

7618 PC DEPOT Corporation

Re-examining Solution Services Mainly for Premium Members

August 31, 2016

First section of Tokyo Stock Exchange (TSE)

Key Points

- On August 14, 2016, information was circulated on the Internet that the Company's premium membership service contract with the elderly seemed unfair, and intense criticism started to spread. This aroused suspicions that fraudulent high-pressure selling is conducted, resulting in a plunge in the stock price to half.
- In response, the Company admitted that it provided services unsuitable for usage by elderly people. The Company (1) decided on a guideline for promoting improvement on August 17, 2016 and (2) announced specific actions on August 25, 2016. The Company will examine all 400,000 members who are receiving some form of the Company's services, and if customers' usage is inconsistent with their service contracts, the Company will accept changes in plans and the cancellation of contracts for free. This confirmation procedure may take three to six months.
- For this procedure, a project team comprising 300 people will be formed and will execute the project under the direct control of the President. The Company will ensure thorough training of full-time and part-time employees. When drawing up a contract, a quality management staff as well as the staff in charge will double check the appropriateness of the contract in the Company.
- With this opportunity, the Company will examine overall services and promote reform. Using this measure, the Company will make every possible effort to regain trust for the primary goal of fulfilling "a social mission to solve problems in IT society." It may take two years to achieve results.
- Business profit will be affected by (1) the extent of cancellation, (2) the fall in service sales, (3) an increase in costs for actions taken by the Company, (4) a decrease in sales capabilities at stores, and (5) the spread of a diminished reputation. The Company will receive the most unfavorable financial results during the second half of the current term, but business profit will recover from the second half of the next term. The Company posted an operating income of 4.3 billion yen in the previous term. Although it initially targeted an operating income of 4.9 billion yen in the term ending March 2017, this will fall to roughly 3.5 billion yen. Even if operating income plunges in the next term, it should remain around 3.0 billion yen.
- A single case has aroused doubt about the essence of our services, which is the provision of support for digital-illiterate users. Since its business model has not collapsed, we would like to pay close attention to how far the Company can recover based on the drastic measures to be taken this time.

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Company rating: B

Stock price (August 31, 2016): 713 yen

Market capitalization: 31.3 billion yen (43.852 million shares)

PBR 1.37

ROE 10.3%

PER 13.3

Dividend yield: 2.2

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

Fiscal yearend	Sales	Operating	Ordinary	Net	EPS	Dividend
Mar. 2009	42899	1259	1429	684	20.7	4.7
Mar. 2010	44740	1226	1306	677	20.7	4.7
Mar. 2011	46912	1368	1509	737	22.8	4.7
Mar. 2012	49693	553	717	280	8.7	4.7
Mar. 2013	51353	876	933	445	13.6	4.7
Mar. 2014	53816	2310	2411	1554	46.1	5.7
Mar. 2015	51285	3089	3205	1941	51.1	8.3
Mar. 2016	51784	4314	4366	2867	71.8	11.5
Mar. 2017 (forecast)	50000	3500	3500	2300	53.6	15.6
Mar. 2018 (forecast)	49000	3000	3000	2000	46.6	15.6

* Forecasts are based on financial results as of June 2016.

Total assets: 34,559 million yen Net assets: 22,376 million yen Equity ratio: 64.6%

BPS: 520.3 yen

NOTE: ROE, PER and dividend yield are based on the most recent forecast. On October 1, 2013, the Company carried out a share split at a ratio of 1:100 and on January 1, 2015, a share split at a ratio of 1:1.5. The EPS and dividends for the preceding terms have been revised accordingly. The Company plans to carry out a share split at a ratio of 1:1.2 on October 1, 2016

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

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

1. Case: Where problems exist and the Company's response

What happened

Doubt spread on the Internet concerning a contract made by an elderly person that may not match his use. The main point of contention was whether or not the cancellation charge imposed when the elderly person's son canceled the service, and the actual conditions of services received were appropriate.

The problem

This report has regarded the premium service provided by PC DEPOT highly. However, a rumor spread with doubts as to whether "there was fraudulent conduct targeting elderly people" and whether "the conduct had malicious intents even if it was not illegal."

We should examine the following six points: (1) whether the elderly person was able to fully understand the content of services, (2) whether the contract was signed without the customer's understanding, (3) whether the service was appropriate for the customer, (4) what explanation and response the Company will provide in this case, (5) whether the response was persuasive enough, and (6) how this situation will affect future earnings.

There are customers who subscribed to the premium service and found the service useful with five PCs and five smartphones used in a household of five. When a computer is broken, the Company restored it immediately. It also extracted data and made the data available for reuse. When the customer purchased a new PC, it transferred all the data and set up the new PC like the previous one to make it ready for immediate use. When the customer purchased a new smartphone, the phone became available for immediate use in the same manner.

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This service has two aspects: one is the service provided by specialists when a hardware is broken or a software stops functioning because the user does not know what to do. Another is the service for when a user feels that spending time on reading manuals and making inquiries by telephone is troublesome and would like to entrust it to someone else despite being able to deal with it by him/herself. Both of these are maintenance-type services providing support when problems occur. However, this varies greatly between individuals.

Moreover, there is another type of service—services included with products purchased in installments. The Company calls these service-inclusive products.

Some subscribers purchase PCs as products in a single payment and not in installments. Smartphones are purchased in installments and not in a single payment, which is common. A customer wanted to use Wi-Fi at home and introduced a router service. The wireless signal from the router could not reach the first floor and basement one. The customer used to have two lines with two routers but a PC DEPOT staff visited the customer's home and examined the state of the signal. The staff discovered that one router was enough if a repeater was placed in the right position and made necessary arrangements. Everything was included in the service, and no additional cost was required in this case.

If an elderly person lives alone and subscribes to the Family Wide 10 Devices plan, it would have been unnecessary. The elderly person would not need to pay 5,500 yen per month as the Single Plan for One Device costs 2,500 yen per month.

However, if a household only has one person but that person intends to use a PC, smartphone and tablet with Wi-Fi at home, it requires the Personal Plan for Three Devices, which costs 4,000 yen per month.

Cancellation charges vary depending on cases such as (1) cancellation within the first month of admission to membership, (2) cancellation after one year, and (3) cancellation after three years. The Company expects to collect payment based on the assumption that the customer is on a three-year installment payment plan. Therefore, when a contract period ends up being shorter than three years, customers are required to pay the outstanding amount of hardware in use. This is also a common method.

The Company makes the policies on how to sell the services and what price to set on services. If a service does not meet customers' needs, the service will not sell. If unnecessary services are offered, customers can request to remove those services.

Based on the writer's many years of experience in the financial industry, financial

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transactions with elderly people require meticulous care. Even though elderly people agree on conditions at the time of contract signing, they sometimes claim that they have never been informed of certain items.

In the IT industry in this case, the occurrence was against the essence of the service, which is the provision of support for digital-illiterate users. For this reason, the case came under criticism.

The Company's response

With regard to the premium service contract, the Company viewed seriously the fact that services that were unsuitable to customers' usage have been provided, and specified measures to promote improvement. The Company has decided to introduce the following measures to its service subscribers of roughly 400,000 people:

- (1) If the contract is unsuitable to the customer's usage, the Company will accept changes in plans or the cancellation of contracts for free, provided that the customer returns the devices that were provided.
- (2) In the past, when customers aged 75 or older subscribed to a new service, changes in plans and the cancellation of contracts were free of charge within one month. From this point onwards, when customers aged 70 or older subscribe to a service, (i) the Company will check with a family member or a third party, and (ii) changes in plans and the cancellation of contracts are free of charge for the first three months.
- (3) For new subscribers aged 75 or older, the Company will accept changes in plans and the cancellation of contracts for free regardless of the time of the subscription.

The main point is that the Company will check with a family member or a third party when any elderly people aged 70 or older subscribe to a new service.

Specific actions

As specific actions, the Company will (1) assess and confirm the situation of service usage through direct mails and calls to all members, (2) set up counters for members' exclusive use at stores to provide explanation and information, and to confirm the details face-to-face, and (3) assign new quality management staff for the premium service at stores and create a system to double check contracts with store staff. The Company will assign 100 quality management staff at stores for the above. These actions will be implemented progressively from the beginning of September.

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Effectiveness

With a project of 300 staff under the direct control of the President, the Company will check with 400,000 subscribers whether its services agree with their needs. This procedure will require three to six months.

The Company will ensure thorough training of employees and will implement a checking procedure conducted by quality management staff. With these actions, premium services not meeting customers' needs will be thoroughly reviewed.

