

A large blue circular logo with a white "R" inside, connected to a network of blue dots and lines.

SR Research Report  
2014/3/6

## Happinet Corporation (7552)

---

Shared Research Inc. has produced this report by request from the company discussed in the report. The aim is to provide an "owner's manual" to investors. We at Shared Research Inc. make every effort to provide an accurate, objective, and neutral analysis. In order to highlight any biases, we clearly attribute our data and findings. We will always present opinions from company management as such. Our views are ours where stated. We do not try to convince or influence, only inform. We appreciate your suggestions and feedback. Write to us at [sr\\_inquiries@sharedresearch.jp](mailto:sr_inquiries@sharedresearch.jp) or find us on Bloomberg.



## Contents

Recent Updates.....	4
Highlights.....	4
Trends and outlook.....	4
Business.....	9
Description.....	9
Market and value chain.....	20
Strategy.....	22
Other information.....	23
History.....	23
Major shareholders.....	24
Profile.....	25



Income Statement (million yen)	FY03/09 Cons.	FY03/10 Cons.	FY03/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Est.
<b>Total Sales</b>	<b>166,778</b>	<b>194,246</b>	<b>190,891</b>	<b>198,021</b>	<b>176,757</b>	<b>205,000</b>
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	16.0%
<b>Gross Profit</b>	<b>19,990</b>	<b>22,467</b>	<b>22,326</b>	<b>25,007</b>	<b>22,501</b>	
YoY	9.2%	12.4%	-0.6%	12.0%	-10.0%	
GPM	12.0%	11.6%	11.7%	12.6%	12.7%	
<b>Operating Profit</b>	<b>2,137</b>	<b>2,327</b>	<b>2,855</b>	<b>4,855</b>	<b>2,973</b>	<b>3,400</b>
YoY	47.3%	8.9%	22.7%	70.1%	-38.8%	14.4%
OPM	1.3%	1.2%	1.5%	2.5%	1.7%	1.7%
<b>Recurring Profit</b>	<b>2,322</b>	<b>2,513</b>	<b>3,013</b>	<b>5,032</b>	<b>3,081</b>	<b>3,500</b>
YoY	48.0%	8.2%	19.9%	67.0%	-38.8%	13.6%
RPM	1.4%	1.3%	1.6%	2.5%	1.7%	1.7%
<b>Net Income</b>	<b>1,135</b>	<b>1,179</b>	<b>1,376</b>	<b>2,458</b>	<b>2,011</b>	<b>2,000</b>
YoY	-	3.9%	16.7%	78.6%	-18.2%	-0.5%
Net Margin	0.7%	0.6%	0.7%	1.2%	1.1%	1.0%
<b>Per Share Data</b>						
Number of Shares (thousands)	12,025	12,025	12,025	24,050	24,050	
EPS	97.6	104.6	61.3	109.7	89.8	88.9
EPS (Fully Diluted)	-	-	-	109.6	89.6	
Dividend Per Share	30.0	30.0	30.0	38.8	22.5	24.8
Book Value Per Share	1,599.1	1,692.8	883.7	972.1	1,036.2	
<b>Balance Sheet (million yen)</b>						
Cash and Equivalents	5,463	6,312	8,220	12,359	10,155	
<b>Total Current Assets</b>	<b>44,864</b>	<b>40,140</b>	<b>41,039</b>	<b>48,269</b>	<b>47,930</b>	
Tangible Fixed Assets, net	1,952	1,668	1,555	1,392	1,110	
Other Fixed Assets	3,355	3,405	2,780	2,946	2,976	
Intangible Assets	4,488	3,836	3,132	1,715	985	
<b>Total Assets</b>	<b>54,661</b>	<b>49,050</b>	<b>48,507</b>	<b>54,323</b>	<b>53,003</b>	
Notes and Accounts Payable	20,748	19,832	20,204	23,042	22,672	
Short-Term Debt	5,520	2,460	-	-	-	
<b>Total Current Liabilities</b>	<b>33,171</b>	<b>27,436</b>	<b>25,837</b>	<b>29,617</b>	<b>26,883</b>	
Long-Term Debt	430	30	-	-	-	
<b>Total Fixed Liabilities</b>	<b>3,305</b>	<b>2,651</b>	<b>2,867</b>	<b>2,909</b>	<b>2,829</b>	
<b>Total Liabilities</b>	<b>36,476</b>	<b>30,088</b>	<b>28,704</b>	<b>32,527</b>	<b>29,713</b>	
<b>Net Assets</b>	<b>18,184</b>	<b>18,962</b>	<b>19,802</b>	<b>21,795</b>	<b>23,289</b>	
Interest-Bearing Debt	5,950	2,490	-	-	-	
<b>Cash Flow Statement (million yen)</b>						
Operating Cash Flow	951	6,232	5,083	4,609	-1,505	
Investment Cash Flow	-851	-391	-315	-50	-108	
Financing Cash Flow	-975	-4,481	-2,852	-421	-588	
<b>Financial Ratios</b>						
ROA	2.2%	2.3%	2.8%	4.8%	3.7%	
ROE	6.2%	6.3%	7.1%	11.8%	8.9%	
Equity Ratio	33.3%	38.7%	40.8%	40.1%	43.9%	

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

The company initiated a 1-for-2 stock split on December 1, 2011.



