7618 PC DEPOT Corporation

Further Progress in Examination of Solution Services, Mainly for Premium Members

June 17, 2017

First section of Tokyo Stock Exchange (TSE)

Key Points

• The problems caused by the harmful rumors have already calmed down and our improved services at stores should favorably be accepted by customers. So far, there have been no specific problems of note and things are proceeding in the right direction. The Company promptly took action in responding to a case that occurred in August last year where services for an elderly premium service subscriber were deemed inappropriate. The Company created a guideline for promoting improvements in August 2016, and further improved its customer services in September by having consumer advisers take part in the action, and in November, the Quality Management Department and the Customer Service Promotion Department were established.

• The Company sent direct mail by the end of October 2016 to the approximately 400,000 members who receive some form of the Company's services and confirmed the usage situations of all members over the phone and at shop counters. If customer usage is found inconsistent with their service contract, the Company will allow making changes to the plans and allow cancelling of contracts at no charge to the customer. This confirmation procedure made considerable progress by the end of March 2017 and mostly achieved its goals.

• The Company has established the Quality Management Department comprising 300 people that will ensure thorough training of full-time and part-time employees. When drawing up a contract, the quality management staff as well as the sales staff will double check at the company that the contract is appropriate. In this way, the Company is making every possible effort to regain trust toward achieving its primary goal of fulfilling its "social mission to solve problems in the IT society."

• Business profit will be affected by (1) the number of cancellations, (2) the fall in service sales, (3) an increase in costs for actions taken by the Company and (4) a decrease in sales capabilities at stores. However, the Company is currently coming out of an unfavorable phase in business and profits will start to recover in the second half of FY2017. The operating income has been improving, from 2.1 billion yen and 1.2 billion yen for the first and second halves of the previous term, respectively, to 1 billion yen and 1.4 billion yen for the first and second halves of the current term, respectively.

• The Company's business model has not collapsed. As the Company will strengthen the service system that further meets customer needs, a more rigid system will be established by one year's time. With this system, more demand for services will be captured, and more repeat customers will be retained even though costs will increase. Therefore, profit is likely to recover and grow higher than before. As profit is expected to achieve a record high in a few years, the Company seems to be in a noteworthy phase.

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Company rating: B

Stock price (June 16, 2017): 578 yen

Market capitalization: 30.4 billion yen (52.622 million shares)

PBR 1.30 ROE 7.2% PER 18.1 Dividend yield: 2.2%

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

Fiscal yearend	Sales	Operating	Ordinary	Net	EPS	Dividend
Mar. 2010	44740	1226	1306	677	17.3	3.9
Mar. 2011	46872	1308	1447	683	19.0	3.9
Mar. 2012	49631	526	684	238	6.0	3.9
Mar. 2013	51359	867	924	441	11.2	3.9
Mar. 2014	53772	2256	2357	1536	38.0	4.7
Mar. 2015	51261	3045	3162	1914	42.0	6.9
Mar. 2016	51729	4086	4139	2693	56.9	9.6
Mar. 2017	46290	3378	3465	2260	43.9	13.0
Mar. 2018 (forecast)	46600	2420	2500	1650	32.0	13.0
Mar. 2019 (forecast)	48000	3000	3000	2000	38.8	13.0

Total assets: 35,576 million yen Net assets: 23,010 million yen Equity ratio: 64.5%

BPS: 445.6 yen

NOTE: ROE, PER and dividend yield are based on the most recent forecast. In October 2013, the Company carried out a share split at a ratio of 1:100, in January 2015, a share split at a ratio of 1:1.5 and in October 2016, a share split at a ratio of 1:1.2. The EPS and dividends for the preceding terms have been revised accordingly. Corrections of the financial results of prior terms due to revisions to the balance of accounts receivable were made for the terms covering the term ended March 2012 to the term ended March 2016.

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. Near-term responses: Further progress in review of member services

Making services for members appropriate for elderly people

Criticism spread on the Internet in last August concerning a contract made by an elderly person that did not seem to match his usage situation. 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 following six points were to be examined: (1) whether the elderly person was able to fully understand the services provided; (2) whether the contract was signed without the customer understanding its contents; (3) whether the service was appropriate for the customer; (4) what response the Company will provide in this case; (5) whether the response will be persuasive enough; and (6) how this situation will affect future earnings.

Services for members have 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 these tasks to someone else, despite being able to perform them 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 can choose the purchase method for certain products. For example, a subscriber purchases a PC as a product from a single payment and not in installments. Smartphones are purchased in installments and not in a single payment, which is common.

This would not have been necessary for an elderly person visiting the store who had subscribed to the Family Wide 10 Devices plan at that time. The elderly person would not have needed to pay 5,500 yen per month as the Single Plan for One Device costs 2,500 yen per month. But if a household only has one person but that person intends to use a PC, smartphone and tablet with Wi-Fi at home, it would require 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 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 incident was considered to go against the essence of the service, which is to provide support for digitally illiterate users. For this reason, the case came under criticism.