The most important point is to determine how many people are dissatisfied with PC DEPOT's current services, and are planning to review and cancel services through the inquiry to be conducted this time.

We cannot estimate the exact number until we get the results of the examination; however, we need to consider the following points: (1) demand for services has been growing at a rate of 20% per year for the past several years, (2) when a service period terminates and is renewed after three years, devices are also renewed, and (3) the service menu has also been renewed during the period.

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

Bridging the digital divide is a corporate mission

PC DEPOT is prioritizing support for customers struggling to use digital network devices. To this end, the Company is improving 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 not take excessive risks. The Company experiments, confirming a new course before carefully expanding business.

The Company has been developing IT solution stores known as Smart Life Partner (SLP) stores that customers can maintain a relationship with over the long term. Instead of merely enjoying the convenience of a neighborhood PC superstore, users can have the Company solve the problems they experience when using IT equipment and networks.

New devices and services are continuously entering the market, which is a characteristic of the information and communication technology market. Customers need support in order to maintain an IT environment that enables them to fully utilize

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the products and services they use. SLP stores provide services and detailed explanations so that users can make full use of the features of their desktops, notebooks, smartphones, tablets (multi-function mobile terminals), and other devices, and meeting any other user requirements as a total set.

These services are truly convenient. 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 (age 57) used to work at Nojima, a consumer product mass retailer (Code No. 7419, listed on the first section of the TSE). 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.

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Nojima was 34 years old when he started his business, which is now in its 23rd 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 became listed on JASDAQ. Subsequently, the Company was promoted to the first section of the TSE in November 2015.

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. When viewed in the broad sense of the consumer electronics and computer superstore sectors, the Company ranks in a low position in terms of size, but it is competing on a different playing field to its rivals. The Company is not directly competing with the biggest companies, such as Yamada Denki, Edion, and K's Denki, but differentiating itself from these companies.

Converting franchises to directly-managed stores: 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 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.

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(specializing in cameras) also became PC DEPOT franchisees. 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.

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.

As of the end of June 2016, there are 54 directly-managed PC DEPOT stores (including 28 SLP stores), 13 stores outside the Kanto region run by the PC DEPOT Stores Co., Ltd. subsidiary, and 3 franchise stores, for a total of 69 stores. In addition, there are 53 directly-managed PC Clinics, 5 stores run by the PC DEPOT Stores Co., Ltd. subsidiary. The number of subsidiaries of PC DEPOT PC Clinic has increased by five as the Company purchased PC Clinic stores from Hokuetsu K's CO., LTD. As such, the Company currently operates 128 stores.

PC Clinic was operated mainly by FC stores until seven 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.

Store development conditions

(Number of stores)

Number of stores (at the end of June 2016)			
PC DEPOT	Directly-managed	26	PCs and related products for home users; technical support services Kanto region (Kanagawa, Tokyo, Chiba, Saitama, Shizuoka, Gunma, Tochigi and Ibaraki)
	(SLP stores included in the above)	28	
	Subsidiaries	13	PC DEPOT Stores (Kyushu, Chubu, Shikoku, Koushinetsu and Tohoku regions)
	FC	3	Kinki and Chugoku regions
	Subtotal	70	
PC DEPOT	Directly-managed	53	Operations inside the premises of other mass home electronics retailers
PC Clinic	Subsidiaries	5	PC DEPOT Stores
	Subtotal	58	
Total		128	

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

Among the 26 directly-managed PC DEPOT stores, 20 stores are Smart by Solutions (S x S) stores.

Among the 13 stores directly managed by a subsidiary, 9 stores are Smart by Solutions (S x S) stores.

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Ongoing Web business

EJWORKS Co. (ejworks), a PC DEPOT subsidiary, is engaged in the IT solution business and has lines of business that include internet service provision and Web content creation. The Internet services market started from around 2000. 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 use of part-time workers, and it has hired some of them as regular employees.

At the end of June 2016, in addition to 817 regular employees, 1,345 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-time workers have been working for the Company for years, and each year roughly 60 to 70 workers change their status from part time to full time.

Complying with corporate governance: Increase in the number of outside directors

The Company is complying with corporate governance as a company with auditors. There were three outside directors (including two independent outside directors), but the Company increased the number of outside directors to four at the last general shareholders meeting. These outside directors include a certified public accountant, an attorney, a university professor, and an entrepreneur. With eight inside directors and four outside directors, discussions at the board of directors are becoming more animated. Mr. Mineo Fukuda, an outside director, successively filled the post of director at Recruit Holdings Co., Ltd., KADOKAWA CORPORATION, and Jupiter Telecommunications Co., Ltd. He has extensive experience in the media industry. Mr. Yoshinari Noguchi, an

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auditor, has long experience in internal audits at Oracle Corporation.

Most directors who execute business are in their 40s, showing that management talent has developed. President Nojima established this Company after leaving Nojima Corporation. Regarding the operation of the company, the president is aiming to implement business management suitable to fulfill the need for PC DEPOT, as a public company, to continuously develop in the rapidly-changing IT industry.

3. 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.

The Company leads the industry in PC repairs and maintenance services. Moreover, the revenue generated by these services has been growing in double digits annually and as such is demonstrating rapid growth. Although the Company is a middle-standing company in the industry in terms of the number of PCs sold, it has unique service characteristics.

Over last 10 years, while PC DEPOT gradually shifted its business to services, the Company ran into difficulties in 2011 and 2012 when it opened five large conventional-type stores. The earnings fell around this time, and the balance of interest-bearing debt grew to over 7 billion yen.

The Company has achieved a unique presence among its competition with mass home electronics retailers. 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. Under these circumstances, the Company did not overextend itself when opening new stores. It decided, however, to become a customer-orientated IT solutions company, by

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striving to improve its services, instead of increasing the sales numbers for desktops, notebooks and other hardware. The Company markedly changed its tack to follow this direction in 2005. This was the second turning point for the Company since it was founded.

Providing solutions in combination with various services is key. The Company provides telecommunication services using SoftBank's network (former Y- MOBILE's) as a Mobile Virtual Network Operator (MVNO). Also providing fiber-optic network services as a fixed virtual network operator (FVNO). Moreover, when members subscribe to the Company's premium services, they can get any support they need: maintenance, call-center services, anti-virus support, and a "full installation" service for when customers replace old PCs.

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 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.

Unique business model with premium services as its income source

The services have various aspects, including (1) the continued subscription of premium members, (2) repair and maintenance, (3) MVNO and FVNO, and (4) content and solution services that connect the above-mentioned merchandise horizontally. The categories in the previous sentences 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, solution services have been growing on a full scale.

The Company's business model is quite unique, even when compared to companies outside of Japan. The model consists of product sales, service sales, its operation as an MVNO, and other areas. 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-

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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.

Trend in constituent ratios of sales

(% , millions of yen)

	2009.3		2010.3	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	
	Sales	Constituent ratios	Sales							
Goods sales	35572	82.4	78.2	75.8	72.3	69.0	66.9	58.7	49.7	25761
PCs and peripherals	24375	58.5	56.9	52.0	46.5	46.4	42.7	33.7	25.3	13101
Accessories, supplies, and software	6554	14.6	15.0	13.9	12.6	12.1	10.8	8.4	7.6	3944
Used items and others	4643	9.3	6.3	9.9	13.2	10.5	13.5	16.6	16.8	8715
Service sales	11340	17.6	21.8	24.2	27.8	31.0	33.1	41.3	50.3	26022
Sales from solution services	8726	10.3	14.4	18.6	23.3	27.3	30.2	38.4	47.6	24644
Royalties and other revenue (FC)	522	1.3	1.3	1.1	0.8	0.3	0.3	0.3	0.2	110
Internet-related businesses	2090	6.0	6.1	4.5	3.7	3.4	2.6	2.6	2.5	1267
Total	46912	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	51784

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 5,000 yen per month (for up to 7 devices) and 5,500 yen per month (for up to 10 devices). The packages are also cloud-capable. These services have been gradually expanded and improved.

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

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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 new three-year elite personal plan) costs 6,800 yen (7,344 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

The business model at PC DEPOT is unique, and competitors have started to open stores similar to SLP stores. Since these competitors have not established a system or trained employees to provide premium services at the same level as the Company, the competition has not really become serious.

The Company is a retail service company for personal devices that provides solution services under a membership system. With no other companies pursuing a solution-service-based business model in the same manner as the Company does, the Company is building up the one and only business.

