7618 PC DEPOT Corporation

Format Shift to Smart Life Partner (SLP) Stores with Premium Membership Services

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JASDAQ

Key Points

- Enhancement and stability of profitability have gained traction. The Company 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. The achievement of earnings from service income has become evident.

- The shift to Smart Life Partner (SLP) stores with premium membership services will accelerate. The number of the stores will increase by 12 from 4 in the term ended March 2014 to 16 in the current term. The Company will open an estimated two new stores while transforming existing stores to SLP stores. The shift to SLP stores will allow further tapping of service demand. Leveraging equity finance funds (2.3 billion yen) raised in January 2014, the Company will start a comprehensive shift to the new-format stores and further expand the shift in the term ending March 2016.

- In terms of the profit structure, although sales of hardware such as PCs account for nearly 70% of total sales, this figure has declined year after year, with service income exceeding 30%. Service sales, including technical services and premium services, represent a rapidly growing share of profits. Premium service is a scheme under which the Company asks users to pay a certain monthly use fee after their buying a PC or smartphone and provides them with convenient service for content and maintenance.

- The investment burden accompanying the opening of new conventional stores from the term ended March 2013 has run its course. Contributions from service income have exceeded hardware product sales losses. As the yen became weak and the price deterioration in PCs halted, earnings entered a recovery path. For the term ended March 2014, ordinary income was 2.4 billion yen (up 158.4% YoY), the highest such figure in three years. Ordinary income will renew its peak to increase to 2.9 billion yen for the current term (up 20.3% YoY) and to 3.6 billion yen for the next term (up 24.1% YoY).

- The Company has converted its profit structure successfully into one in which profit is ensured by steady sales of services. As smartphones and tablets are shaping new markets, the Company has been cultivating service demand, basing its operations on PCs as the platform. The Company’s goals are ordinary profit equivalent to 7 to 8% of total sales, and ordinary income of 4 to 5 billion yen. These targets are almost within its reach. Using finance funds, the Company can reasonably target ROE in the 15% range in two years. With PBR at 1.7, recognition in the stock market has risen, and the Company can be expected to increase dividends.

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Company rating: B

Stock price (June 12, 2014): 891 yen　Market capitalization: 23.1 billion yen (25.952 million shares)

PBR: 1.68　ROE: 12.9%　PER: 13.0　Dividend yield: 1.1%

(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	53,816	2,310	2,411	1,554	69.2	8.5
Mar. 2015 (forecast)	53,000	2,800	2,900	1,740	68.7	10.0
Mar. 2016 (forecast)	54,500	3,500	3,600	2,160	85.3	12.0

* Forecasts are based on financial results as of March 2014.

Total assets: 27,138 million yen　Net assets: 13,464 million yen　Equity ratio: 49.5%

BPS: 530.8 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.

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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.

1. Characteristics: Evolution to stores specializing in Internet device service

A shift to a new format, with a corporate mission of bridging the digital divide

PC DEPOT gives priority to serving consumers who have difficulty handling digital network devices. To this end, the Company improves its services in a slow and steady manner. These efforts cultivate a service market, enabling the Company to realize its unique business model. President Nojima says that the Company will take up challenges but will take excessive risks. The Company is always careful to expand business after experimenting and confirming its new course.

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

President Nojima used to work at Nojima, a consumer product mass retailer (Code No. 7419, listed on JASDAQ). The eldest son of Nojima Co.'s founder is currently president of that company, while Takahisa Nojima, his brother, is president of 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 21st year. In the early days after the founding of his business, consumers wanted to buy PCs, but the devices were still beyond their budgets. 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 billion 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 May 2014)	
PC DEPOT	Directly-managed (SLP stores included in the above)	50 (5)	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
	FC	6	
	Subtotal	55	
Total		121	

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), 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. Afterwards, however, as major operators became dominant in the consumer product mass retailer format, general discount stores found it difficult to sell PCs. FC stores of Mr Max Co. were bought by the Company and became its subsidiary (the present 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 5 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, and 6 franchise stores, for a total of 55 stores. As such, the Company currently operates 121 stores.

PC Clinic was operated mainly by FC stores until five years ago, but the Company transformed the FC stores to 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 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.

The Company has made good effective and flexible use of part-time workers, and it has hired some of them as regular employees.