Continuing to respond promptly

President Nojima took the criticism to heart and implemented four measures. First, a department specializing in quality management was established and an officer in charge was appointed. Secondly, to introduce an external point of view for service development, the Company is adopting ideas from consumer advisers. Thirdly, improving customer satisfaction is being emphasized more in the in-house employee performance evaluation system. Finally, as part of an enhancement of risk management, the Company involved experts to strengthen governance. The Company announced that it will make every possible effort to contribute to society as an IT solution store by implementing these reform measures.

Last November, the Quality Management Department was established. While the existing Sales Department tends to focus on sales management, the Quality Management Department monitors the quality of the products and services provided to customers to make sure that they are customer-first services. Since customer opinions are now reflected directly into the services provided, a positive effect can be expected.

The Company implemented measures to promote the improvement of premium service contracts.

(1) If a contract is seen as inappropriate at that time for usage by any of the roughly 400,000 service subscribers, the Company will allow making changes to the plan or will allow cancelling contracts at no charge 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 if made within the first month. The Company changed this practice and today, when customers aged 70 or older subscribe to a service: (i) the Company checks 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.

Moreover, the Company: (1) assessed and confirmed customers' service usage situations through direct mail and calls to all members; (2) set up counters for members to exclusively use at stores to provide explanations and information, as well as to confirm the details face-to-face; and (3) assigned new quality management staff for the premium service at stores and created a system to double check contracts, independently from confirmation by store staff. The Company has assigned 100 quality management staff at stores for the above. These actions have been implemented incrementally since the last September.

Aiming for full recovery in the second half of the term ending March 2018

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. Although we cannot estimate the exact number until we get the actual results, the cancellation rate does not seem to have worsened.

The Company has assigned in-house personnel to be responsible for quality and has been prioritizing the allocation of human resources to check subscribers' usage of services under contracts. In addition to an increase in personnel expenses, narrowing the products for sales will be required. As 300 employees were transferred to the Quality Management Department, the number of personnel inevitably became insufficient in sales to customers at stores. To cope with this situation the company has narrowed the sales product range and service-inclusive product sales.

Cancellation rate for premium service contracts

(%)

Month	This time	Usual case
2016.8	0.9	0.6
9	1.6	0.6
10	1.6	0.6
11	1.2	0.6
12	1.1	0.7
2017.1	1.1	0.7
2	1.0	0.6
3	1.3	0.9
4	1.2	0.8

NOTE: The usual case column represents the rate in the same month of the prior year. Including expiration.

While the cancellation rate dropped to 1.1% in January and 1.0% in February after its peak of 1.6% in October, the rate recorded 1.3% and 1.2% in March and April respectively, so it is still showing some ups and downs. The situation is expected to improve, because the number of new premium members is increasing while the number of cancellations is decreasing.

While customers still voice various opinions, the problems concerning services for elderly customers which were widely criticized on the Internet have now subsided. The cancellation rate has declined to such a level that it no longer needs close attention. Renovated stores are also seeing an increase in the number of customers. The new Setagaya-Kinuta Store has finally begun to get operations on track. Among the small-scale stores located in central Tokyo, the Azabu-Juban Store in particular is exhibiting good performance.

The Company started posting leaflet advertisements again in November after stopping in August last year. It has also started full-fledged sales promotion activities that take into consideration the shortage in personnel, after narrowing products and services provided.

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 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.

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, 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.

Store development conditions

(Number of stores)

Number of stores (at the end of March 2017)			
PC DEPOT	Directly-managed	23	PCs and related products for home users; technical support services
	(SLP stores included in the above)	31	Kanto region (Kanagawa, Tokyo, Chiba, Saitama, Shizuoka, Gunma, Tochigi and Ibaraki)
	Subsidiaries	13	PC DEPOT Stores (Kyushu, Chubu, Shikoku, Koushinetsu and Tohoku regions)
	FC	3	Kinki, Chugoku and Shikoku regions
	Subtotal	70	
PC DEPOT PC Clinic	Directly-managed	53	Operations inside the premises of other mass home electronics retailers
	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 23 directly-managed PC DEPOT stores, 19 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.

Converting franchises to directly-managed stores

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 CORPORATION (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 felt much empathy with Shuichi Kato, Chairman of K'S HOLDINGS CORPORATION. The Company focuses on basically being a chain store operation that is easy for customers to use, for example, offering self-service sales apart for parts and offering discounts for paying in cash instead of points cards.

