which might consequently cause the Corporation to miss the demand. Therefore, the Corporation adopted various ideas in order to increase advertising efficiency, such as advertisements that focus on services and targeting of existing members. This marked the first time since 2007 that sales from existing stores in the first quarter showed positive growth on a YoY basis (101.4%).

What the figures from existing stores tell us

In the first quarter of FY2013, the number of visitors to existing stores fell by 16.1% YoY, while sales from such stores increased by 1.4% YoY. Simple calculation reveals that sales per customer increased by 17.5% YoY, but such a figure does not reveal the truth.

Analysis of the Corporation'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 goods have actually been sold, sales figures cannot be analyzed based simply on the number of members and Average Revenue Per User (ARPU) as is done for service sales of telecommunication carriers. The Corporation's figures include a mixture of sales from goods and monthly fees. That said, it cannot be denied that service sales owing to the cumulative effect have made a greater contribution to the Corporation's favorable performance.

Looking at the quarterly-based sales results posted by the Corporation in the past for the time when it engaged mainly in goods sales, the trend was that sales were not bad during the first quarter, down in the second quarter and became favorable in the third and fourth quarters. This seasonal trend is now disappearing because the Corporation has shifted its focus from goods sales to service sales. Thus, the Corporation's performance should become more stable.

Regarding dividends, the Corporation aims to stably return profits to shareholders over the long term and it targets a payout ratio of 20%.

Time to strengthen the foundation

In August 2013, the Corporation launched a Smart Life store as the first step for its next business offensive. Moreover, the Corporation has positioned FY2013 as a year for solidifying its corporate foundations and it is focusing its efforts into revitalizing existing stores. Response to demands for services is centered and there would be less stores to be newly opened.

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There will be new stores if any good location or any premise with existing furnishings could be found suitable for PC DEPOT, but the Corporation intends to wait and see for a while. As for PC Clinic, the Corporation intends to open if any premise is available at some K's Denki store. However, there might be no PC Clinic newly opened in any K's Denki store if there is no potential for business.

Number of stores increased from 88 to 123, in two and a half years from the end of March, 2010, and at this point the Corporation intends to strengthen the whole scheme. Besides, opening new stores as a whole is planned with its center on Kanto region, and efficiency provided by dominance in this area is envisioned.

In FY2013, the Corporation plans to open two or three new stores. The actual openings will depend on conditions in the coming months, but capital investment is likely to settle down to around the 800 million yen level. The Corporation will also complete the amortization of goodwill in FY2013.

Premium service is accelerated

Service menu has been further enhanced, so high growth of service sales can be deemed to continue for the time being. Customers need services strongly, and every store is busy expanding service counter. On weekend two to three times as many guests come than weekdays, many of them want services. Services specific to the Corporation such as repair, how to use, functional upgrading are highly appreciated. On weekend, waiting time becomes longer and therefore more staff members are required.

The Corporation has currently 680 regular employees and about 1,000 part-time employees (conversion by 8 hours). At present demands for services are so big that about 200 more staff members are required.

Spaces for selling TV sets at stores have been substantially reduced. Instead, support counter is expanded and responds to such demand for services increased due to rush of new products, making efficient use of space.

Members have been continuously increasing. A customer buys some merchandise related to PC, smartphone or tablet device, and he/she is eligible to subscribe to premium service. Nowadays several persons in a family have digital devices, so growing number of members subscribe to service for more than one devices. Depending on the number of devices, various courses of monthly fees are available such as 2,450 yen (3 devices), 2,950 yen (6 devices) and 3,450 yen (10 devices), and this is certainly convenient as wide variety of services can be provided. As the monthly fee increases in accordance with rises in the number of devices, the Corporation's added value also increases.

Response to internet shopping

There is a concern that internet shopping might be a threat to over-the-counter sales. In fact, some people take a look at some commodities at stores and actually buy them via internet. Prices are lower on the internet. That's why.

In such cases, there is no problem if the user is able to make full use of the hardware. Elsewhere, there are strong needs for convenient services in cases where the user does not understand how to use the hardware fully or faces some failure. That is where the Corporation has a chance to show off. Simply selling such as iPhone, iPad, Nexus or Kindle does not make much profit. But if the customer subscribes to premium service, relationship with him/her can be maintained for a long time and service sales will contribute to earnings. In that sense, the Corporation keeps dealing with new products proactively.

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Pursuit of lifetime value

“Lifetime value” is a concept that a time span during which a customer uses a product is considered as the product’s duration (lifetime), and value for the customer during the lifetime is raised as a whole, according to which earnings would be made.

The Corporation’s service sales are growing, but the pattern is normally for services to generate profits only by the second or third year of a three-year contract. Quality of service should be improved so that members would like to buy new products at the same store. Of course, stock of members is bigger at existing stores than new stores. New stores have to compete in goods sales and thereafter, increase their members. So, if prices go down in competitions of goods sales, making profit at new stores would be slower than expected. By increasing members, service sales can be raised and several years later, surplus profit thereof would be generated.