At the end of March 2014, in addition to 721 regular employees, 1,235 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 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	2014.3	
	Sales	Constituent ratios	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	66.9	35,984
PCs and peripherals	24,375	58.5	56.9	52.0	46.5	46.4	42.7	22,981
Accessories, supplies, and software	6,554	14.6	15.0	13.9	12.6	12.1	10.8	5,724
Used items and others	4,643	9.3	6.3	9.9	13.2	10.5	13.5	7,278
Used items and others	11,340	17.6	21.8	24.2	27.8	31.0	33.1	17,831
Sales from technical services and commissions	8,726	10.3	14.4	18.6	23.3	27.3	30.2	16,237
Royalties and other revenue (FC)	522	1.3	1.3	1.1	0.8	0.3	0.3	174
Internet-related businesses	2,090	6.0	6.1	4.5	3.7	3.4	2.6	1,419
Total	46,912	100.0	100.0	100.0	100.0	100.0	100.0	53,816

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.

Premium service is an income source.

The service has various aspects, including (1) the continued subscription of premium members, (2) repair and maintenance, (3) MVNO and (4) content. The categories in the previous sentence are listed in order with respect to the percentage of total sales represented by each such category. In this sense, with premium membership service at the core, focus is placed on the extent to which the content service will grow in the future.

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.

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.

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. Including other services, typical packages for these services are 3,450 yen per month (for up to 7 devices) and 4,450 yen per month (for up to 10 devices). The packages are also cloud-capable.

Main menu of the principal premium services

	Family plan	Family wide plan
Initial setting/support	up to 7 all devices	up to 10 all devices
Wireless internet connection	complete & delivery at store front	High-speed wireless devices 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 7 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 7 Windows PC, Mac or smartphone	up to 10 Windows PC, Mac or smartphone
OS upgrade & backup	up to 7 all devices	up to 10 all devices
Inspection at store front/ periodic backup	up to 7 all devices	up to 10 all devices
Trouble restoration service	up to 7 all devices	up to 10 all devices
Data reconfiguration upon replacement	up to 7 all devices	up to 10 all devices
Memories in smart video	500 yen per month (excl. tax) up to 10 videos tapes (VHS, 8mm and/or miniDV)	500 yen per month (excl. tax) up to 10 videos tapes (VHS, 8mm and/or miniDV)
Tethering set-up	as many devices as needed	as many devices as needed
Extended warranty for PC repair	Unlimited repairs for 800 yen per month (excl. tax)	Unlimited repairs for 800 yen per month (excl. tax)
Monthly fee	3,450 yen (492 yen per device)	4,450 yen (445 yen per device)

PC DEPOT's business model, which generates 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, however, when a fixed month fee is paid, a wireless router is leased to enable the consumers to use high-speed internet service with the purchase of a PC alone. (Depending on the package, there is no extra fee for as many as 3 to 10 devices.)

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 Clinic can readily be used as a one-time-only technical service. 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 mechanism that is impossible for others to copy

Service income tends to increase in accordance with new PC sales. Moreover, service income has increased rapidly along with increasing sales of smartphones and tablets. An individual does not have only one device, but multiple devices. Also, families own multiple devices. Needs for dependable service arise in accordance with the number of devices owned, which makes it easier for the Company to have such users as regular customers.

It seems that competitors would be able to copy this mechanism, but it is actually quite difficult for them to do so. It takes labor and time to give technical consultation, and it requires a high level of knowledge. Many years are needed before making money by providing services. It requires developing human resources, creating a viable a mechanism and continuing the process for many years. It is considered that present consumer product mass retailers cannot achieve this type of business in full scale.

3. Medium term business plan: Fully fledged opening of SLP stores that will open up the content and services markets

A successful launch of new type of store: the PC DEPOT Smart Life Partner (SLP) stores

In the first half term, four SLP stores were opened by renovating existing stores, one each at Nishimagome (in August), Higashifuchu (in November), Himonya (in February) and

Shin-Yokohama (in February). In the current term ending March 2015, stores have been opened in succession at Tomei-Kawasaki (in May), Minato-Mirai (in June) and Chofu (in June).

With these developments, three types of stores have become SLP stores. We have three types of stores with floor spaces of 100, 200 and 300 *tsubo* (one *tsubo* is 3.3 square meters). SLP stores have areas of 100 *tsubo* in Nishimagome, 150 *tsubo* in Himonya, 150 *tsubo* in Tomei-Kawasaki, 250 *tsubo* in Higashifuchu, 300 *tsubo* in Shin-Yokohama, 300 *tsubo* in Minato-Mirai and 300 *tsubo* in Chofu. Taking advantage of its dominant regional strength, the Company is renovating its stores. The logo of the stores has been simplified, and the store color has changed from its traditional blue to orange.