From the very start, Mr Max Co. (who run general discount stores) and Kitamura Co. (specializing in cameras) also became PC DEPOT franchisees. 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 March 2017, there are 54 directly-managed PC DEPOT stores (including 31 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 70 stores. In addition, there are 53 directly-managed PC Clinics, 5 stores run by the PC DEPOT Stores Co., Ltd. subsidiary. 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.

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.

In April, 70 new graduates joined the Company. The retention rate of employees is high, while the turnover rate is low. At the end of March 2017, in addition to 797 regular employees, 1,372 part-timers (on an 8-hour shift basis) were working for the Company. Ten categories of tasks are assigned, including operations (cashiers and baggers), attending to customers (customer-service personnel), Smart Life Partner (SLP, customer-service personnel), clinic services (preventative and recovery services) and quality improvement; 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: Review of outside directors

Two outside directors will resign this June when they will pass the maximum term of eight years prescribed in the Company's by-laws. As a result, the number of outside directors will decrease to two in the next term. The Company needs to review the number of outside directors and whether this number should be increased.

The Company is complying with corporate governance as a company with auditors. 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 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 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 Visual 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 Company's solution services consist of three categories of services. The first is the PC Clinic, which provides installation, repair and replacement services. Support for solution services are provided at all stores and is managed by about 1,000 employees.

The second is premium services, which solve problems customers are having. The services cover: (1) any type of product; (2) products regardless of how old they are; and (3) products purchased at the stores of other companies. The premium services are separated into four major service plans. The third is solution services which combine content and communication. By subscribing to the services, customers can read digital magazines on their iPad or receive full support for low-priced smartphones. All services are backed up in the cloud (automatic data storage), providing sufficient capability to cope with defective hardware or security issues.

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-virus software, configure the initial settings and set a password, and then comes to a dead end, he or she will be stuck without some help. PC DEPOT's premium services are solutions to help such users over the Internet.

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

A patent for this router's systems was registered in March 2012. The packages are also cloud-capable. The Company has gradually been expanding and improving these services. 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.

Trend in constituent ratios of sales

(%, millions of yen)

	2009.3		2011.3	2013.3	2015.3	2016.3	2017.3	
	Sales	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Sales
Goods sales	35572	82.4	75.8	69.0	58.8	49.7	43.4	20099
PCs and peripherals	24375	58.5	52.0	46.4	33.7	25.3	23.5	10885
Accessories, supplies, and software	6554	14.6	13.9	12.1	8.5	7.6	6.7	2644
Used items and others	4643	9.3	9.9	10.5	16.6	16.8	14.2	6569
Service sales	11340	17.6	24.2	31.0	41.2	50.3	56.6	26191
Sales from solution services	8726	10.3	18.6	27.3	38.3	47.6	53.7	24857
Royalties and other revenue (FC)	522	1.3	1.1	0.3	0.3	0.2	0.2	75
Internet-related businesses	2090	6.0	4.5	3.4	2.6	2.4	2.7	1258
Total	46912	100.0	100.0	100.0	100.0	100.0	100.0	46290

Note: Sales from solution services include sales of service inclusive products and technical services/fees.
Sales by FCs on which royalties are payable amount to 1,330 million yen in the term ended March 2017.

As mentioned above, PC DEPOT also is an MVNO. An MVNO does not have its own mobile communication network, but provides services under its own brand by renting network space from major carriers. The Company provides services to customers as a telecommunications carrier, rather than acting as an agent for other carriers in exchange for incentives. This makes it possible to provide services that customers may want in a single package, making for a very convenient premium service.

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.

SLP stores are fashionable and convenient: Specialization in services

Smart Life stores display less merchandise than conventional stores. 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.

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 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 has been 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 have been 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

President Nojima stated that the Company will learn from this case (inappropriate services contrary to customer needs) and focus on store operations and personnel training in the next one to two years.

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 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.

Store development history of PC DEPOT

(Stores)

Number of stores at the end of each term	1995.3	2000.3	2005.3	2010.3	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	2017.3
PC DEPOT											
Directly managed	1	10	28	43	44	48	50	46	36	28	23
SLP stores								4	15	25	31
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	53
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	128

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.

Opening a large number of SLP stores by renovating existing ones

The Company continues to open new SLP stores by renovating and reopening existing stores. The Company also plans to open new SLP stores, with more focus in central Tokyo than the case for current 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 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.

New SLP store openings: Setagaya-Kinuta

The Setagaya-Kinuta Store was the first new SLP store. Customers are now steadily increasing there. 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 2016 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.

Opening stores 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.

The Aoyama Store is located on the first floor of the new Aoyama Quartz Tower (a comprehensive medical facility). The store will occupy two floors with an area of 70 *tsubo*. This will be a new small-sized SLP store and the first store within the circle of the Yamanote Line. The Company has been making 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.

Located in central Tokyo, this store will provide high-quality services and support fitting the area. 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.