Even if another company tried to provide such services, it would be extremely difficult to (1) train the personnel required for technical services, (2) tolerate a decline in profits in the early stages due to the shift to a service income type business, and (3) provide an extensive service menu, from now. Thus, we may say that the Company's superiority over its rivals is significant.

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.

The Company provides services by assigning experts in each service category and having them work as a single team. It has spent more than 10 years developing this system, which has become a business model that constitutes part of its corporate culture.

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Establishment of intellectual assets: Knowledge, router, and cloud services

There are three notable items in terms of unique intellectual assets. 1) Store staff are connected by transceivers and can talk to staff at the knowledge center at the head office. The Company obtained a patent for this cyber system 11 years ago. The system has been making significant contributions to information sharing and improvements in customer services. 2) The Company also obtained a patent for router technology (SSW and SGW) four years ago. Customers can receive services without bringing their routers to the store counter since store staff can produce a home Wi-Fi environment at the store counters and can complete the settings. Customers can receive Wi-Fi services through routers without any trouble. 3) Regarding cloud services, the Company has obtained a patent for identity authentication performed when cloud services are provided. Moreover, the Ozzio drive cloud service is now patent pending. Since data in PCs and smartphones is automatically stored in the cloud, customers can easily recover data at the time of failure or during replacement of equipment.

SLP stores are fashionable and convenient: Specialization in services

The Smart Life Nishimagome 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 in a store 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 customers' needs (such as computer repairs) has been 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.

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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 acceptable.

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.

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 by giving preference to customers who were not familiar with PCs. In

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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 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.

4. Medium term business plan: Full rollout of SLP stores providing solution services

Not easily influenced by the sales volume of PCs, tablets and smartphones

The market of PCs, tablets, and smartphones is saturated, and sales volumes are expected to decrease. However, demand for the Company's services has been increasing and has been barely affected by the sluggish sales volume in the market.

Changes constantly occur in the industry such as the launch of new products and

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services, and the termination of existing services. As a result, more customers seek support since they cannot master how to use peripherals and software as well as PCs, smartphones, and tablets. Since the Company's services are not available in many people's neighborhoods, the Company should be able to acquire new customers by opening new stores.

One issue is how best to provide services to customers. In the Company business model, stores solve the difficulties customers are facing and earn revenue in the long run by providing solution services. The time required to serve each customer becomes longer with good customer service. Higher customer satisfaction will result in a good relationship between the stores and customers. Quick customer throughput is not the priority.

Opening a large number of SLP stores by renovating existing ones

The Company plans to continue renovating 10 existing stores and to reopen them as SLP stores. The Company also plans to open four new SLP stores. SLP stores will be more focused in central Tokyo than is the case for existing stores.

SLP stores transformed from existing PC DEPOT stores already have a certain level of 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.

Firstly, the Company has been increasing SLP stores mainly through renovation. As the service grows, and the percentage of total sales that it represents increases, profitability will further improve as a result. 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.

On the other hand, there remains considerable room for new SLP store openings. 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. The Company reckons that it requires 100 to 200 *tsubo* of

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land in Tokyo's 23 wards and 200 to 300 *tsubo* (1 *tsubo* = 3.3 sq. meters) of land in the greater Tokyo area if it plans to effectively open an SLP store in a vacant space. However, the Company has learned that SLP stores can be opened on even smaller areas of land.

Store development history of PC DEPOT

Number of stores at the end of each FY											(Stores)
	1994	1999	2004	2009	2010	2011	2012	2013	2014	2015	2016 (forecast)
PC DEPOT											
Directly managed	1	10	28	43	44	48	50	46	36	28	18
SLP stores								4	15	25	39
Subsidiaries				4	4	12	11	11	13	13	13
FC		8	32	17	17	5	5	5	3	3	3
PC DEPOT PC Clinics											
Directly managed					30	46	49	49	52	52	57
Subsidiaries						1	1	1	0	5	5
FC				24	6	7	7	7	6	1	0
Total	1	18	60	88	101	119	123	123	125	127	135

NOTE: SLP stores include both new and renovated stores. Some directly managed stores have been renovated so as to be changed into SLP stores, and thus the relevant numbers have decreased. Ten stores are projected to be renovated in FY2016.

New SLP store openings: Setagaya-Kinuta

The Setagaya-Kinuta Store was the first new SLP store. Customers are gradually increasing. Many customers are bringing in hardware purchased from other companies for repairs, increasing the store's customer base. This store was launched on a full-fledged basis in March and the Company invested around 400 million yen in this store opening due to its wide floor space of 300 *tsubo*. However, this is an exceptional case. The Company usually invests roughly 200 million yen in stores with a floor space of 100 to 150 *tsubo*, and roughly 40 million yen in stores that have all their fixtures and furnishings.

Since this is the first new SLP store, not a renovated store, the store does not have any existing customers. It is not attempting to attract customers with product sales as traditional PC DEPOT stores do. Instead, first the store encourages customers to visit and then it attempts to gain their acceptance by providing them with services in which they can readily seek advice if they encounter any problems. It may take some time for the store to build up its popularity; however, customers will start counting on the store when they have difficulties with their smartphones, PCs, and tablets. Local residents will appreciate having such a store located in Setagaya.

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Opening a store in Aoyama in central Tokyo

Many people want the solution services provided by PC DEPOT. The Company launched the Aoyama Store in December 2015 and the Azabu-Juban Store in March 2016 as city-center stores in Tokyo. These stores target new customers living in central Tokyo. Customers visiting the Aoyama Store live in the neighborhood. More female customers than expected are visiting the store. The number of customers is increasing, and a generation of people somewhat younger than seniors is visiting the store.

Both the Aoyama and the Azabu-Juban Stores started to steadily acquire regular customers. Customers are increasing, and one of the reasons for this is that an SLP store was introduced on TV (in the program called “*Gacchiri Monday*” broadcast in May 2016). That said, public recognition of SLP stores is still low. SLP stores value serving customers on a one-to-one basis to solve customers' problems. If customers who are not reasonably familiar with PC DEPOT are kept waiting due to a sudden increase in customers, this may give them a negative impression. For this reason, the Company is endeavoring to steadily expand SLP stores.

The Aoyama Store was opened in December 2015 and is located on the first floor of the new Aoyama Quartz Tower (a comprehensive medical facility). This will be a new small-sized SLP store and the first store within the circle of the Yamanote Line. The Company will make a base of members by targeting people living within a two-kilometer radius of the store. The Aoyama Store is located in a premium location along a main street. Company President Nojima believes that the Aoyama Store will be a symbol of the SLP store, and other stores to be opened in central Tokyo will not need to be situated along a main street if people living within one to two kilometers can locate it easily.

The Aoyama Store will occupy two floors with a space of 70 *tsubo*. The prices of solution services rendered by the Aoyama Store will be higher than those of other stores. In other words, taking the type of customers into account, pricing will reflect the convenience of the store. As customers will not visit this kind of store if they do not need the service, the Company will be more selective about its target customers.

Located in central Tokyo, this store will provide high-quality services and support fitting the area. Thus, service fees may be determined under a different pricing structure. Instead of competing with low-cost BICCAMERA INC. services, the store will attempt to establish unique, high-quality services and branding. Also, the store expects people visiting central Tokyo to visit PC DEPOT SLP in Aoyama to learn about its excellent services, enticing local SLP store visits.

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City-center small type stores and acquiring regular customers

New stores in Kinuta, Aoyama, and Azabu do not have existing customers and will need more time to develop new customers. This takes more time than in previous store openings that focused on product sales. However, once the stores gain customer trust, the relationship will last a long time since the relationship starts from customer demand for services. The prospects for the business will be certain after a one-year period. There should not be much of a problem in making the new stores profitable.

Unexpectedly, some customers are in the younger generation in central Tokyo. People in the grandparent generation also bring their grandchildren. There are growing numbers of people of a younger generation who do not use PCs but instead use only smartphones. In some cases, grandparents and parents know about PCs better than they do. These people visit stores and receive services as customers.

Types of stores launched can be categorized as Version 0 (V0), Version 1 (V1), and Version 2 (V2). An example of V0 is the Azabu-Juban Store, which is a very small store. This store focuses on services, and product lineups are limited. Even so, the store will be moderately successful due to its location close to the station. An example of V1 is the Himonya Store, which is a little larger and has more product lineups. The Company will start more aggressive operations in the city center with these V0 and V1 type stores. Large stores are categorized into V2, and the Inagi-Wakabadai Store is now operating on a test basis. Once the Company is confident of business prospects for large stores shifting to SLP stores, the Company's large stores will be able to enter a new phase of development, and demand for services will further increase. The Company will open new stores in central Tokyo, focusing on five urban districts: Shinjuku-ku, Shibuya-ku, Chuo-ku, Chiyoda-ku, and Shinagawa-ku.