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.”

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.

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 has embarked on full-scale store innovation. 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 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.

Store development history of PC DEPOT

(number of stores at the end of each FY)

		1994	1999	2004	2005	2009	2010	2011	2012	2013	2014 (forecast)	2015 (forecast)
PC DEPOT	Directly-managed	1	10	28	32	43	44	48	50	46	36	30
	SLP stores									4	16	21
	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	0	0
	FC	0	0	0	5	24	6	7	7	7	6	6
Total		1	18	60	61	88	101	119	123	123	123	122

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

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.

All of them were transformed to SLP stores from existing PC DEPOT stores, maintaining store recognition and regular customers. 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. The Company has learned that this format can work well and is speeding up the opening of SLP stores.

Firstly, SLP stores will be increased to up to 20 stores, mainly through renovation. As service grows and the percentage of total sales represented thereby increases, profitability will further improve. After that, progress will depend on the speed at which new stores are opened and the development of store format. As big-box PC DEPOT stores are competitive, they do not need to be transformed into SLP stores soon. Rather, it would make sense to develop a market by opening small SLP stores from scratch and using former tenants' store layouts and structures.

Costs for renovation are lower than those for opening new stores. Moreover, a marked impact can be noted. Comparing the situation before and after renovation, the profitability of renovated stores is about 20% higher than that of existing ones. The expenditures required to open a new store with an area of 400 to 500 *tsubo* could be used for the renovation of four stores each with an area of 300 *tsubo*. Furthermore, the probability of recouping investments is higher, and the returns are also higher. Therefore, such moves are given first priority.

Four stores were renovated to become SLP stores during the previous term, with 10 stores scheduled to be renovated in the current term. In the next term, about 10 stores will be renovated. The previous term saw no new store openings, but there are plans to open two stores during the current term. In the next term, two new stores can be expected, but that number may increase to three to four stores, depending on the availability of locations.

The Company raised 2.3 billion 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, 1.1 billion yen to renovating existing stores, and 300 million yen to improving its IT system.

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. Although the stores put emphasis on providing services before selling hardware products, they have learned that they can also sell more professional peripheral devices than expected. 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.

Forecast number of new PC DEPOT stores to be opened

(number of stores)

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

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.

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
GetNavi	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	Shogi Sekai	1,000	800	Three times in a month
Slugger	1,500	860	Monthly	Nikkei Business	1,900	690	Weekly
Smash	1,200	650	Monthly	Tsuribito	1,200	935	Monthly
dancyu	1,200	860	Monthly	Kamimura Mieko no Oshaberi Cooking	1,000	450	Monthly
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	Package of two magazines	1,500 2,000		
Flick!	1,200	—	Monthly	Package of three magazines	2,000 1,900		
Fujingaho	1,200	1,200	Monthly	Package of four magazines	3,000		
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. Prices of packages depend on combinations. The iPad mini is the 16 GB/Wi-Fi model.

Original development of content and services: more than 50 types 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

The unique service of distributing digital magazines through tablets has further spread throughout the market. Recently, even *Nikkei Business* and the *Asahi Shimbun* can be distributed that way. What is more, a subscription for a certain period results in lower costs than those for print-based magazines and newspapers.

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 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. More than 50 kinds of packages are already being offered.

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 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
iPhone	Extended warranty on property damage (device failure, failure due to water leakage or breakage) Synchronizing iPhones and PCs Making reduced-rate telephone calls with an iPhone Listening to radio programs with an iPhone
iPad	Device failure due to water leakage and breakage (a maximum of twice in two years) Synchronizing iPads and PCs Data sharing with your Mac and iPhone + iPad Watching iPad contents on a large screen
Windows machine	Initial settings + data recovery disk Data migration + HDD backup Support with a one-point quick lecture
Nexus 7	E-mail setting + account registration Safety measures against virus and for personal information protection + 1TB cloud package Reading the Asahi Shimbun on the Nexus 7

Gaining service members by troubleshooting for our customers

In-store arrangements like those of SLP stores are found in Europe, but the Company's business model, which allows it to retain customers mainly through providing services, does not exist either in the West or in Asia.