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.

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, 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.

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.

New store openings and shift to SLP stores

	2014.3	2015.3	2016.3	2017.3	2018.3 (forecast)	2019.3 (forecast)	2020.3 (forecast)
PC DEPOT stores							
Directly managed							
SLP stores (new)		1	3	2	2	4	4
SLP stores (renovated)	4	10	7	5	7	7	7
Subsidiaries		3					
PC Clinics							
Directly managed		2		1			
Total	4	16	10	8	9	11	11

NOTE: SLP stores (renovated) indicate the number of SLP stores opened by renovating and changing directly managed PC DEPOT stores. Forecasts by an analyst are marked (forecast).

Future store development

The Company's store development will mainly consist of renovating conventional-type stores to SLP stores. The Company still has 36 conventional-type stores, 5 to 10 of which will be renovated to new SLP stores.

The renovated stores have a completely new store image, which shows itself in its relationship with customers. There is now more time to listen to customer requests through face-to-face communication, since the new stores are not meant for selling products. More families, couples and groups with women will visit the stores. President Nojima uses the phrase "Please drop by" to show his stance that the Company wants people visiting the stores to become regular and long-time customers, as the SLP stores offer new type of relationship with them.

The Company will mainly renovate suburban-type Version 1 (V1) stores first and the renovation of large stores (V2 stores) will come later. The Company plans to continue renovating 20 more stores in the current manner.

Renovation per store costs between 70 to 100 million yen and stores under renovation will be closed for about a month and a half. PC Clinics are an exception and will continue operating to provide repair services. The renovation program will last at least three years, assuming that seven stores are renewed each year.

The Company will gradually open new stores. The current decision is that the Company will open a new store in Roppongi this July. The store is planned to be a city-center super-small type Version 0 (V0) store, the same type as the Azabu-Juban store. The Company can afford to launch two to four stores per year and could accelerate the pace of launch in the future.

New premium service

(yen/month)

Plan (From February 2017)	3 year plan Monthly fee	2 year plan Monthly fee	1 year plan Monthly fee	Usage environment
PC plan	2500	—	3300	Internet connection to be setup by the member.
Home network plan	3500	—	4800	Home Wi-Fi Support for up to 5 devices
Multi-network plan	4500	—	5800	At home and outside With smartphone support Support for up to 5 devices
Assembled PC plan	3000	—	4300	Support for assembled PC
Smartphone plan	—	1000	—	Data support
Mobile Internet plan	7000	—	—	Mobile wireless support Includes mobile communication charges Support for up to 5 devices

NOTE: Initial administration fee is 5,000 yen (3,000 yen for smartphones). The monthly fees are subtracted on pro-rata basis in the event of cancellation during the contract period.

Responding to service demand: Renewing the menu for premium services to make it easier to understand

The Company changed all menus for membership services to make the selection process easier. The menu for premium services was renewed in February 2017, where the plans are offered according to the usage situation rather than the number of devices owned, which was how the previous service plans were based.

The plans include: 1) PC plan with a monthly fee of 2,500 yen (Internet connection to be setup by the member), 2) Home network plan with a monthly fee of 3,500 yen (home Wi-Fi), 3) Multi-network plan with a monthly fee of 4,500 yen (at home and outside), and 4) Smartphone plan with a monthly fee of 1,000 yen.

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 improved, customers will be upgraded.

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 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			
	Windows Updates	0	6000
	Creating restore functions for PC not purchased from us	6000	8000
	Solving printer problems	500	3000
	Installing additional memory/ replacing memory	1000	3000
Security measures			
	Deleting spyware	0	5000

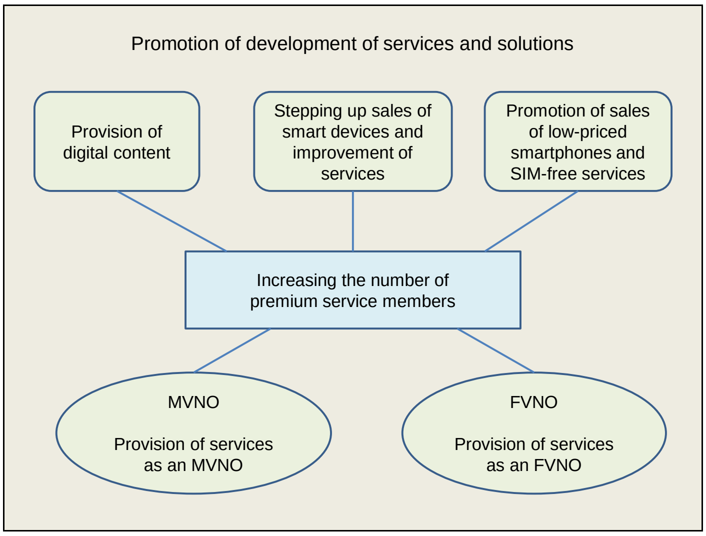
NOTE: "Member" refers to a service member of PC DEPOT; "General" refers to others.
Consumption tax is not included.