Forecast number of new PC DEPOT store opening

		(number of stores)						
		2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	2017.3 (forecast)
PC DEPOT	Directly-managed	1	4	3	0	0	0	0
	SLP stores				0	1	3	4
	Subsidiaries	0	6	2	0	2	0	0
	FC	0	-12	0	0	-2	0	0
PC Clinic	Directly-managed	30	16	3	0	3	0	5
	Subsidiaries	0	1	0	0	0	5	0
	FC	-18	1	0	0	0	-5	0

NOTE: New directly-managed stores are SLP stores. PC Clinics depend on projects with partners.

FC stores became PC DEPOT's subsidiaries.

In the term that ended March 2016, the FC stores became PC Clinic's subsidiaries.

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The ongoing shift to SLP stores has been extended to large-scale stores with the Inagi-Wakabadai Store now being tested out

Large PC DEPOT stores with services provided at SLP stores are Smart by Solutions. This type of store was first opened in September 2014, and the stores numbered 16 by the end of March 2015, and 31 by the end of March 2016.

The Company introduced Smart by Solutions (S×S) at the Tomisato-Interchange store in Chiba. This store has been installed with a counter that, similar to that in SLP stores, has the blue signboard of large conventional stores, not orange as in SLP stores. Large PC DEPOT stores are renovated with a Smart Counter installed inside, as in SLP stores. Although the size of stores renovated into SLP stores was up to 300 *tsubo*, the Company is making a different attempt with larger version 2 (V2) stores.

In September 2015, the Inagi-Wakabadai Store, formerly a conventional PC DEPOT, was renovated into a new SLP store. It is a large-scale store with a floor space of 500 *tsubo*. The store was designed and arranged in such a way as to enable customers to experience IoT. Many of the major consumer electronics superstores are operating around this store. This store, mainly providing services, needs 1.5 times the manpower of the former business format. The Company is aiming to differentiate the store by providing a service that the superstores cannot replicate.

This large SLP store will focus more on IoT visualization, compared to conventional stores. Since the store has sufficient space, it can offer 120 seats. The Setagaya-Kinuta Store has 85 seats. Moreover, customers can try out IoT devices allowing them to experience Smart Life.

While renovating stores with floor space of 300 *tsubo* costs 70 million yen, converting stores with floor space of 500 *tsubo* into SLP stores costs roughly 100 million yen. If this store is successful, converting large stores into SLP stores will expand.

Responding to service demand and upgrading customers

Customers receive various services. Therefore, it is not appropriate to consider the Company's service fee income by looking at the number of members multiplied by the average membership fee. Some customers visit stores for repairs, others for specific services. Some customers subscribe to premium services and then once they have received the Company's services, they come to realize that being maintenance-free is advantageous, and that additional services would also be useful. More customers will use the cloud service. What is going to happen next? As the quality of services is

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improved, customers will be upgraded.

Main menu of the principal premium services

	All device family plan	All device family wide plan
Data support services at the time of purchase	1 PC	1 PC
Wireless Internet connection service	Free for high speed setup at store counters	Free for high speed setup at store counters
Measures against virus infection/data leakage/entering dangerous sites	up to 7 PCs or smartphones (antivirus software enhancement)	up to 10 PCs or smartphones (antivirus software enhancement)
Internet fraud countermeasures	up to 7 for all devices	up to 10 for all devices
ozzio email account registration/setting	1 address	1 address
Explanation on basic operations at store front	up to 7 PCs or smartphones	up to 10 PCs or smartphones
OZZIO cloud automatic backup service	up to 1TB	up to 1TB
24-hour remote support by telephone	Free up to 10 supports per year	Free up to 10 supports per year
OS upgrade & backup	up to 7 for all devices	up to 10 for all devices
Inspection at store front/periodic backup	up to 7 for all devices	up to 10 for all devices
Trouble restoration service	up to 7 for all devices	up to 10 for all devices
Data reconfiguration upon replacement	up to 7 for all devices	up to 10 for all devices
Memories in smart video	up to 5 videos stored	up to 5 videos stored
Extended repair guarantee for PCs	Unlimited repairs for 800 yen per month (excl. tax) (An exemption clause is included)	Unlimited repairs for 800 yen per month (excl. tax) (An exemption clause is included)
Monthly fee	5,000 yen (714 yen per device)	5,500 yen (550 yen per device)

The Company plans to steadily expand service lineups and move to prices corresponding to service expansion. The focus is shifting to improved software with increased security and improved usability with increased router speed.

In March 2015, the Company launched a member support system, called JIMAS, which comprehensively increases the efficiency of services. (JIMAS stands for *Jitaku* (home) Internet device Multi-Assistant System). Customers are invited to join the service with a device management system. Under this service, the condition of certain devices is constantly monitored with a dedicated application installed on the device. If a device is lost, it can be locked remotely. These services allow the Company to manage

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digital information and store it as customer records. Using these records, customer service can be further enhanced.

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 restoration service	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 a 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.

Stepping up efforts to provide solutions

The future sales policies of the Company are to (1) step up smartphone sales and (2) concentrate on providing solutions. As smartphones sell well, the Company is required to provide solutions to support them. Recently, an increasing number of users have printed directly from their smartphones and tablets using printers, and this encourages better sales of printers. The Company has started to provide services that enable customers to use a printer at a monthly fee of 500 yen rather than purchase a printer for 25,000 yen. Thirty percent of the Company's customers acquire a printer through this type of service.

NTT East and NTT West have started wholesaling optical line services. These services allow other companies to lease NTT's networks to provide fixed-line services under their

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own brands as fixed virtual network operators (FVNO) like mobile virtual network operators (MVNO). Up to now, the Company has acted as an agency for optical lines, but from now on it will provide them under its own brand. From the Company's router onward, the same line can be used, and therefore, NTT's optical line will be replaced by the Company's own. Since it can incorporate these into the premium services, the Company can improve its overall services without any particular difficulties.

Specifically, the Company can (1) provide hardware maintenance services for smartphones, (2) offer services associated with smartphone replacement, (3) lower communications fees by incorporating FVNO services into its premium services and (4) help users to achieve greater efficiency in home communications hardware and software. These services will be useful to users. The Company will be able to charge higher monthly service fees that correspond to such services.

Increased added value with FVNO

It seems that a few thousand customers a month are joining the service using FVNO. When customers switch to the Company's fiber-optic network service, a communication fee of 4,000 to 5,000 yen per month is recorded as sales from services. While profit margins will be higher compared to conventional agency commissions, profit ratios for services will decrease.

PC DEPOT high-speed optical line (Optical Internet service as an FVNO)

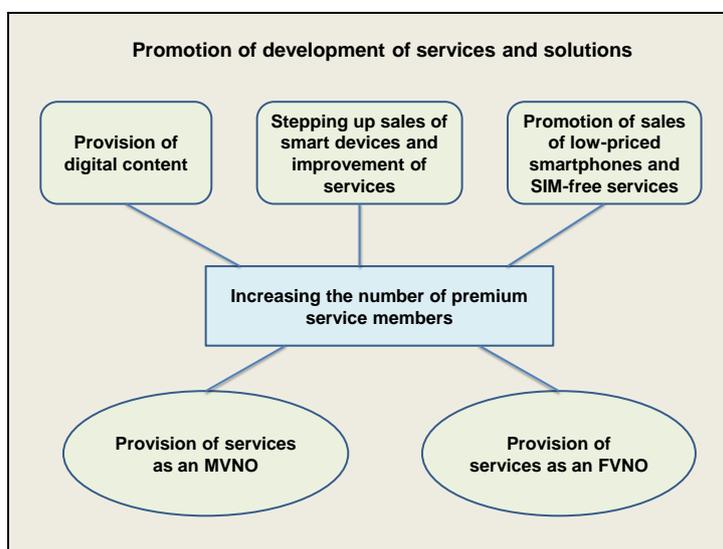
- The Company has developed "OZZIO Hikari" as an FVNO (fixed virtual network operator), starting in February 2015.
- It is being integrated with the Company's MVNO services, such as premium services, support services, content services and low-priced
- OZZIO Hikari is provided by the Company by buying wholesale optical lines from NTT.
- The Company's premium members can get a good-value set of services and enjoy the convenience when they change from NTT's optical lines to OZZIO Hikari.