The inspiration for this business model dated back more than 10 years. At first, the Company started to put priority on serving consumers who were not familiar with PCs. In those days, there was a perception that PC users were somehow a different “tribe” or subculture of people. President Nojima, however, aimed to make customers of people who were not skilled at using PCs. He did not offer PC training courses. He tried to provide free help to people who were unable to use PCs easily and those who wanted to reset their frozen PCs.

Next, he gave priority to serving “people who have difficulties.” He dug deep into the technical support business and made it a tool for differentiating his company from others. Thinking that it would be more convenient to receive service continually by paying monthly fees than paying fees every time a technical problem occurred, he launched a monthly fee system in 2006.

Today, the service has been refined into a scheme that can provide services when users face any technical trouble. The convenience of the premium service has been enhanced as more women and families use PCs.

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.

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. However, once the initial outlay has been covered, profit is generated at a fixed rate from the second year onward.

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.

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.
Consumption tax is not included, so 8% of these prices will be added as the consumption tax.

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

Recently, smartphones seem to be sold cheaply, as if they were a commodity. However, the Company does not merely sell hardware such as PCs and tablets, but offers services. Specifically, this is a system under which convenient solutions are provided on a continual basis for a monthly fee.

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 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.

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.

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.

Focusing on human resources development

Location and human resources are key factors. With the Company's services, people always contact consumers by analog methods, and this is where a benefit is found. Users pay monthly fees because they feel the convenience of a certain frequency of use.

At present, the Company has a workforce of about 2,000, with 721 regular employees and 1,235 part-time workers. (These figures are based on eight hours of work per day.) The Company plans to add 100 regular employees and 300 part-time workers annually. In other words, in order to achieve a 20% increase in the service business, it is necessary to increase the workforce at a certain rate. Furthermore, an increase in the number of workers should occur ahead of business growth. The Company plans to turn 50 to 60 part-time workers into regular employees each year.

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 raised basic wages (a regular wage hike) by over 2% in July 2013 in an effort to improve employee treatment.

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.

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

PC DEPOT has been evolving to achieve a brand new type of format by completing a total makeover of PC mass retailers. After transformation to SLP stores, stores experience changes in comparison from their previous formats, in that (1) customers stay in the stores longer, (2) more female customers visit, (3) customers revisit more frequently and (4) customers consult with employees about various matters.

The extent of sales in terms of customer hardware purchases changes little after renovation. However, sales from providing service are certain to increase. In other words, the stores gain long-term customers.

A short interval between visits means that visitors revisit the store again sooner once they have bought a product or service. Increasing numbers of female visitors represent the fact that needs for digital devices in households have risen and people wish to have a better command of them. In this sense, President Nojima hit a bull's eye.

On the other hand, some customers miss the old stores, where many products were displayed. Others have found the fact that they cannot see many products to be less attractive. However, clarifying the function of stores has highlighted the uniqueness of the Company.

When the Company used a blue logo (for the former PC DEPOT), employees always were looking over their shoulders at competitors. However, after the change to the orange logo (the new SLP stores), they have no longer been paying excessive attention to competitors. It is said that they spend more time in the store explaining products to customers and less time negotiating with customers about prices.

"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.

The number of service subscription members is increasing, so "lifetime value" of a particular level can 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.

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

The shift to SLP stores has sped up the transformation from a flow-based business model to an asset-based one. Connections between customers and the Company have become stronger. Moreover, giving consultation to customers increases contact with them.

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.

Number of stores operating for less than one year

(number of stores)

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

NOTE: The figure in "FY2013 4Q" under "Total" indicates the total number of stores that have been in operation for less than one year for the period from FY2013 1Q to FY2013 4Q.

The figure in "FY2012 4Q" under "Total" indicates the total number of stores that have been in operation for less than one year for the period from FY2012 1Q to FY2012 4Q.

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%. In terms of accounts receivable, sales of service-inclusive products like communication terminals by MVNO and premium services (maintenance service products for members for a monthly fee) increased.

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 by 14 billion yen (up 21.1% YoY), raising the percentage of total sales represented by services to 27.3%. Increased service sales boosted the gross profit margin of total sales from 29.7% in the previous 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 smartphones, which occurred in conjunction with the increase in the number of Internet devices owned per person. Members use more units. Service fees become higher when the members want to receive services in bulk.

The term ended March 2013 saw a clearer improvement in earnings from the second half. 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 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 term ended March 2014 saw another large increase in profit.