President Nojima has set his basic policy as not to be beaten in selling. He tries to ensure that in a flyer, price for an identical product is lower than any other competitors. The Corporation specializes in PCs and seeks to make difference in services with PC Clinics at the center. Suppose a customer buys a PC and subscribes to premium service for a period of three years. Then the total earnings and profitability can be determined based on the cumulative total over the three years. On the other hand, without selling a product, contract for service sales cannot be made. Thus, on the basis of not to be beaten in selling, quantity should be considered, which would lead to service sales.

President Nojima makes his motto that the Corporation should be aggressive in price competitions, not to be defensive. Nevertheless, service subscription members are increasing, and certain level of lifetime values may be ensured taking the periods of the members’ subscription terms into account. The game is towards expanding this stock-type business. The Corporation does management, reading its service sales.

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

Response to consumption tax: Adoption of tax-exclusive pricing for services

How should the Corporation respond to consumption tax? Every mass home electronics retailer displays prices including tax. Consumption tax is not displayed separately, so customers do not understand explicitly how much it is. It is already included in the price as displayed.

In this regard, price display including tax continues with respect to goods sales. On the other hand, with respect to services, prices have been shown excluding tax, since November, 2012. Essentially, consumption tax is to be paid separately by consumers. With respect to services, the Corporation decided to respond and prepare earlier.

Entering an upward phase in profitability

President Nojima is growing increasingly confident that an ordinary profit rate of 4% is in sight as a result of a series of efforts to shift business models as well as that the Corporation will be able to achieve a rate of 7–8%, which is the medium-term target, within a few years.

However, there is some risk. If any major domestic PC manufacturer stops making PCs, this would affect the lineup of commodities that the Corporation handles. As the Corporation’s business model is based on the concept that demand for services increases by offering hardware, there is the possibility that a decrease

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in the number of major products may negatively affect the Corporation's performance. Close attention must be paid to this risk.

5. Evaluation:

Profitability restored: High expectations for the next development

ROE has improved significantly through the shift of profit structure

The Corporation has clearly shifted to a stock-type profit structure based on service sales. FY2014 could see its ROE reach 10%. Although the shift of business model has been favorably evaluated, the Corporation is still required to make a certain level of efforts for its next business offensives, such as increasing the number of Smart Life stores. In consideration of this, the Corporation is rated B. (Please refer to the front page for an explanation of corporation ratings.)

Reorganization of mass home electronics retailers has effect also on the Corporation. Those having got advantage in purchase prices thanks to the reorganization would make attempts to discount, which should spread to the whole market. The Corporation's business model is to stably generate service sales by selling Internet devices and other hardware. Even if a PC DEPOT store is located near a large mass home electronics retailer, customers can be segregated, president Nojima says. Some customers may prefer PC DEPOT because they can receive fine-tuned services for PCs. The strategy is that such users should be captured in a long-time relationship as premium service members. Smart Life stores, a new type of store, have the potential to be opened in central Tokyo as they have lower investment costs.

As a measure of improving profitability, gross profit rate of goods sales should be raised by 2 to 3%. Then expansion of burden of sales activities on goods sales would be slower, and profit derived from increase in services would come to the surface. Increase in operating income of 1,000 million yen per year may be anticipated. In addition, if unit price of services per person could be increased by 500 yen per month, increase in operating income of 2,000 million yen per year may be anticipated in the mid-term. If these two improvements could successfully go on, operating income of the entire Corporation can be estimated as 4,000 million yen per year. Consequently, the Corporation would be able to establish its unique status as a service company of personal communication, both in name and reality. Such possibilities are in sight.

The Corporation has 3,273 shareholders, which meets TSE's main market listing requirement. There is a chance to explore a better method for financing while increasing the liquidity of the Corporation's shares by selling shares and making a public offering in order to lower the ratio of shares held by the same family. With a rise in profitability, there is a possibility that the Corporation will change its listing market from JASDAQ to the TSE main market.

Based on its stock price of August 21 (42,000 yen), PBR is 0.91, ROE is 10.7%, PER is 8.5, and dividend yield is 1.7%. What kind of era will follow the current PC era? Will the Corporation be able to compete against mass home electronics retailers? It is considered that the Corporation is capable of maintaining a certain level of presence and that its framework for generating profits through IT solution services and its positioning of itself so as to co-exist with the other mass home electronics retailers in different market segments has finally led it to become profitable. At this point, the value of the Corporation will be reconsidered more favorably. For the time being ordinary income of 2,000 million yen and an ROE of over 10% have become feasible targets and it can be highly anticipated that PBR will exceed 1.0.