## Recent Updates

### Highlights

SR initiates coverage of **Happinet Corp** with this report.

## Trends and outlook

### Quarterly results

Quarterly Performance (million yen)	FY03/13				FY03/14				FY03/14	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY Est.	FY Est.
Sales	36,895	39,316	61,472	39,074	36,172	51,199	78,090	-	80.7%	205,000
YoY	-13.1%	-14.7%	-11.1%	-3.3%	-2.0%	30.2%	27.0%	-	-	16.0%
Gross Profit	5,202	4,990	7,250	5,059	5,020	5,763	8,023	-	-	-
YoY	-7.1%	-20.5%	-7.7%	-4.2%	-3.5%	15.5%	10.7%	-	-	-
GPM	14.1%	12.7%	11.8%	12.9%	13.9%	11.3%	10.3%	-	-	-
SG&A	4,436	4,749	5,275	5,067	4,416	4,815	5,551	-	-	-
YoY	-2.0%	-5.6%	-1.2%	-3.6%	-0.5%	1.4%	5.2%	-	-	-
SG&A / Sales	12.0%	12.1%	8.6%	13.0%	12.2%	9.4%	7.1%	-	-	-
Operating Profit	766	241	1,975	-9	604	947	2,472	-	118.3%	3,400
YoY	-28.5%	-80.6%	-21.5%	-	-21.1%	292.9%	25.2%	-	-	14.4%
OPM	2.1%	0.6%	3.2%	-	1.7%	1.8%	3.2%	-	-	1.7%
Recurring Profit	804	268	2,004	5	614	965	2,483	-	116.1%	3,500
YoY	-29.8%	-79.0%	-21.6%	-90.9%	-23.6%	260.1%	23.9%	-	-	13.6%
RPM	2.2%	0.7%	3.3%	0.0%	1.7%	1.9%	3.2%	-	-	1.7%
Net Income	519	190	1,286	16	260	1,115	1,248	-	131.2%	2,000
YoY	-27.2%	-76.6%	54.6%	-84.0%	-49.9%	486.8%	-3.0%	-	-	-0.5%
NPM	1.4%	0.5%	2.1%	0.0%	0.7%	2.2%	1.6%	-	-	1.0%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

#### Seasonality

Toy business typically accounts for 40% of annual sales and 50% of operating profit. Retail toy sales peak in the weeks leading up to Christmas, thus the company's sales and operating profit are highest in Q3 which includes December.

### Q3 FY03/14 results (out February 12, 2014; see table above)

For cumulative Q3, sales were JPY165.5bn (+20.2% YoY), operating profit was JPY4.0bn (+34.9% YoY), recurring profit was JPY4.1bn (+32.0% YoY), and net income was JPY2.6bn (+31.5% YoY).



## **Toys**

Sales were JPY61bn (+2.8% YoY) and operating profit was JPY2.7bn (+27.3% YoY). Kamen Rider Gaim character products for boys made by Bandai did well, along with the Aikatsu! character goods for girls (also Bandai).

## **Visual and music**

Sales were JPY33.0bn (-1.7% YoY) and operating profit was JPY313mn (-24.3% YoY). The packaged-product market was sluggish due to growth in online content distribution. The company posted valuation losses on some products.

## **Video games**

Sales were JPY54.3bn (+82.9%YoY) and operating profit was JPY351mn (-44.3% YoY). The overall packaged-game market was weak amid the spread of mobile online games. The sales increase reflects the acquisition of Toys Union Co Ltd, a major wholesaler of Nintendo video games. Operating profit fell from a year earlier because of valuation losses on high inventory products.

## **Amusement**

Sales were JPY17.1bn (+13.8% YoY) and operating profit was JPY1.6bn (+96.0% YoY). Products linked to Aikatsu! and Dragon Ball Heroes for card game machines, as well as capsule toy machines, were strong.

The company raised its year-end dividend forecast for FY03/14 to JPY13.5 a share from JPY11.25. The annual dividend is expected to be JPY24.75 as a result. The company announced the dividend forecast revision when it released its 3Q earnings.

## **Q2 (1H) FY03/14 results** (out November 12, 2013; see table above)

1H sales came in at JPY87.3bn (+14.6% YoY); operating profit was JPY1.6bn (+54.0% YoY); recurring profit was JPY1.6bn (+47.3% YoY); and net income was JPY1.4bn (+93.8% YoY).

## **Toys**

Sales nudged JPY31.8bn (-1.6% YoY) while operating profit hit JPY563mn (-32.4% YoY). Zyuden Sentai Kyoryuger character products for boys made by Bandai did well, along with the Aikatsu! character goods for girls (also Bandai). But adverse changes in the starting months of TV programs featuring some characters of the company's toys dampened overall performance.

## **Visual and music**

Sales ticked up to JPY21.3bn (+2.8% YoY) while operating profit topped out at JPY377mn (+250.1% YoY). The packaged-product market tracked sideways on growth in online content distribution. Yet original movies—part-funded Nobou no Shiro and 100% in-house Zoids—were very profitable, swelling operating profits.