For the term ended March 2014, the Company delivered very good results with 53,816 million yen (up 4.8% YoY) in sales, 2,310 million yen (up 163.6% YoY) in operating income, 2,411 million yen (up 158.4% YoY) in ordinary income and 1,554 million yen (up 248.7% YoY) in net income. Income figures were the highest in the Company's history.

The reasons for this are as follows: 1) service sales remained firm, up 28.7% from the previous year and growing to account for 30% of total sales; 2) frontloaded demand for PCs took place before the consumption hike as maintenance for XP was terminated; and 3) prices of PCs and other equipment stabilized with the continuing trend of a weak yen. By product, sales of hardware declined, but the frontloaded demand in March may amount to 1.5 to 1.8 billion yen. Although existing stores had been prepared for a decrease, they performed well, with a 4.8% increase.

The total number of stores as of the end of March has not changed since the previous year, but 4 out of 66 PC DEPOT stores were renovated to become SLP stores (PC DEPOT Smart Life Partner stores).

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%. Due to good earnings, the Company increased dividends.

Comparison of earnings forecasts and of profit ratios

(millions of yen, %)

	2011.3	2012.3	2013.3	2014.3	2015.3 (forecast)	2016.3 (forecast)
Net sales	46,912	49,693	51,353	53,816	53,000	54,500
Gross profit	13,640	14,756	16,134	18,429	19,600	20,700
Ratio to sales	29.1	29.7	31.4	34.2	37.0	38.0
SG&A expenses	12,271	14,202	15,258	16,118	16,800	17,200
Ratio to sales	26.2	28.5	29.7	30.0	31.7	31.6
Operating income	1,368	553	876	2,310	2,800	3,500
Ratio to sales	2.9	1.1	1.7	4.3	5.3	6.4
Ordinary income	1,509	717	933	2,411	2,900	3,600
Ratio to sales	3.2	1.4	1.8	4.5	5.5	6.6

NOTE: Forecasts are by analysts.

What the figures from existing stores tell us

It would not be correct to view the growth rate in the Company's existing stores based on a separation of the number of visitors from sales per customer. 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 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.

Good performance continues in the current term ending March 2015.

During the term ending March 2015, the Company is forecast to achieve 53,000 million yen in sales (down 1.5% YoY), 2,800 million yen (up 21.2% YoY) in operating income, 2,900 million yen (up 20.3% YoY) in ordinary income and 1,740 million yen (up 11.9% YoY) in net income. These figures are in line with the Company's guidelines.

The shift to SLP stores will further speed up from this term. Over the course of the previous term, four stores were renovated. During this term, two new stores will be opened, in addition to 10 stores to be renovated.

In terms of composition of sales, service is expected to continue to grow 20%. Sales of hardware will decrease by the frontloaded amount. Gross profit margin will further increase from 34.2% to 37.0% due to the high growth in service. Demand for service to support products will grow as numerous new smartphones and tablets will continue to be introduced to the market during the current term. In the wake of the termination of support for XP, the need to replace XP PCs with new PCs is emerging. The need for security support remains firm.

Policies for this term are (1) strengthening of handling smart devices, (2) promoting a shift to solutions that combine content and service, (3) developing and offering service products with higher emphasis on worry-free use and security and (4) making an effort to renovate to SLP stores and open new stores. For the next term, the direction will be the same, and continued improvement in profitability can be expected.

Balance sheets comparison

(million yen, %)

	2010.3	2011.3	2012.3	2013.3	2014.3
Current assets	10,511	11,678	14,185	13,991	18,494
Cash and deposits	1,754	2,505	2,083	2,982	4,679
Accounts receivable-trade	2,251	2,533	3,619	4,098	6,939
Inventories	5,316	5,500	7,285	5,986	5,775
Fixed assets	7,443	8,051	9,052	8,942	8,644
Tangible fixed assets	2,844	3,736	4,941	5,073	4,836
Goodwill	1,025	690	406	155	10
Guarantee deposits	1,479	1,440	1,466	1,387	1,349
Lease deposits	1,329	1,234	1,272	1,268	1,248
Total assets	17,954	19,729	23,238	22,933	27,138
Current liabilities	6,473	6,449	9,225	9,009	9,758
Accounts payable-trade	2,764	2,421	3,506	2,087	3,506
Short-term loans payable	800	700	2,100	2,550	900
Long-term loan payable (within one year)	690	1,004	1,518	1,849	1,727
Fixed liabilities	2,743	3,747	4,449	4,149	3,915
Long-term loans payable	1,936	2,759	3,809	3,479	3,244
Net assets	8,738	9,533	9,563	9,722	13,464
Interest-bearing liabilities	3,426	4,463	7,428	7,879	5,871
Interest-bearing liabilities ratio	19.1	22.6	32.0	34.4	21.6

Working capital is on the increase.