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.

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 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

When customers who joined the service using FVNO switch over to the Company's fiber-optic network service, the communication fee of 4,000 to 5,000 yen per month is listed as a service sale. While profit margins will be higher compared to conventional agency commissions, profit ratios for services will decrease.

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 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 is greatly expanding 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.

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.

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. The Company has already created a mechanism through which it can make profits. Even if mass home electronics retailers try to imitate its model, it is impossible for them to develop the same functions by deploying such personnel at their stores.

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."

Smartphone with original support—JUST PRICE FON

- 5 models with contract period plans of 2 years and 3 years
- Smartphone (hardware), MVNO, and premium services are integrated.
- Two types of plans are available with monthly charges of 2,990 yen and 3,990 yen.
- The charges include payment for smartphones and support fees.
- Additional fees are required for options such as a flat rate service for phone calls and a wireless LAN at home.

Full-on sales of low-priced smartphones: premium service for smartphones is also provided

The Company is focusing on low-priced smartphones. The Company is one of the retailers of mineo, Y!mobile and UQ mobile, and customers can also purchase the Company's original support service for smartphones for a monthly fee of 1,000 yen. Apart from that support service, the Company sells its original low-priced smartphones that come with its support services. There are two models at monthly charges of 2,990 yen and 3,990 yen with a three-year contract period. Low-priced smartphones are likely to become totally popular from hereon so it is anticipated that some new users won't know how to handle smartphones by themselves and will reach out to the Company for help.

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.

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 original support services. Presently, stores offer five models at monthly charges of 2,990 yen and 3,990 yen.

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.

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 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.

Accounts receivable increased 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 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.

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 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.

Changes in gross profit of products and services (provisional)

(million yen, %)

	2013.3		2014.3		2015.3		2016.3	
Overall sales (consolidated)	51359	100.0	53772	100.0	51261	100.0	51729	100.0
Service sales (consolidated)	12622	24.6	16194	30.1	19696	38.4	24631	47.6
Goods sales (consolidated)	38737	75.4	37578	69.9	31565	61.5	27098	52.4
Cost of services (non-consolidated, provisional)	3176	25.2	4676	28.9	5520	28.0	7443	30.2
Overall gross profit (consolidated)	16114	31.4	18273	34.0	19472	38.0	21715	42.0
Service gross profit (provisional)	9446	74.8	11518	71.1	14176	72.0	17188	69.8
Goods gross profit (provisional)	6668	17.2	6755	18.0	5296	16.8	4527	16.7

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.

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.

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 should compete in terms of products sales initially, and then, going forward, they will increase their member numbers.

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 the management goals of an ordinary income to sales ratio of 10% and ROE of 15% as the key performance indicators (KPI). 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 quality 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 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.

Balance sheets

(millions of yen, %)

	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	2017.3
Current assets	11678	14076	13888	18368	19771	25381	26070
Cash and deposits	2505	2083	2982	4679	2370	4754	7726
Accounts receivable-trade	2533	3495	3969	6731	9609	13249	11220
Inventories	5500	7285	5986	5775	6548	6128	6103
Fixed assets	8051	9052	8942	8644	9336	9622	9506
Tangible fixed assets	3736	4941	5073	4836	5013	5041	4857
Goodwill	690	406	155	10	5	1	0
Guarantee deposits	1440	1466	1387	1349	1639	1810	1750
Lease deposits	1234	1272	1268	1248	1275	1323	1369
Total assets	19729	23128	22831	27012	29108	35004	35576
Current liabilities	6449	9225	9009	9758	11647	12271	6735
Accounts payable-trade	2421	3506	2087	3506	1691	1245	1227
Short-term loans payable	700	2100	2550	900	4520	5200	0
Long-term loans payable (within one year)	1004	1518	1849	1727	1447	1044	2125
Fixed liabilities	3747	4449	4149	3915	2428	1347	5830
Long-term loans payable	2759	3809	3479	3244	1796	751	5265
Net assets	9533	9464	9671	13342	15032	21334	23010
Interest-bearing liabilities	4463	7428	7879	5871	7764	7197	7391
Interest-bearing liabilities ratio	22.6	32.1	34.5	21.7	26.7	20.6	20.8

Response to working capital is also important

On the balance sheet as of the end of March 2017, accounts receivable posted a decrease due to an intentional reduction in sales of service-inclusive products. In terms of cash flow, free cash flow increased owing to the cancellation of two store openings originally planned in the second half.

The growth of SLP stores is spurring sales of services Types of customer segments have been changing. The efficiency of fixed assets has been increasing. Capital investment reached 1.3 billion yen in the term ended March 2016. 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.