## **Video games**

Sales rose to JPY23.0bn (+75.5% YoY); operating profit fell to JPY34mn (-64.6% YoY). Despite some hit products the overall packaged-game market was weak amid competition from social network games. The sales boost reflects the Toys Union Co Ltd acquisition, a big wholesaler of Nintendo video games. Profits at Toys Union sank after Happinet overhauled the newly consolidated subsidiary's inventory valuation method to increase efficiency (Happinet's valuation method was applied to Toys Union).



### Amusement

Sales rose to JPY11.1bn (+11.9% YoY) while operating profit soared to JPY1.2bn (+96.7% YoY). Top performers: goods relating to Aikatsu! and Dragon Ball Heroes for card game machines, plus capsule toy machines.

### Full-year outlook: FY03/14

FY03/14 Forecast (million yen)	FY03/13 Act.			FY03/14 Estimates		
	1H	2H	Full Year	1H	2H	Full Year
<b>Sales</b>	<b>76,211</b>	<b>100,546</b>	<b>176,757</b>	<b>87,371</b>	<b>117,629</b>	<b>205,000</b>
CoGS	66,019	88,237	154,256	76,587		
<b>Gross Profit</b>	<b>10,192</b>	<b>12,309</b>	<b>22,501</b>	<b>10,783</b>		
GPM %	13.4%	12.2%	12.7%	12.3%		
SG&A	<b>9,185</b>	<b>10,342</b>	19,527	9,231		
SG&A/Sales	12.1%	10.3%	11.0%	10.6%		
<b>Operating Profit</b>	<b>1,007</b>	<b>1,966</b>	<b>2,973</b>	<b>1,551</b>	<b>1,849</b>	<b>3,400</b>
OPM %	1.3%	2.0%	1.7%	1.8%	1.6%	1.7%
<b>Recurring Profit</b>	<b>1,072</b>	<b>2,009</b>	<b>3,081</b>	<b>1,579</b>	<b>1,921</b>	<b>3,500</b>
RPM %	1.4%	2.0%	1.7%	1.8%	1.6%	1.7%
<b>Net Income</b>	<b>709</b>	<b>1,302</b>	<b>2,011</b>	<b>1,375</b>	<b>625</b>	<b>2,000</b>
Net Margin %	0.9%	1.3%	1.1%	1.6%	0.5%	1.0%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

In FY03/14 the company sees sales rising to JPY205.0bn (+16.0% YoY), operating profits nudging JPY3.4bn (+14.4% YoY), recurring profit touching JPY3.5bn (+13.6% YoY), and net income of JPY2.0bn. Company expectations:

### Toys

Forecast sales of JPY75.0bn (+0.5% YoY) and operating profit of JPY2.1bn (+2.2% YoY). Products supplied by Bandai typically account for about half of sales. SR estimates that character goods such as those relating to Kamen Rider, Aikatsu!, and Super Sentai account for around 70% of Bandai toy sales. The following sales results and forecasts for character toys in Japan were released by Namco Bandai Holdings Inc (TSE1: 7832):

- Toys relating to the Kamen Rider television series were popular in FY03/12 and FY03/13, boosting sales. However, the company expects that full-year earnings for FY03/14 will show a drop in the popularity of these toys.
- The company expects to see a 25% YoY increase in sales of Super Sentai toys, thanks to the popularity of Zyuden Sentai Kyoryuger.
- Aikatsu!, a television animation program derived from a card game with the same title, started in October 2012. From FY03/14 Bandai launched more related products to bolster sales.

The company expects to see sales level off for original and exclusive products, a key business area in its medium-term plan.

### Visual and music

The company forecasts sales of JPY41.0bn (-8.5% YoY) and operating profits of JPY600mn (+94.2% YoY). As the packaged-product market declines amid growth in online content distribution, the company thinks sales will decrease. However, it plans to improve profits by focusing on investment in visual products, and products for which it has exclusive selling rights—such as The Floating Castle (Nobou no Shiro), ZOID, The Family, Human Trust (Jinrui Shikin), and Kyoaku.



## Video games

The company forecasts sales of JPY68.0bn (+16.7% YoY), and operating profit of JPY800mn (+18.0% YoY). The company expects sales to grow in both new hardware and games, in light of Sony Computer Entertainment Inc's launch the new PlayStation 4 console in Japan on February 22, 2014. This console had achieved global sales of 4.2mn units as of December 28, 2013. Nintendo launched a number of games as sequels to previous hits on the 3DS console, such as Monster Hunter 4, and Pokémon X and Y. The company also expects to see large increases in sales figures as a result of its purchase of Toys Union Co Ltd (henceforth Toys Union), a video game distributor, in July 2013. Toys Union is now a subsidiary.

## Amusement

The company forecasts sales of JPY21.0bn (+2.7% YoY) and operating profit of JPY1.2bn (-5.1% YoY). The company expects to see an increase in profit margins in its toy vending machine business, thanks to the introduction of a system for collecting sales data from machines without visiting their locations. The move is expected to make the operations more efficient. Dragon Ball Heroes and Aikatsu! (card games) are likely to continue to perform well.