FVNO's service provision using optical lines is an epoch-making change. In the 30-year history of the privatization of NTT, sales of mobile phones have increased, centering

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on NTT DOCOMO, while fixed telephone lines have been on the decrease. Under such conditions, NTT East and West first tried to expand optical network lines on their own; however, later they completely changed their policy.

In short, they decided to terminate their retail business and devote themselves to wholesale business. As the optical lines of NTT are sold on a wholesale basis, it has become possible for anyone to initiate retail services. NTT DOCOMO is able to provide services for both mobile phones and optical fixed telephone lines, while other companies in various industries also sell optical fixed telephone lines at retail among their services. In that sense, competition will become fierce, but the Company can greatly expand the range of its services and products.



FVNO services will also support fixed-line services. So far, the Company has provided services by attaching its Wi-Fi router to the tip of optical fiber lines, but now it has become possible to provide services including fixed optical lines.

The Company will have to compete with mobile phone shops of carriers in FVNO services. In the competition, each company will make the most of its characteristics. The Company will have existing members subscribe to FVNO services and communicate the advantages of the Company's unique services to customers.

PC DEPOT's unique services using optical fixed telephone lines have a good reputation. Customers can check faxes that have come to their homes via their smartphones, use their smartphones as cordless handsets at home, and make telephone calls and send

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faxes within 10 minutes 300 times a month without paying any surcharges. Customers can use these services at the cost of 2,000 yen per month by subscribing to the Company's optical Internet services.

Convenient services — “Just Show up and Buy a New PC”

In addition to MVNO, FVNO has entered the market. Thus far, people have visited PC DEPOT only when they need something related to PCs; however, from now on, they may visit PC DEPOT for any types of Internet devices, including smartphones, tablets, printers, and fax machines. Unlocked SIM services became available from May 2015. The service costs 2,000 yen per month. Optical fixed line service costs about 5,000 yen per month. A certain contribution to profits can be expected from the second or third year if these services grow.

Under such conditions, the key is the cloud. The Company will launch full-fledged “Comprehensive Cloud Services.” Now that stable server operation has been secured, the Company will be able to provide new services going forward. One of the representative new services is “Just Show up and Buy a New PC.” The Company provides its premium members with an automatic data backup service for Internet devices such as PCs and backup data reproduction services at store counters using a patent-pending proprietary comprehensive cloud system.

As data on PCs are backed up, when you buy a new PC, you don't need to bring your own PC to the store to take data from it. Customers can have their new PCs ready for use without difficulty as the general mirroring service (backup of the same data on the cloud) provided by the Company allows them to save the data on their PCs on the cloud. Their smartphone data is also saved on the cloud via PCs. Investments in such services do not necessitate much money. It is not a big investment compared to that involved in the creation of a new store. The Company can expand this service gradually.

It will be difficult for other companies to offer the same service. The Company has enhanced the PC Clinic functions at its stores. It has trained and developed engineers with expertise in PCs, smartphones, and the Internet. We have already created a mechanism through which we can make profits. Even if mass home electronics retailers try to imitate our model, it is impossible for them to develop the same functions by deploying such personnel at their stores.

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Original development of content and services: more than 50 types of digital content services

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

Digital-contents services (examples)

Contents (magazines)	Magazines + iPad Air Monthly fee	Fixed prices of magazines (yen)		Contents (magazines)	Magazines + iPad Air Monthly fee	Fixed prices of magazines (yen)	
Weekly Toyo Keizai	2200	690	Weekly	Nikkei PC21	1500	650	Monthly
DIAMOND Weekly	2200	710	Weekly	Mainichi ga Hakken	1300	—	Monthly
Nikkei Woman	1500	580	Monthly	News Week	1800	460	Monthly
Nikkei Business Associe	1500	650	Monthly	PEN	1500	650	Biweekly
Nikkei Money	1500	690	Monthly	Seventeen	1500	590	Monthly
Nikkei Trendy	1300	570	Monthly	non·no	1300	650	Monthly
GetNavi	1300	610	Monthly	MAQUIA	1500	650	Monthly
LEVOLANT (Le Volant)	1500	1010	Monthly	Marisol	1500	800	Monthly
Lettuce Club	1300	329	Biweekly	BAILA	1500	730	Monthly
ESSE	1300	500	Monthly	eclat	1500	940	Monthly
President	1500	690	Monthly	LEE	1300	670	Monthly
DigiCAPA	1200	910	Monthly	MEN'S NON-NO	1500	770	Monthly
CAPA	1500	700	Monthly	Haiku	1500	920	Monthly
Mac Fan	1500	780	Monthly	Tanka	1500	930	Monthly
Soccer Digest	1500	480	Weekly	EVEN	1300	741	Monthly
WORLD SOCCER DIGEST	1500	620	Biweekly	Shogi Sekai	1300	800	Three times in a
Nikkei Health	1300	600	Biweekly	Nikkei Business	2200	690	Weekly
Smash	1500	670	Monthly	PRESIDENT	2300	750	Monthly
dancyu	1500	880	Monthly	Tsuribito	1500	935	Monthly
DOS/V POWER REPORT	1500	1180	Monthly	Kaminuma Emiko no Oshaberi	1300	490	Monthly
Golf Digest	1800	390	Weekly	Cooking			
RIDERS CLUB	1500	905	Monthly	Shumi no Engei	1300	545	Monthly
BiCYCLE CLUB	1500	720	Monthly	Kyono Kenko	1300	545	Monthly
Discover Japan	1300	1008	Once in two months	Igo Koza	1300	545	Monthly
Flick!	1300	—	Monthly	Thank You!	1300	420	Monthly
Fujingaho	1500	1200	Monthly	Otona no OFF	1200	700	Monthly
ELLE	1300	690	Monthly	National Geographic	1200	1010	Monthly
25ans	1300	780	Monthly	Package of two magazines	1800 2300		
MEN'S CLUB	1300	780	Monthly	Package of three magazines	2200 2300		
				Package of four magazines	3300		

NOTE: All monthly fees are standard prices, and discount prices are also shown if available.

Prices of packages depend on combinations. The iPad Air is the 16 GB/Wi-Fi model.

Customers can purchase a Lettuce Club package with content published twice monthly at 350 yen per issue and an iPad Air2 (16 GB Wi-Fi only model) for a monthly fee of 1,300 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

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yen. But with this package, customers do not have to pay that much. The Company aims to package and offer services that customers want in order to retain them as long-term customers.

The unique service of distributing digital magazines through tablets has further spread throughout the market. *Nikkei Business*, *Toyo Keizai*, and other magazines are now available in this 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 1,010 yen a month, but if readers pay a subscription price of 1,500 yen a month, they can get an iPad Air2 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 Airs, all they need to do is to buy the digital version of this magazine. They can of course buy an iPad and the magazine separately, but doing so will cost them more than 1,500 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.

Specialist services are needed even with the 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 will become the main infrastructure. 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, the Company has established a fundamental policy of "helping users to resolve their problems."

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Original smartphone: JUST PRICE FON

- Nine models with a contract period of three years
- Smartphone (hardware), MVNO, and premium services are integrated.
- A flat rate service for phone calls can be attached, and three types of plans with a monthly charge of 3,490 yen, 3,990 yen and 4,990 yen are available.
- The charges include payment for smartphones and premium support fees.

Launch premium service for smartphones

Major carriers have unlocked smartphone SIMs. Up to now, the subscriber identity module (SIM) cards for mobile phones in Japan have been locked. In other words, the SIM card, which records information such as phone numbers that identify individuals, can only be used for a particular mobile phone.

Overseas, any mobile phone can be used as one's own phone merely with the insertion of one's SIM card. In other words, if one has a SIM card, one can easily buy new smartphones. One may own two to three smartphones allowing their use for different purposes.

The Company released low-priced smartphones with services included. How should the Company go about selling these? Meanwhile, customers who are having problems installing Windows 10 brought in their PCs one after another for servicing. Customers who purchased their hardware from other companies also came to PC Depot. A free download of Windows 10 was available up until the end of July.

Premium services were added to PCs and premium services for smartphones are now provided on a full-scale. Low-priced smartphones are being released simultaneously on the market. Even though customers purchase low-priced smartphones, many of them may not know how to use these phones if the Company merely sells hardware as an MVNO. The selling point for the Company's low-priced smartphones is not just the price but also the fact that they come with services included and this has made them popular.

The Company started to sell Just Price Fon at the end of April 2016. This original smartphone sold by an MVNO comes with unlimited calls and support for premium services. Stores offer nine models at monthly charges of 3,490 yen, 3,990 yen, and 4,990 yen.