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 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. Through the financing in November 2015, the Company raised 4.0 billion 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 store openings, 500 million yen for system investment and 1.0 billion yen for working capital. As the number of outstanding shares increased by 12.6%, a dilution occurred to the extent of this increase. However, the dilution can be more than absorbed by the growth in profits.

Cash flow trends

(millions of yen)

	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	2017.3
Cash flow from operating activities	1121	-635	1597	2010	-2512	516	4307
Net profit after tax	713	-95	537	1848	1790	2742	1335
Depreciation	595	691	728	685	781	897	943
Amortization of goodwill	334	296	259	145	5	4	0
Accounts receivable	-281	-1014	-476	-2783	-2903	-3640	2050
Inventories	-184	-1785	1299	210	-772	420	24
Accouts payable	-343	1088	-1421	1417	-1816	-449	12
Cash flow from inbesting activities	-1440	-2537	-994	-441	-1436	-970	-1127
Tangible fixed assets	-1287	-1691	-844	-332	-797	-604	-841
Intangible fixed assets	-163	-140	-135	-374	-260	-291	-199
Free cash flow	-319	-3172	603	1569	-3948	-454	3180
Cash flow from financing activities	1070	2752	295	127	1637	2837	-207
Long-short term borrowings	1037	2964	451	-2007	1892	-767	394
Comon stock issuance	0	0	0	2289	0	3983	0
Common stock repurchases	194	-25	0	0	-1	0	-5
Cash dividends paid	-150	-153	-155	-153	-253	-380	-612
Cash and cash equivalents at end-term	2505	2083	2984	4679	2370	4754	7726

5. Near-term operating results: Earnings recovery to start in this second half with further progress in the examination of services for members

Correction of financial data

Due to errors in past reported numbers, the Company corrected financial data from the past six years. This was due to discrepancies and mistakes made by personnel in accounting procedures and clerical processing for contract cancellation process. The amount due to errors for each term was insignificant and the accumulation was an over-statement of net assets amounting to 280 million yen.

The cause of the discrepancies and mistakes is as follows: when the Company began offering service inclusive products combining products and services, it had used a simple IT system to manage the processing of contract cancellations; and as a result, the situation in which some data had not been reflected in the system continued. When the Company changed to the full-scale systems for managing accounts receivable, it checked ledgers in the process of contract cancellation and found: (1) omissions of offsetting accounts receivable; and (2) double-counting of sales.

Regarding the accounting procedures, accounts receivable of sales of service inclusive products were programmed based on installments of 36 months. When contracts were cancelled, the system continued to process the remaining balance of installments without reflecting the change. There were no issues with customers. Since contracts were cancelled, the amount to be earned by the Company out of the remaining revenues should have been recorded in lump-sum at the time of cancellation, but it continued to record it in installments. There were also some related clerical mistakes. The Company has corrected these errors.

Regarding accounts receivable management, the new systems started to operate in December last year, when the past recording errors were revealed. The errors occurred because the management of service inclusive products was not carried out properly due to the low rate of cancellation.

The amount of downward revision of operating income for each term was: 31 million yen for the term ended March 2011 (March 2011 term); 68 million yen for March 2012 term; 4 million yen for March 2013; 62 million yen for March 2014 term; 43 million yen for March 2015 term; and 200 million yen for March 2016 term. In and as of the end of the term ended March 2016, operating income and net assets were revised down by 4.6% and 1.4% respectively. Despite the insignificant amount and ratio of the revision, it must be noted that the internal control of the Company was inadequate, considering that: (1) the figures of accounts receivable were incorrect; and (2) the errors continued for a long time.

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 Ended March 2016		Term Ended 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	4505	36.2	5635	46.1	6867	54.5
2Q	3083	25.8	3894	31.8	4681	39.3	5995	48.7	6597	58.5
3Q	3223	23.5	4215	30.6	5229	38.3	6491	47.6	5792	52.2
4Q	3329	24.7	4396	28.2	5281	39.9	6510	48.0	5601	49.5

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. 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 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.

Quarterly results

(millions of yen)

	Net sales				Operating income
	Products	Solution services	Internet-related	Total	
2016.1Q	5465	6807	314	12606	1344
2016.2Q	4278	6657	322	11277	789
2016.3Q	4956	5792	316	11100	577
2016.4Q	5400	5601	306	11307	668

Earnings for the term ended March 2017 fell due to the review of membership services since the second half

For the term ended March 2017, the Company reported net sales of 46,290 million yen (down 10.6% YoY), operating income of 3,378 million yen (down 17.8% YoY), ordinary income of 3,465 million yen (down 16.8% YoY), and net income of 2,262 million yen (down 17.1% YoY).