## Outlook

In May 2012 Happinet unveiled its sixth medium-term business plan for FY03/13 to FY03/15. For the final year the company targets sales of JPY250.0bn and recurring profits of JPY7.0bn. It wants consistent growth in existing businesses and will seek new business areas, in sync with strengthening distribution.

## Existing business

The company wants to beef up market share in all existing segments.

Business Segment	Market Share		Key Tasks
	FY03/13 (Actual)	FY03/15 (Target)	
Toy	30%	40%	Actively develop original products
Visual and Music	14%	20%	Expand original visual products, strengthen ties with major video makers
Video Game	12%	20%	Boost sales of new consoles, promote products with exclusive selling rights
Amusement	60%	70%	Increase sites for toy vending machines, promote products with exclusive rights

Source: Company data, SR Inc. Research

## New areas

The company aims to increase sales of original products and products with exclusive selling rights based on exclusive selling agreements with makers. The company hopes to lift total sales of such products from JPY12bn in FY03/12 to JPY25bn in FY03/15.

Business Segment	Original Products/Exclusive-Rights Products (billion yen)	
	FY03/13 Sales (Actual)	FY03/15 Sales (Target)
Toy	3	5
Visual and Music	6	14
Video Game	3	5
Amusement	0	1

Source: Company data, SR Inc. Research



SR believes that meeting the profit goals might be a tall order, but sees potential for the company to increase its market share in certain areas, and to achieve its sales goals for products developed in-house. SR thinks the company's growth sources lie in expanding its in-house development of products in the toy business, and increasing the number of machines and their efficiency in the amusement business, through the introduction of a system for collecting sales data.

### **Toys: strengthening original products**

SR believes that tie-ups with TV programs and movies are vital for original products to be successful and secure stable sales.

The company is formulating a plan for collaborating with publishing companies and TV stations to create and show animated cartoons. The company then plans to develop and sell toys based on characters from these animated cartoons. SR believes that the company will act on this plan in the course of its medium-term business plan (FY03/13 to FY03/15).

The company stated that it can expect relatively high gross profits when it develops products in-house, because doing so allows it to collect its gross profit margin as both a manufacturer and a distributor.

### **The introduction of a sales data acquisition system, and increasing machine placements in the amusement business**

The company wants to expand sales in its operation of toy vending machines, by increasing the number of machines placed at outlets while capping costs through a new POS system providing data on capsule sales. The company developed the POS system, and introduced it as a pilot scheme in five locations in February 2013. It plans to roll out the system at 200 outlets nationwide in FY03/14. The system uses an embedded ejection sensor to allow the company to collect real-time sales data.

If the system operates as planned, it will remove the need for Happinet staff to visit outlets frequently, and the company will be able to monitor sales efficiently, refill capsules as required, and collect money from machines. This should prompt higher sales by increasing the number of locations where vending machines are placed without incurring additional labor costs, while also increasing the operating efficiency of existing locations.

As of December 2013 the company was operating toy vending machines at 4,800 locations nationwide. There were 8,600 locations in 2007 when Happinet acquired Sunlink Co Ltd and The Apple Corporation, so it appears there is significant potential for sales expansion over the medium term with the POS system. The toy vending machine business posts a higher gross profit margin than the distribution business, and thus can be expected to make a sizable contribution to profits.





## Business

### Description

**Leading intermediary distributor for toys, DVDs, CDs and video games.** The company buys goods from makers and distributes to retailers, managing inventories and handling orders/shipments. Segment breakdown: toys (42.2% FY03/13 sales), visual and music (25.4%), video-game (20.8%), and amusement (11.6%).

Consolidated Sales and OP by Segment (million yen)		FY03/09	FY03/10	FY03/11	FY03/12	FY03/13	FY03/14
		Act.	Act.	Act.	Act.	Act.	Est.
Sale	Totals	61,813	65,654	69,104	77,313	74,660	75,000
	YoY	-1.7%	6.2%	5.3%	11.9%	-3.4%	0.5%
	Composition	37.1%	33.8%	36.2%	39.0%	42.2%	36.6%
	Visual and Music	36,570	67,838	57,759	55,719	44,810	41,000
	YoY	-5.1%	85.5%	-14.9%	-3.5%	-19.6%	-8.5%
	Composition	21.9%	34.9%	30.3%	28.1%	25.4%	20.0%
	Video Game	50,474	44,372	46,447	42,704	36,839	68,000
	YoY	-7.4%	-12.1%	4.7%	-8.1%	-13.7%	84.6%
	Composition	30.3%	22.8%	24.3%	21.6%	20.8%	33.2%
	Amusement	17,919	16,381	17,579	22,282	20,447	21,000
	YoY	38.3%	-8.6%	7.3%	26.8%	-8.2%	2.7%
	Composition	10.7%	8.4%	9.2%	11.3%	11.6%	10.2%
	Total	166,778	194,246	190,891	198,021	176,757	205,000
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	16.0%	
OP	Totals	996	1,865	2,321	3,009	2,055	2,100
	YoY	-24.6%	87.2%	24.4%	29.6%	-31.7%	2.2%
	Composition	29.1%	50.4%	55.8%	48.6%	47.7%	44.7%
	Visual and Music	1,330	253	-656	448	309	600
	YoY	3494.6%	-81.0%	-359.3%	-	-31.0%	94.2%
	Composition	38.9%	6.9%	-15.8%	7.2%	7.2%	12.8%
	Video Game	1,221	1,035	1,156	936	678	800
	YoY	-7.6%	-15.2%	11.7%	-19.0%	-27.6%	18.0%
	Composition	35.7%	28.0%	27.8%	15.1%	15.7%	17.0%
	Amusement	-127	544	1,340	1,801	1,265	1,200
	YoY	-	-	146.3%	34.4%	-29.8%	-5.1%
	Composition	-3.7%	14.7%	32.2%	29.1%	29.4%	25.5%
	Total	3,420	3,699	4,162	6,196	4,309	4,700
Adjustments	-1,283	-1,371	-1,307	-1,341	-1,335	-1,300	
Consolidated Operating Profit	2,137	2,327	2,855	4,855	2,973	3,400	
YoY	47.3%	8.9%	22.7%	70.0%	-38.8%	14.4%	