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Demand for premium services especially for PCs is growing and the number of subscribers is increasing. One subscriber receives multiple services with the PC as the base unit. Nowadays it is common for one household to possess multiple PCs and smartphones.

Moreover, the needs for multiple support on a base of smartphones without PCs are increasing. Some people have purchased low-priced smartphones at other mass home electronics retailers but found they could not use them easily. More and more of these people are visiting the Company stores for support. Just Price Fon is so to speak, a “moderately priced smartphone.” This was released under the Company's own brand label. Hardware, software, and support are integrated into this service.

Premium smart services for smartphones

Services	<ul style="list-style-type: none"> ▪ Initial setup of devices ▪ Address book synchronization ▪ Support for LINE ▪ Explanation of basic operation at store counters ▪ Security measures 	<ul style="list-style-type: none"> ▪ Email account settings ▪ Cloud service exclusive to email account settings (Automatic backup of photos and address books up to 50 GB) ▪ Recovery services for trouble that might occur ▪ Remote lock and remote data erasure services 	
Fees	Support for 1 smartphone Support for 3 smartphones Support for 5 smartphones	1,000 yen per month 2,000 yen per month 3,000 yen per month	
Options	Additional device option Support option Security option Safety option	PC support Additional PCs Tablets	500 - 2,200 yen/month 1,000 - 1,500 yen/month 500 - 800 yen/month 200 - 1,990 yen/month

Various IoT support is available

The new IoT technology will rapidly spread to homes. President Nojima believes that the base of the technology is in PCs. To put it more plainly, he believes that the area where the Company's engineers and support teams play an active role will expand rapidly.

If IoT devices start to be used in various areas including watches, healthcare, and residential gateways, their services will be needed. For instance, when a customer buys a smartwatch, the person can choose from several options, such as buying the unit alone for 50,000 yen, or paying a monthly fee that includes the full setting to connect with smartphones, and after-sales maintenance.

The Company is developing services, one after another, including a device lock in case of loss of the device, smartphone data automatic storage in the cloud, and backup systems

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that connect smartphones, PCs and the cloud in a system. Patent applications have also been made.

To make full use of IoT, there will be a variety of service-inclusive products with a monthly-fee membership, like Premium Service Solution & Things. Use of devices such as smartphones expands new connectivity in areas including healthcare, wearable computing and networks, security, entertainment, and content, and it develops new uses. Contract details including liability exemptions are expected to change.

Examples of IoT include health control using data transferred from OMRON Corporation scales to smartphones, connected to Panasonic Corporation fax machines, allowing users to view fax content via smartphone.

The Company will pursue IoT for personal use, maintaining PCs as a platform. Companies such as Google Inc., Apple Inc., and Amazon.com, Inc. will begin providing new services. Robots will be used in homes. Under any circumstances, the introduction of a new network will require new support. This is the Company's raison d'être in specialized areas.

From the term ended March 2016, "technical services/fees" changed to "solution service sales" due to an increase in sales of products that integrate hardware and software services. Another reason for the change is an increase in services with printers, iPads, and fiber-optic networks.

In new solution services, accounts receivable from sales including service fees are on the increase.

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. For example, iPad Air + magazine sales are growing. They are recorded first as product sales and then as service sales. The monthly fee charging service for tablets and printers is designed to sell hardware first and then collect its price through monthly fees. In other words, this means that accounts receivable grow on the balance sheet.

This accounts receivable item grew by 600 million yen in the term ended March 2013, by 1.9 billion yen in the term ended March 2014, by 4 billion yen in the term ended March 2015 and by 3.8 billion yen in the term ended March 2016. Worded differently, the Company needs more working capital as such accounts grow. If the Company makes progress in collecting monthly fees, however, the amount of working capital needed will

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not increase as it is currently doing because a balance between outstanding accounts receivable and required working capital will be gradually achieved.

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.

Transition to store operations with extended authority

The primary aim is personnel recruitment and development. Regarding store management, the Company is endeavoring to break out of the conventional way of operating chain stores. Stores cannot really help out their customers on the ground by following a manual written by head office and handed down from on high.

The Company is endeavoring to implement independent store operation by assigning a store manager, a staff member responsible for technical services, and a staff member responsible for management at each store. Stores devise services that are responsive to local needs in terms of products, promotions, and home visiting services. Although this may seem inefficient, independent decision-making by stores has been definitely seen to lead to increased revenue.

Each employee provides unique services for customers with his/her specialty at his/her own post as a member of a team. This new store management system was introduced to five stores in the term ended March 2016. After April, eight stores operate under this new store management system. The Company is planning to continue increasing the number of personnel, providing appropriate training.

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Focusing on human resources development

The Company is hurriedly expanding personnel for new store openings and renovations. In April 2016, the Company hired 110 full-time employees consisting of 40 new graduates and 70 employees switching from part-time to full-time posts, and plans to increase these to 100 and 80 respectively next year. When hiring employees, the Company emphasizes an ongoing learning attitude, curiosity about new experiences, and relationships with their parents. Of importance to the Company in the assessment of personnel is taking good care of their parents and being able to communicate. The Company ensures that their parents are familiar with PC DEPOT where their children work.

When hiring employees, the Company requires that they submit a project. Upon employment, the Company seeks to foster employees capable of active learning in an environment full of technological changes.

Location and human resources are key factors for store development. With the Company's services, people always contact consumers by analog methods, and this is where a benefit can be found. Users pay monthly fees because they feel the convenience of a certain frequency of use. It also intends to increase its part-time staff by 300 people annually. In other words, along with the growth of the service business, it is necessary to increase the workforce at a certain rate. Moreover, this increase in the number of workers should occur ahead of business growth.

The Company is conducting HR development to support its new-store openings. PC DEPOT has attracted employees who like PCs. It also 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

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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.

Active use of part-time working seniors

Stores are employing working seniors who provide better customer care, use polite, well-mannered greetings, have a tidy personal appearance, and provide good customer service. The number of part-time working seniors increased to 150 by the end of the term ended March 2016. One or two working seniors are assigned to each store.

Hiring senior aged part-time workers employs people aged 55 to 75 in second careers. These workers will: 1) advise customers; 2) improve store conditions and security; 3) provide health management and career advice to young staff; and 4) apply their experience as specialists in technology or sales. This unique system is attracting attention from the market.

Changes in gross profit of products and services (provisional)

(million yen, %)

	2013.3		2014.3		2015.3		2016.3	
Overall sales (consolidated)	51353	100.0	53816	100.0	51285	100.0	51784	100.0
Service sales (consolidated)	12616	24.5	16237	30.2	19720	38.5	24644	47.6
Goods sales (consolidated)	38736	75.4	37579	69.8	31565	61.5	27140	52.4
Cost of services (non-consolidated, provisional)	3176	25.2	4676	28.8	5520	28.0	7443	30.2
Overall gross profit (consolidated)	16134	34.2	18429	34.2	19676	38.4	22147	42.8
Service gross profit (provisional)	9440	74.8	11561	71.2	13804	70.0	17201	69.8
Goods gross profit (provisional)	6694	17.3	6868	18.2	5872	18.6	4946	18.2

NOTE: Goods sales includes other services (royalties, Internet related).

Figures in the column next to sales amount are a ratio of each segment sales to overall sales. Provisional values are not necessarily accurate; these are approximations as reference data.

The quality of services is its source of competitiveness: active use of “Platinum Partners”

The Company does not merely sell hardware such as PCs and tablets, but offers services. This is a system under which convenient solutions are provided on a continual

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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 PCs owned by our customers, which brings about efficiency.

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.

However, even when profits derived from product sales and from service sales are viewed from the perspective of operating income under certain prerequisites, 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. Originally, the Company core policy of differentiation from its competitors is to provide services requiring time and effort for customers who are having difficulties using their purchases, but not for customers who do not require any follow-up services after purchase. Such customers are the main target of other companies.

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, because of 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.

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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.

“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 be ensured, depending on the terms of the members’ subscriptions. PC DEPOT is meeting the challenge of expanding a business model that is dependent on a customer base formed of members who are subscribed to its services. The Company operates while carrying out analysis of its service sales.

Aiming to achieve an ordinary income to sales ratio of 10% and ROE of 15%

President Nojima has set an ordinary income to sales ratio of 10% and ROE of 15% as

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the new KPI (key performance indicators). If the proportion of income from services increases in the current business model, the profitability ratio of 10% can definitely be achieved.