The results above were due to the substantial decline in performance in the second half, caused by the review of the Company's business structure triggered by the case in August last year. Operating income in the first half was 2,136 million yen and 1,242 million yen in the second half.

The actual results of the last term ended March 2017, however, exceeded the numbers in the revised earnings outlook for the term announced in November (net sales of 45,500 million yen, operating income of 2,950 million yen and ordinary income of 3,000 million yen).

The Company reported higher sales and profits in the first quarter, lower sales and higher profits in the second quarter and lower sales and profits in the third and fourth quarters. The impact of and responses to the problem regarding services to an elderly customer, which occurred in August, prominently affected the earnings. Sales and profits declined considerably, due to factors such as assignment of in-house personnel to the Quality Management Department, narrowing of product offerings, disposal of product inventories and voluntary restraint in advertising and promotional activities. Though customers were gradually coming back, the number remained low.

The Company made steady progress in confirming current member service situations through direct mail and phone calls. Since the Company assigned 300 in-house personnel to the newly established Quality Management Department, there is currently a shortage of sales staff in the stores. Although promotion activities resumed in November, the sales effort made at the end of the year was not sufficient due to the staff shortage.

Regarding product sales, the gross profit from product sales decreased due to disposal of long-term inventories. Sales of service inclusive products decreased because not enough attention was paid to that area due to the sales staff shortage.

Sales from solution services increased by 20% YoY (year-over-year) in the first quarter and by 10.5% YoY in the second quarter, but decreased by 13.4% YoY in the third quarter and by 14.0% in the fourth quarter. The impact of the case in August, especially the reduction in the number of premium service members and the lower sales of service inclusive products, was most prominent in the third and fourth quarters.

On the balance sheet, accounts receivable decreased due to the decrease in sales of service inclusive products. Cash flow has significantly improved owing to the decrease in sales of service inclusive products, as well as restraint in opening new stores. That portion was used to reduce short-term borrowing.

Component ratio for sales from solution services

	Membership support	Technical services	Service-inclusive products
First half of the term ended March 2017	75% or less	15% or less	10% or more
Second half of the term ended March	80% or more	15% or less	5% or less

(Source): PC DEPOT

New products leading the business

The basic structure of the premium service has not been changed; however, its menu has been reviewed. Various payment methods have been prepared for membership fee payment—such as payment at the time of contract, payment in one year, and payment in three years—so that customers can choose a payment method with a clear understanding of it. Ideas from consumer advisers are being reflected in this.

Members subscribing to services necessarily want to contact stores when inquiring how to use devices and about updating software, malfunctions, and replacement purchases. In IT business, many new products for consumer use come out on the market every year. One of the hottest trends this year is a full-fledged roll-out of smart speakers using voice recognition technology. Following the Amazon Echo and Google Home, Microsoft is also expected to launch a new product.

The PC market is regaining some momentum. The need for support increases when new products such as smart speakers are launched. The Company now intends to increase sales of product-inclusive solution services it has voluntarily refrained from offering for some time, properly responding to customer needs.

The effect from the new sales service system appear in the days ahead

The need for support will not decrease. Rather, the number of subscribers will increase because sales activities for customers have significantly improved. The new system was fully launched in the term ending March 2018. As the prospects for the responses to existing members is almost certain, the next focus will be on producing results from the store management and support system.

Comparison of earnings forecasts

(millions of yen, %)

	2013.3	2014.3	2015.3	2016.3	2017.3	2018.3 (forecast)	2019.3 (forecast)	2020.3 (forecast)
Net sales	51359	53772	51261	51729	46290	46600	48000	50000
Gross profit	16114	18273	19472	21715	21122	20420	21500	23000
Ratio to sales	31.4	34.0	38.0	42.0	45.6	43.8	44.8	46.0
SG&A expenses	15246	16017	16426	17628	17744	18000	18500	19000
Ratio to sales	29.7	29.8	32.0	34.1	38.3	38.6	38.5	38.0
Operating income	867	2256	3045	4086	3378	2420	3000	4000
Ratio to sales	1.7	4.2	5.9	7.9	7.3	5.2	6.3	8.0
Ordinary income	924	2357	3162	4139	3465	2500	3000	4000
Ratio to sales	1.8	4.4	6.2	8.0	7.5	5.4	6.3	8.0

Earnings in the term ending March 2018 will improve after bottoming-out in the first half of the term

The Company's plan for the current term ending March 2018 includes a net sales of 46,600 million yen (up 0.7% YoY), an operating income of 2,420 million yen (down 28.4% YoY), an ordinary income of 2,500 million yen (down 27.8% YoY), and a net income of 1,650 million yen (down 27.1% YoY). The plan continues to post lower profits.