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

Distribution channels are specialty stores, including consumer electronics and camera stores (34.2% FY03/13 sales), general merchandise stores (20.9%), convenience stores (12.9%), E-commerce (10.9%), large-format suburban specialty stores (9.8%), and others (11.3%).



Sales by Channel		FY03/09	FY03/10	FY03/11	FY03/12	FY03/13
(million yen)		Act.	Act.	Act.	Act.	Act.
Sales	Specialty Stores	55,200	63,900	65,300	62,500	60,400
	YoY	8.4%	15.8%	2.2%	-4.3%	-3.4%
	Composition	33.1%	33.0%	34.3%	31.6%	34.2%
	General Merchandise Stores	27,000	35,600	36,700	40,300	36,900
	YoY	-9.4%	31.9%	3.1%	9.8%	-8.4%
	Composition	16.2%	18.4%	19.3%	20.4%	20.9%
	Convenience Stores	14,100	21,500	21,300	26,300	22,800
	YoY	11.9%	52.5%	-0.9%	23.5%	-13.3%
	Composition	8.5%	11.1%	11.2%	13.3%	12.9%
	E-Commerce	28,800	22,200	24,100	25,000	19,200
	YoY	-17.7%	-22.9%	8.6%	3.7%	-23.2%
	Composition	17.3%	11.4%	12.7%	12.6%	10.9%
	Large-format Suburban Specialty Stores	9,000	19,300	18,500	19,300	17,200
	YoY	-33.3%	114.4%	-4.1%	4.3%	-10.9%
	Composition	5.4%	10.0%	9.7%	9.7%	9.7%
	Wholesalers	17,000	21,500	15,400	15,200	11,500
	YoY	14.1%	26.5%	-28.4%	-1.3%	-24.3%
	Composition	10.2%	11.1%	8.1%	7.7%	6.5%
	Others	15,300	9,900	9,200	9,100	8,500
	YoY	27.5%	-35.3%	-7.1%	-1.1%	-6.6%
	Composition	9.2%	5.1%	4.8%	4.6%	4.8%
Total		166,700	193,900	190,500	198,000	176,700
	YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

\* Others include Department Stores

Happinet is the largest intermediary distributor of toys, DVDs and CDs in the industry, with a 60% market share in capsule toys and card games.

**Toys business (42.2% FY03/13 consolidated sales; 47.7% operating profit)**

**Happinet is Japan's largest intermediary distributor of toys, with a 30% market share.** It handles 80% of toy distribution in Japan for Bandai (a Namco Bandai Holdings [TSE1: 7832] subsidiary).

In this segment, Happinet enjoys a gross profit margin buying goods from toy makers and selling them to retailers. The company liquidates unsold inventories each month. Gross profit margin moves up or down by 1% given fluctuating inventory write-offs.

The company buys goods from big toy makers like Bandai and Tomy and sells them to toy retailers such as Toys"R"Us-Japan Ltd (unlisted), large consumer electronics stores and retail chains, and major online retailers.

This table shows Happinet's main toy suppliers:



Toy Sales (million yen)		FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.
Sales	Bandai	28,900	32,700	37,400	42,300	38,800
	YoY	-3.7%	13.1%	14.4%	13.1%	-8.3%
	Composition	46.8%	49.8%	54.1%	54.7%	52.0%
	TAKARA TOMY	4,800	5,000	7,000	6,300	5,300
	YoY	0.0%	4.2%	40.0%	-10.0%	-15.9%
	Composition	7.8%	7.6%	10.1%	8.2%	7.1%
	Happinet original	1,200	1,400	1,400	2,200	2,500
	YoY	-53.8%	16.7%	0.0%	57.1%	13.6%
	Composition	1.9%	2.1%	2.0%	2.8%	3.4%
	Other	19,500	18,400	23,100	26,400	27,900
	YoY	-3.0%	-5.6%	25.5%	14.3%	5.7%
	Composition	31.6%	28.0%	33.5%	34.2%	37.4%
	Other makers	7,300	7,900	-	-	-
	YoY	-	8.2%	-	-	-
	Composition	11.8%	12.0%	-	-	-
Total		61,800	65,600	69,100	77,300	74,600
	YoY	-1.7%	6.2%	5.3%	11.9%	-3.4%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

**Japan's toy market centers on fads, rather than long-selling, staple products.** Goods featuring characters from TV animation series tend to have a one-year sales cycle with products refreshed when a new series begins. Popularity drops and sales falter for products whose TV programs have finished.