Assuming the monthly fee for membership services is five thousand yen, if the number of members grows to one million, the income from services could reach 60 billion yen. How will the Company capture customer demand for those services? The market will be paying attention to its strategy for the deployment of stores and the development of a new service menu.

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. Members of the service system exhibit several usage patterns, which cannot be explained only by the number of members and average values such as the average unit price. The conventional pattern has been service on a per-household basis. However, in the age of cloud services, the personal management of data has become important, and accounts for individual users are therefore important. The nature of services will also be further diversified.

There are four challenges. The first challenge is to secure locations for opening new stores. The second challenge is the manner of attracting customers. As opening new stores in the form of SLP stores is intended to obtain customers who need services in particular, more ingenuity is required in attracting customers for this purpose than for mainly selling products that the Company used to focus on. Because sales that originate from rendering services to members become the core, the time of the period for recouping investment tends to be longer than in the past. On the other hand, as more and more customers become members, the profitability can be maintained easily once business turns profitable.

The third challenge is employee training. While the Company has been achieving success in technical training, which is its area of expertise, it is important for it to nurture employees in the level immediately below the store manager. For example, to what extent are the staff members responsible for management, store operations, and technical services able to pay careful attention to what is happening over an entire store? In this regard, the Company has been hiring retired and talented office workers as part-time working seniors to raise the level of courtesy and service to customers in stores.

The fourth challenge is governance in its daily operations. Rather than selling

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products, the stores provide services and then recruit customers as members by providing solution services. On the other hand, products are sold in the form of installment sales accompanied by services. The Company emphasizes a stock-type business, not a flow-type business. In this situation, the governance at stores in its broad sense includes the management of customer information and the full-time and part-time employees, and this management needs to be appropriately implemented.

Response to working capital is also important

With the development of SLP stores, sales of services are growing steadily. Types of customer segments have been changing. The efficiency of fixed assets has been increasing. Capital investment will increase to 1.7 billion yen in the term ending March 2017 compared to 1.3 billion yen in the term ended March 2016. The reason for this is an increase in new store openings. Since the Company still has sufficient funds raised from equity finance, and its earning power has been increasing, capital investment can be covered by internal funds without any problems.

Meanwhile, accounts receivable increased by 3.8 billion yen in the term ended March 2016. Most of this amount originated from installments receivable related to premium services. For example, when a Just Price Fon (a low-priced smartphone) is sold, payment for the hardware of 30,000 yen will be collected as part of the monthly service fees. Namely, the 30,000 yen is the credit sales price.

The rate of increase will gradually slowdown from the term ending March 2018 as receivables are collected. The increased receivable amount will stop growing and then start to decrease. The total receivable amount on the other hand will continue to increase, however, this can be managed within the operating cash flow and will not considerably increase interest-bearing debt. Even though the accounts receivable increases, the Company will not remove this from the balance sheet. Since the Company is fully aware of its customer attributes, there is virtually no risk of irrecoverable debt. The Company can manage with funds on hand and handle loans without any problem.

There are no major financial concerns. So how should the Company make efficient use of its free cash flow from now on? Well, the Company will be able to put more effort into investing in human resources and start to consider R&D-type open innovations. As a financial strategy, the Company considers a sound financial position to be an equity ratio of at least 50% and a degree of indebtedness within 25%. The Company raised 2.3 billion yen through equity financing in January 2014. In terms of the usage of these funds, the

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Company allocated 900 million yen to opening new stores, 1.1 billion yen to renovating existing stores, and 300 million yen to improving its IT system.

Cash flow trends

(millions of yen)

	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	2017.3 (forecast)
Cash flow from operating activities	1121	-635	1597	2010	-2512	516	400
Net profit after tax	713	-63	441	1902	1834	2970	2400
Depreciation	595	715	728	686	781	897	1000
Amortization of goodwill	334	296	259	145	5	4	0
Accounts receivable	-281	-1087	-479	-2840	-2967	-3828	-3000
Inventories	-184	-1785	1299	210	-772	420	-500
Accounts payable	-343	1085	-1418	1417	-1816	-449	500
Cash flow from investing activities	-1440	-2537	-994	-441	-1436	-970	-1500
Tangible fixed assets	-1287	-1691	-844	-332	-797	-604	-1200
Intangible fixed assets	-163	-140	-135	-374	-260	-291	-300
Free cash flow	-319	-3172	603	1569	-3948	-454	-1100
Cash flow from financing activities	1070	2752	295	127	1637	2837	450
Long-short term borrowings	1037	2964	451	-2007	1892	-767	1000
Common stock issuance	0	0	0	2289	0	3983	0
Common stock repurchases	194	-25	0	0	-1	0	0
Cash dividends paid	-150	-153	-155	-153	-253	-380	-550
Cash and cash equivalents at end-term	2505	2083	2984	4679	2370	4754	4104

NOTE: Forecasts are by analysts.

Through the financing from October to November 2015, the Company raised 3,478 million yen through public offering of 4,300,000 shares for a capital increase, and 504 million yen through a third party allotment of 624,000 shares, totaling 3,982 million yen. The usage of the funds can be broken down to 1.5 billion yen for renovation to SLP stores, 1.0 billion yen for new SLP openings, 500 million yen for system investment and 1.0 billion yen for working capital. With the number of outstanding shares increased by 12.6%, a dilution occurred. However, there will be no problem because the dilution can be more than absorbed by growth in profits.

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Balance sheets

(millions of yen, %)

	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3
Current assets	11678	14185	13991	18494	19920	25652
Cash and deposits	2505	2083	2982	4679	2370	4754
Accounts receivable-trade	2533	3619	4098	6939	9906	13734
Inventories	5500	7285	5986	5775	6548	6128
Fixed assets	8051	9052	8942	8644	9336	9622
Tangible fixed assets	3736	4941	5073	4836	5013	5041
Goodwill	690	406	155	10	5	1
Guarantee deposits	1440	1466	1387	1349	1639	1810
Lease deposits	1234	1272	1268	1248	1275	1323
Total assets	19729	23238	22933	27138	29257	35275
Current liabilities	6449	9225	9009	9758	11647	12271
Accounts payable-trade	2421	3506	2087	3506	1691	1245
Short-term loans payable	700	2100	2550	900	4520	5200
Long-term loans payable (within one year)	1004	1518	1849	1727	1447	1044
Fixed liabilities	3747	4449	4149	3915	2428	1347
Long-term loans payable	2759	3809	3479	3244	1796	751
Net assets	9533	9563	9722	13464	158181	21656
Interest-bearing liabilities	4463	7428	7879	5871	7764	7197
Interest-bearing liabilities ratio	22.6	32.0	34.4	21.6	26.5	20.4

5. Near-term operating results: Earnings are likely to plunge due to the examination of services for members

Further increase in the percentage of sales from services in the term ended March 2016

In FY2015, the Company reported favorable results with net sales of 51,784 million yen (up 1.0% YoY), operating income of 4,314 million yen (up 39.7% YoY), ordinary income of 4,366 million yen (up 36.2% YoY), and a net income of 2,867 million yen (up 47.7% YoY). Demand for services further increased in association with the installation of Windows 10. PC sales have substantially decreased by 34%. On the other hand, the sales of secondhand PCs have increased by 5.2%. This is due to customers looking for a PC with Windows 7.

The percentage of sales from solution services has increased to 47.7% of total sales. The percentage was 30% five years ago. It increased to 35%, then 40%, and is now approaching 50%. Although existing stores targeted 100%, it turned out to be slightly lower at 99.2%. Gross profit ratio increased from 40.5% to 42.8%. Gross profit from product sales is also increasing due to the Company's expanding support services linked to products rather than taking part in the price competition.

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Changes in the percentage of total sales accounted for by service sales

(million yen, %)

	Term Ended March 2013		Term Ended March 2014		Term Ended March 2015		Term Ending March 2016		Term Ending March 2017	
	Service sales	As a percentage of total sales	Service sales	As a percentage of total sales	Service sales	As a percentage of total sales	Service sales	As a percentage of total sales	Service sales	As a percentage of total sales
1Q	3025	24.8	3689	30.3	4495	36.1	5651	46.2	6782	53.8
2Q	3083	25.8	3894	31.8	4690	39.3	5992	48.7		
3Q	3223	23.5	4215	30.6	5248	38.4	6525	47.8		
4Q	3285	24.5	4439	28.4	5286	39.9	6475	47.7		

The extent to which the number of members will decrease

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. 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.