The balance sheet for the term ended March 2014 saw an increase in accounts receivable due to the frontloaded demand in March. Shareholders’ capital increased considerably after 2.3 billion yen in finance funds was injected through a public offering. Capital-to-asset ratio jumped to 49.5%.

With the profitability of this Company rising, the Company can make capital investments with internal funds alone. The finance funds of 2.3 billion yen will also be used for making new stores. Capital investment will increase from 800 million yen in the previous year to 1.3 billion yen in the current term. Renovation costs 70 million yen per store. Opening a new store costs 200 to 300 million yen. It is less expensive to open a SLP store than to open a conventional new PC DEPOT store. On the other hand, when service sales increase, operating funds grow faster than such sales. As a result, the investments will be recouped over a few years.

Cash flow trends

(millions of yen)

	2010.3	2011.3	2012.3	2013.3	2014.3	2015.3 (forecast)	2016.3 (forecast)
Cash flow from operating activities	182	1,121	-635	1,597	2,010	1,650	2,160
Net profit after tax	651	713	-63	441	1,902	1,740	2,160
Depreciation	512	595	715	728	686	700	800
Amortization of goodwill	344	334	296	-479	145	10	0
Accounts receivable	-356	-281	-1,087	1,299	-2,840	-1,000	-1,000
Inventories	-564	-184	-1,785	-1,418	210	-300	-300
Accounts payable	28	-343	1,085		1,417	500	500
Cash flow from investing activities	-1,561	-1,440	-2,537	-994	-441	-1,500	-1,500
Tangible fixed assets	-1,341	-1,287	-1,691	-844	-332	-1,300	-1,300
Intangible fixed assets	-56	-163	-140	-135	-374	-200	-200
Free cash flow	-1,379	-319	-3,172	603	1,569	150	660
Cash flow from financing activities	1,330	1,070	2,752	295	127	-1,200	-500
Long-short term borrowings	1,715	1,037	2,964	451	-2,007	-1,000	-200
Common stock issuance	0	0	0	0	2,289	0	0
Common stock repurchases	-225	194	-25	0	0	0	0
Cash dividends paid	-154	-150	-153	-155	-153	-253	-303
Cash and cash equivalents at end-term	1,753	2,505	2,083	2,984	4,679	3,629	3,789

NOTE: Forecasts are by analysts.

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. On the balance sheet, accounts receivable have increased. When service sales increase, accounts receivable grow because a product that combines a tablet with magazines, for instance, is a package of service and a product for which costs are collected partly after the sale from a monthly fee. Store investments have settled down, but the amount of working capital needs to be increased as service sales grow.

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 number of new stores, though it will do so while closely watching market conditions.

Entering an upward phase in profitability

In the term ending March 2016, the Company will increase sales to 54.5 billion yen, ordinary income to 3.6 billion yen, and ordinary income rate up to 6.6%. President Nojima has become more confident that the Company is on track to achieve the medium-term goal of ordinary income representing 7 to 8% of total sales within some years based on a series of changes in the business model. ROE will also exceed 15%.

However, if any major Japanese computer manufacturer stops making PCs, this would affect the lineup of products that the Company handles. The business model necessitates increasing demand for service through products. Therefore, a reduction in the number of the main products on store shelves may negatively affect the Company's business. 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. Eight years after that, profits have caught up with the business model shift.

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 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.

Considering enhancement of profitability, the gross profit margin has improved. As the burden of selling goods decreases in the product sales department, income from a large service increase will be more evident. In addition, the unit price of service per customer has increased steadily. With the two trends developing as planned, the Company soon will be able to achieve its target of an operating profit that is 8% of total sales. 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 number of shareholders is 2,150, which is slightly short of the requirement for listing on the first section of the Tokyo Stock Exchange (TSE). As profitability has improved, the Company has the potential to move from JASDAQ to the TSE sooner or later.

Based on its stock price of June 12 of 891 yen, PC DEPOT has a PBR of 1.68, an ROE of 12.9%, and a PER of 13.0, with a dividend yield of 1.1%. 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.