Also, toy manufacturers often make use of overseas factories, particularly in China. It takes about three months from when toys are manufactured till they are ready to be sold by retailers, due to strict procedures for managing and checking quality—after all, these are products that will be used by children.

Intermediary distributors like Happinet lie between manufacturers and retailers, and add value by absorbing inventory risk. By trading with intermediary distributors, retailers need only take inventory risks for the goods on their store shelves.

Toy distribution:

- Happinet and toymakers agree on order quantities three months prior to the release of new products.
- On product launch, toymakers deliver toys to the company, which in turn delivers them to retailers that shoulder inventory risk.
- The company holds inventories worth roughly two weeks of sales and partially distributes them in response to additional orders from retailers. Here, the company bears the inventory risk.

Happinet typically sells out most of its inventories at end December and recognizes losses on inventories by disposing of inventories or making inventory write-downs at end March the following year. For toys, annual inventory disposal is 1-2% of annual sales.

SR understands that the company's rise to prominence as the largest intermediary distributor of toys began in the 1990s with the relaxation of the Large Scale Retail Store Law. Happinet responded to changes in the business environment. Distributors began to need advanced information and logistics systems in order to keep up with the growing size of retailers. Also, the growth in Bandai's toy sales was



another contributing factor in Happinet's growth.

SR understands that Bandai—a group company and one of Happinet's main toy suppliers—specializes in making products and accessories that feature characters from popular TV animated cartoons. Bandai has leveraged these character goods to increase its domestic toy sales.

### Bandai's character goods portfolio

Leading toy characters with the highest sales rankings at Bandai are those from the Super Sentai, Kamen Rider, and Precure series. Toei or Toei Animation makes these series; TV Asahi broadcasts them on Sundays. Program sponsor Bandai merchandises related toys. This system has a long history. The Super Sentai series, the longest-running of the trio, started with Himitsu Sentai Gorenger in 1975. Its 37th series, Zyuden Sentai Kyoryuger, aired in 2013. In the 30-minute Super Sentai program, a team of three to five people use special items to become superheroes wearing helmets and color-coded jumpsuits, and fight bad guys or monsters. In each episode the enemy, once defeated, is reborn as a giant monster and the heroes ride a giant robot to destroy it. Each year a TV series starts in February and a movie version is launched in August. With new characters and items added during the year, Bandai merchandises all the transforming items, weapons and robots. All super hero toys are ready for Christmas when sales peak.

Bandai Sales by Character (Domesic Toy & Hobby) (billion yen)

(billion yen)	FY03/09	FY03/10	FY03/11	FY03/12	FY03/13	FY03/14
	Act.	Act.	Act.	Act.	Act.	Est.
Kamen Rider	8.7	17.5	23.0	28.3	27.1	21.0
Mobile Suit Gundam	16.0	14.4	13.4	15.6	16.5	16.5
Precure Series	10.5	11.9	12.5	10.7	10.6	11.0
Anpanman	9.1	8.4	8.6	9.6	10.0	10.0
Super Sentai	12.0	10.5	9.2	13.0	9.6	12.0
One Piece	1.7	2.0	6.8	11.2	8.3	6.0
Dragon Ball	3.7	3.3	2.7	4.4	4.8	4.0
Battle Sprints	2.7	2.6	3.4	4.8	4.2	5.0
Danball Senki	-	-	0.2	3.6	3.3	2.5
Tamagotchi	1.0	2.0	2.9	4.0	3.2	2.5
Ultraman	4.3	3.1	2.8	1.8	2.0	5.0

Source: Bandai data

### Visual and music business (25.4% FY03/13 consolidated sales; 7.2% operating profit)

This segment comprises the visual wholesale section (58.0% of sales in visual and music business), the visual manufacturing section (12.5%), and the music section (29.5%).



Visual & Music Sales (million yen)		FY03/09	FY03/10	FY03/11	FY03/12	FY03/13
		Act.	Act.	Act.	Act.	Act.
Sales	Visual	36,500	42,500	40,300	39,600	31,500
	YoY	-5.2%	16.4%	-5.2%	-1.7%	-20.5%
	Composition	100.0%	62.7%	69.8%	71.1%	70.3%
	Wholesale	29,100	36,800	34,400	33,600	25,900
	YoY	-2.3%	26.5%	-6.5%	-2.3%	-22.9%
	Composition	79.7%	54.3%	59.6%	60.3%	57.8%
	Maker	7,400	5,700	5,800	5,900	5,600
	YoY	-14.0%	-23.0%	1.8%	1.7%	-5.1%
	Composition	20.3%	8.4%	10.1%	10.6%	12.5%
	Music	0	25,200	17,400	16,100	13,200
	YoY	-	-	-31.0%	-7.5%	-18.0%
	Composition	0.0%	37.2%	30.2%	28.9%	29.5%
Total		36,500	67,800	57,700	55,700	44,800
	YoY	-5.1%	85.5%	-14.9%	-3.5%	-19.6%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

### **Visual wholesale section**

Happinet makes a gross profit margin from buying DVDs from visual content manufacturers and selling them to retailers. The company said that intermediary distributors, like itself, do not need to hold substantial inventories compared with toymakers since retailer orders are made and delivered in a week. As wholesalers do not shoulder much inventory risk, the gross profit margin is slimmer than in toy wholesaling.