Thanks to a temporary increase in sales as a result of cancellations, profits in the previous term declined slightly less than the decrease included in the target revised during the term. This will affect the performance of the current term and the decline in operating profit this term will be slightly larger.

As shown in the planned operating profit of 1,050 million yen in the first half (down 50.8% YoY) and 1,370 million yen in the second half (up 10.3% YoY), the Company expects a recovery to start in the second half.

The plan for this term is based on the following assumptions: a growth in sales on a same-store basis by 100% (89.7% in the previous term); a growth in solution services sales by 100% (100.8%); and a gross profit ratio of 44% (45.6%). The Company expects that the solution services business will recover considerably toward the second half. Gross profit ratio in the previous term was 45.6% (first quarter: 46.4%, second quarter: 47.6%, third quarter: 43.5%, fourth quarter: 44.9%). The Company expects the ratio will be higher than that in the second half of the previous term but will not to be able to return to the level as that of the first half of the previous term.

With respect to store development, the Company will prioritize the renewal of stores into SLP stores. The Company will basically continue to curb the opening of new stores, except for cases where the location needs to be secured for certain reasons. Meanwhile, the Company will accelerate its renovation of current stores to SLP stores, from 5 stores in the term ended March 2017 to 5 to 10 in the term ending March 2018. Customer service and profitability has already been proven to increase after the renovation to SLP stores so the effectiveness of store renovation is reasonably certain.

In the area of personnel assignment, the Company strengthened the quality management function by assigning in-house personnel to be responsible for quality. As staff get used to the new flow of operations, improved productivity, better customer service and increase in added value are expected. Enhancement of the support system has led to an increase in personnel expenses, which will result in a decrease of about 1% in gross profit. If, however, customers become more loyal to the products and services provided by the Company, it will improve profits before long through an increase in membership.

The Company is taking the necessary measures. It is currently making efforts to ensure thorough governance and compliance at the store level. Sales are still not too active but will start to smooth out around this second half. Launch of new products and services will be implemented towards the end of the year. The results in the term ending March 2019 are expected to improve further.

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

Future earnings

The Company has set the mid- to long-term goal of an operating income ratio to sales of 10%, which is not a difficult number to achieve. Before the incident occurred, the operating income ratio improved to 7.9% in the term ended March 2016. The ratio is forecasted to decline to 5.2% in this term, but this will be the bottom.

Solution services are accepted by customers and the need for these services will continue to broaden. The profitability of member services will improve as membership increases. More customers will want to use service inclusive products together with support plans.

The sales mix of the Company will continue to shift to more solution services, and the content of these services will also change. In the near term, the Company will aim to achieve sales of 50 billion yen and an operating profit of 4 billion yen.

The Company's business model remains unchanged. As the Company will strengthen the service system that further meets customer needs, a more rigid system will be established. With this system, more demand for services will be captured and more repeat customers will be retained, even though costs will increase. Therefore, profit is highly likely to recover and grow higher than before.

As the basic business model is still thriving, earnings should recover with more momentum starting this second half. Profit is expected to achieve a record high in a few years. Many investors are likely to assess the timing for investment in consideration of the above factors, and the Company is in a noteworthy phase.

Rebuilding trust

The Company had temporarily narrowed down the product offerings considerably. However, the company will become even stronger if employees get used to new governance, including 1) quality management of customer services, 2) promotion of customer services to improve customer satisfaction, and 3) internal framework for legal affairs and compliance, and that fact that such governance works effectively. Since the demand for service is high, the Company will be able to enhance product offerings once the new system gets on the track.

President Nojima is not in a hurry to restore business performance. He is confident that the results will recover to former levels when the internal structure gets used to the new framework and service capabilities improve. Trust from existing members and local communities is in the recovery phase. We intend to pay close attention to a further enhanced business model from PC DEPOT two years from now.

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

Service subscribers will continue to 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. It is almost certain that the Company's business model will retain its niche existence after it overcomes this problem. The Company has been promoting a shift to a stock-type profit structure based on service sales. 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. As a result of the equity financing conducted in 2017, the number of shareholders increased to 11,167 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. In terms of returning profits to shareholders, the Company conducted a 1:2 stock split with September 30, 2016, as the record date and decided to pay a dividend of 13.0 yen per share after the stock split.

Reflecting the strong business results in the first quarter of the term ended March 2017, the share price temporarily exceeded 1,500 yen, and the Company was trading at a PER level of 20. Later however, the share price drastically dropped and the Company has decided to reexamine its services on a fundamental level. Based on a stock price of 578 yen as of June 16, 2017, PC DEPOT has a PBR of 1.30, an ROE of 7.2%, and a PER of 18.1, with a dividend yield of 2.2%. The Company's stock price will be further adjusted in the market, reflecting factors such as the progress of service improvements for 400 thousand members, increase in new members, trends in service sales and the timing for bottoming-out earnings.