With the Company's response in this case, how much will the number of members decrease? With a project of 300 staff under the direct control of the President, the Company will check with 400,000 subscribers whether its services agree with the customers' needs. This procedure will require three to six months. The Company will ensure a thorough training of employees and will implement a checking procedure conducted by quality management staff. With these actions, premium services not meeting customers' needs will be thoroughly reviewed.

The most important point is to determine how many people are dissatisfied with PC DEPOT's current services, and are planning to review and cancel services through the inquiry to be conducted this time. We cannot estimate the exact number of people until we get the results of the examination; however, we need to consider the following points: (1) demand for services has been growing at a rate of 20% per year for the past several years, (2) when a service period terminates and is renewed after three years, devices are also renewed, and (3) the service menu has also been renewed during the period.

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Earnings for the term ending March 2017 will plunge.

In the first quarter of the term ending March 2017, the Company reported net sales of 12,598 million yen (up 3.0% year-on-year (YoY)), operating income of 1,434 million yen (up 75.5% YoY), ordinary income of 1,465 million yen (up 72.9% YoY), and net income of 990 million yen (up 82.5% YoY). Service sales continued to be robust, achieving 120%, while product sales remained at 87.9%. A services to total sales ratio also rose to 53.8%.

During the first quarter, the support needs for the free upgrade to Windows 10 rose before this service terminated at the end of July, which contributed to service sales. On the balance sheet, while accounts receivable from the sales of service offerings ("solution hardware" targeted at premium service subscribers and fiber-optic network service users) increased by roughly 600 million yen, loans payable decreased by roughly 1.1 billion yen.

The case will influence corporate earnings starting mid-August. As this is the beginning of the latter half of the second quarter, the full impact will only be seen from the second half of the year. While the Company posted net sales of 51.7 billion yen and an operating income of 4.3 billion yen in the previous term, the Company's initial goals for the current term are net sales of 54 billion yen and an operating income of 4.9 billion yen. With respect to the above, four scenarios can be considered:

- 1) Earnings will not be significantly influenced and will maintain the status quo. As this scenario is unlikely to occur, the Company's goals for the term ending March 2017 will not be achievable.
- 2) The growth of service sales will cease. This scenario is highly likely to occur. If the growth of service sales ceases for one year from now, net sales and operating income will remain at roughly 52 billion yen and 4 billion yen, respectively.
- 3) In addition to 2) above, sales will decrease due to the cancellation of existing contracts. This scenario is the most highly likely to occur. If the membership cancellation ratio goes much higher than the usual ratio, net sales and operating income will remain at roughly 49 billion yen and 3 billion yen, respectively.
- 4) The business model will collapse. Although this scenario is unlikely to happen, if it does, net sales will remain at roughly 40 billion yen and an operating loss of roughly 2 billion yen will be posted.

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New store openings and shift to SLP stores

(FY)	2012				2013				2014				2015				2016			
	1Q	2Q	3Q	4Q																
PC DEPOT stores																				
Directly managed	2	1																		
SLP stores (new)											1				1	2	1			
SLP stores (renovated)						1	1	2	3	4	1	2	1	2	1	3	2			
Subsidiaries	2										2	1								
PC Clinics																				
Directly managed	1	2									2									
Total	5	3	0	0	0	1	1	2	3	4	6	3	1	2	2	5	3			

NOTE: SLP stores (renovated) indicate the number of SLP stores opened by renovating and changing directly managed PC DEPOT stores. Figures for the first quarter of 2016 are forecasts.

The Company's initial goals for the term ending March 2017 are net sales of 54 billion yen (up 4.3% YoY), operating income of 4.92 billion yen (up 14.0% YoY), ordinary income of 5 billion yen (up 14.5% YoY), and net income of 3.37 billion yen (up 17.5% YoY).

The Company plans to renovate five to 10 existing stores, and seven store renovations are budgeted. The Company also plans to open four new stores. The Company already has the prospect of opening these four new stores. The Tokai Store, which opened in March 2016 is a new store. The Mito Store will be relocated and counted as a new store but this reduces the number of existing stores.

In the current term, the demand for the Company's services will be aroused by (1) the effect from original smartphones, (2) the termination of the providing of Microsoft Windows 10 as free software at the end of July 2016, and (3) the termination of support for Windows Vista scheduled in April 2017.

Comparison of earnings forecasts

	2013.3	2014.3	2015.3	2016.3	2017.3 (forecast)	2018.3 (forecast)
Net sales	51353	53816	51285	51784	50000	49000
Gross profit	16134	18429	19676	22147	22000	22000
Ratio to sales	31.4	34.2	38.4	42.4	44.0	44.9
SG&A expenses	15258	16118	16586	17832	18500	19000
Ratio to sales	29.7	30.0	32.3	34.8	37.0	38.8
Operating income	876	2310	3089	4314	3500	3000
Ratio to sales	1.7	4.3	6.0	7.6	9.1	6.1
Ordinary income	933	2411	3205	4366	3500	3000
Ratio to sales	1.8	4.5	6.2	7.7	9.3	6.1

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6. Evaluation: Fresh start and strengthening the system—how to regain trust

Future earnings

The Company will confirm with all customers on existing contracts, spending three to six months from now, and only services that agree with customers' needs will remain. With these services as a base, the Company will start new sales activities.

Earnings will hit bottom during the second half of the current term. Although the Company will start focusing on sales from next term, earnings will start to increase compared to the same period a year ago from the second half of the next term. Therefore, it may take two years to work through this situation and to build a stronger system than before.

Influence on stock price

When the price of a share exceeded 1,500 yen in reflection of the strong business results in the first quarter, the Company was trading at the level of a PER of 20 on the basis of the business results for the term ending March 2017 (Company's goals). However, as a result of this case, the Company has decided to reexamine its services on a fundamental level. If more members cancel their subscription, operating income will remain at 70% of the initial goal. As PER will also decrease, a realistic stock price range will be between 600 and 700 yen.

Ongoing dividend increases

As for returning profits to shareholders, on August 9, 2016, the Company announced that it would conduct a 1:2 stock split with September 30, 2016 as the record date and will pay a dividend of 13 yen per share after the stock split. The case occurred after this announcement; however, the Company will likely carry out the stock split and dividend increase as planned. The dividend based on the number of shares prior to the stock split corresponds to 15.6 yen, an increase from 11.5 yen for the previous term and 13 yen for the initial projection for the term ending March 2017.

Rebuilding trust

The Company 1) sold traditional goods (products), but 2) changed to selling services that make the usage of goods convenient, and 3) is selling services that are integrated with goods (solution services) now. When the monthly fee sales increase, services will

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account for an increasing proportion of cost price. However, this trend will make long-term provision of services possible.

If existing stores are able to increase sales as a whole by accommodating demand for services, the Company will manage to maintain growth by opening four to five stores a year steadily.

Will service subscribers increase? The Company is focusing its attention on rebuilding trust and heightening its stock effect. Customers of the service system exhibit several usage patterns: some users own several pieces of hardware, while others subscribe to the service system so that their family members can use it. By making these users members of its service system, the Company will have a greater scope for offering services in the future.

It was in 2005 that the Company took the decision to shift its revenue source from selling PCs to providing services. Over the past eight years, the Company has promoted the shift of its business model. Will the Company's business model remain a niche after they overcome this problem? President Nojima's response to this issue will attract the market's attention.

The Company has been promoting a shift to a stock-type profit structure based on service sales; however, the Company is compelled to review its course of action. Since it will take a certain amount of time to regain trust, the Company is rated B. (Please refer to the front page for an explanation of corporate ratings.)

The Company was promoted to the first section of TSE in November 2015. Due to the effect of equity finance conducted in 2015, the number of shareholders increased to 2,759 as of the end of March 2016. In June 2015, the shareholder special benefit plan was improved. The unit required to receive the special benefit was reduced from 400 to 100 shares. The plan distributes a 1,000 yen gift certificate (or 2,000 yen PC Clinic store voucher) for 100 shares, a 2,000 yen gift certificate (or 4,000 yen PC Clinic store voucher) for 400 or more shares, or a 3,000 yen gift certificate (or 6,000 yen PC Clinic store voucher) for 1,000 shares or more. As shareholders can use gift certificates for online shopping, PC DEPOT stores need not be nearby. Increasing that number further will be effective in unifying customers and shareholders.

Based on a stock price of 713 yen as of August 31, 2016, PC DEPOT has a PBR of 1.37, an ROE of 10.3%, and a PER of 13.3, with a dividend yield of 2.2%. We would like to pay close attention to the progress of checking the services for 400,000 subscribers and the trend in terms of service sales.

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