The company buys products from all major content makers, but it has been Nikkatsu Corp's (unlisted) sole distributor since 2009 and Bandai Visual Co Ltd's (a Namco Bandai subsidiary) sole distributor since 2010. The company distributes products to major online retailers and consumer electronics chains.

### **Visual manufacturing section**

Happinet invests in movie production partnerships, thus obtaining videogram rights, or obtains existing videogram rights and then makes and sells DVD products. Income hinges on the amount and ratio of investment in partnerships, box-office proceeds, DVD sales volumes, and videogram royalties.

**Videogram** is a Japanese legal term, used to refer to visual media (movies and TV programs) on a certain format (eg, VHS, DVD) and its packaging. Videogram rights here refer to the rights to manufacture, release, and sell this media.

The movie industry and movie production partnerships handle production, distribution, exhibition, and secondary use (renting/selling movie content to consumers). Video content makers obtain videogram rights to movies by investing in production partnerships or by purchasing the rights from their holders. Rights to receive box-office proceeds are distributed in proportion to the amount invested in the production partnership. Box-office profits are defined as proceeds—ie, number of viewers multiplied by ticket prices—less expenses (cinema operators and distributors, production, and advertising). According to the company, it is difficult to predict the profitability of investing in production partnerships, because production costs, investment stake, and box-office proceeds differ from movie to movie. Also, as part of



the conditions for investing in a production partnership, the company obtains videogram rights to the movie, and will therefore sell it as a DVD.

Another way to obtain videogram rights is from copyright holders, such as production partnerships. This can be done either by paying for the rights, or by paying a minimum guarantee (MG). According to the company, videogram royalties differ widely by movie, so it is difficult to calculate an average profitability for videogram rights.

### **Music wholesale section**

In the music section, Happinet takes its gross profit margin from buying products from music content makers and selling them to retailers. As in its visual wholesale section, the company does not shoulder much inventory risk. Therefore, gross profit margins are tighter than in the toy wholesaling business.

The company buys goods from big music software makers and distributes them to online shops and consumer electronics chains.

Japan's resale price maintenance system (recommended retail price)—as established by Japanese copyright law—means the creators of music media are able to force retailers to observe a certain retail price. Thus the distribution of music media differs from that of visual media. Although in both cases companies are effectively purchasing stock, for music media a limit is set for a proportion of the sales that may be returned, and the seller sometimes ends up taking these returns back.

The proportion of sales that may be returned differs between the manufacturer and the distributor, and between the distributor and the retailer. Therefore, the distributor must accept some inventory risk in cases where there is more leeway for the retailer to return stock to the distributor, than for the distributor to return it to the manufacturer.

#### **Music CDs: resale price maintenance**

A maker or supplier of music imposes selling prices on wholesalers and retailers who abide by this. The resale maintenance system of music software (such as CDs) is approved as an exception to the Antimonopoly Act which normally prohibits such conduct as unfair trading practices.

### **Video game business (20.8% FY03/13 consolidated sales; 15.7% operating profit)**

Happinet makes a margin by buying video game consoles and game software from makers and distributing it to shops. This business has the lowest gross profit margin of all the company's businesses, which stems from the company bearing little inventory risk due to short order placement/delivery times.

Happinet buys products from Nintendo Co Ltd (TSE1: 7974), Sony Computer Entertainment Inc (a subsidiary of Sony [TSE1: 6758]), and Microsoft Corp. It is the only wholesaler handling all consumer game consoles available in Japan.

Nintendo products account for over half of sales, with Sony products next at over 30%. The company distributes products to major online retailers and consumer electronics chains. SR estimates the company's share of Nintendo's game-related sales at around 25%. The company is virtually the sole distributor of Sony Computer Entertainment games and toys, and has exclusive distribution agreements in Japan with Microsoft.



Video Games (million yen)		FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.
Sale	PlayStation (stand-alone)	6,700	6,900	6,000	6,800	5,300
	<i>YoY</i>	-23.9%	3.0%	-13.0%	13.3%	-22.1%
	<i>Composition</i>	13.3%	15.6%	12.9%	15.9%	14.4%
	PlayStation (portable)	10,300	8,000	11,600	12,200	7,100
	<i>YoY</i>	10.8%	-22.3%	45.0%	5.2%	-41.8%
	<i>Composition</i>	20.4%	18.1%	25.0%	28.6%	19.3%
	Nintendo (stand-alone)	4,200	6,400	4,700	3,200	4,400
	<i>YoY</i>	-53.3%	52.4%	-26.6%	-31.9%	37.5%
	<i>Composition</i>	8.3%	14.4%	10.1%	7.5%	12.0%
	Nintendo (portable)	9,600	10,300	9,900	10,400	14,200
	<i>YoY</i>	-24.4%	7.3%	-3.9%	5.1%	36.5%
	<i>Composition</i>	19.0%	23.3%	21.3%	24.4%	38.6%
	Others	19,400	12,500	14,000	9,800	5,600
	<i>YoY</i>	35.7%	-35.6%	12.0%	-30.0%	-42.9%
	<i>Composition</i>	38.5%	28.2%	30.2%	23.0%	15.2%
Total		50,400	44,300	46,400	42,700	36,800
	<i>YoY</i>	-7.4%	-12.1%	4.7%	-8.1%	-13.7%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

Happinet creates and sells original game software and operates social network game sites but profit impact is small (December 2013).

The company entered video gaming in 1994 and expanded sales by acquiring distributors. There is a possibility that there will be an increase in M&A between companies in this industry, as the market in games sold at bricks and mortar stores is expected to shrink—perhaps providing an opportunity for the company to increase its market share.

**Amusement business (11.6% FY03/13 total consolidated sales; 29.4% operating profit)**

The company’s amusement business includes toy vending machine operations and card game operations.

**Toy vending machine section**

The company sells toys in capsules from vending machines at major retail and electronics stores, and shopping malls. It purchases vending machines and capsule toys from Bandai. This business is close to retail, and therefore has the highest gross profit margin of all the company’s businesses.

Capsule toys retail at between JPY100 and JPY500. The vending machines work thus: a capsule toy comes out when the customer inserts money, in coins, and turns the crank in the middle of the machine. The toys themselves are varied, ranging from scale models of animation characters and animal figures, to mobile phone accessories. There is an element of entertainment in the fact that, although the vending machines are themed, the customer does not know the exact contents of the capsule he or she will receive.

As of December 2013, the company had machines at 4,800 locations nationwide.





### Toy vending machines, known as "Gashapon" in Japan.



Source: Company data

In November 2007, Happinet acquired the two leading operators of toy vending machines in the industry, Sunlink Co Ltd and The Apple Corporation. Then, after merging the amusement businesses of these companies with its own in October 2008, the company established Happinet Vending Service Corporation—a consolidated subsidiary that then continued running this business.

According to Happinet, the three companies—Happinet, Sunlink, and The Apple Corporation—together had vending machines at around 8,600 locations nationwide in 2007, but nearly half of these locations were unprofitable. When operating toy vending machines, staff members still need to visit machine sites to monitor sales, refill capsules, and collect takings. The company must therefore allocate labor according to the number of machines at sites and the frequency of visits. There were many unprofitable areas where sales did not cover fixed costs.

After integration, Happinet scrapped and streamlined unprofitable sites and business offices, reducing the number of sites to 4,800 from 8,600. The amusement arm reported an operating profit in FY03/10.

### Digital card game section

The company operates card game machines based on popular animation characters, in major retail and electronics stores. As in the toy vending machine section, gross profits are high for the digital card game section because it is close to retail.

To play on a digital card game machine, a customer inserts JPY100 and the machine ejects an IC card, on which an animation character is shown and electronic data (offensive and defensive abilities, and a special move, in the case of a battle game) is printed in transparent ink. The game unfolds on an LCD, affected by input from a panel that reads the data on the cards. The cards themselves are also collectors' items. The company buys and leases digital card game machines from Bandai, which also supplies the cards.

As of December 2013, the company operated card games based on Dragon Ball, Kamen Rider, Mobile Suit Gundam, and Aikatsu!.





**Card game machine**



Source: Company data

**Group companies**

Happinet Group includes Happinet Corp and seven consolidated subsidiaries. In particular, Happinet Marketing Corp, Happinet Pictures & Music Corp, and Happinet Vending Service Corp have a big impact on consolidated performance, each accounting for more than 10% of group sales.

**Happinet Marketing Corp**

The company distributes a wide range of products nationwide, including Bandai products.

Happinet Marketing (million yen)

	FY03/09	FY03/10	FY03/11	FY03/12	FY03/13
	Act.	Act.	Act.	Act.	Act.
Sales	32,436	31,350	31,531	32,236	31,527
YoY	-	-3.3%	0.6%	2.2%	-2.2%
Recurring Profit	299	597	818	950	773
YoY	-	99.7%	37.0%	16.1%	-18.6%
Net Income	179	349	473	517	465
YoY	-	95.0%	35.5%	9.3%	-10.1%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.

**Happinet Pictures & Music**

Sells visual media and music.

Happinet Pictures & Music (million yen)

	FY03/09	FY03/10	FY03/11	FY03/12	FY03/13
	Act.	Act.	Act.	Act.	Act.
Sales	-	36,275	30,280	52,349	43,956
YoY	-	-	-16.5%	72.9%	-16.0%
Recurring Profit	-	-708	-430	823	876
YoY	-	-	-	-	6.4%
Net Income	-	-1,081	-384	813	865
YoY	-	-	-	-	6.4%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.



## **Happinet Vending Service**

Operates toy vending machines and digital card game machines.

Happinet Vending Service (million yen)

	FY03/09	FY03/10	FY03/11	FY03/12	FY03/13
	Act.	Act.	Act.	Act.	Act.
Sales	-	-	-	22,283	20,524
YoY	-	-	-	-	-7.9%
Recurring Profit	-	-	-	1,924	1,324
YoY	-	-	-	-	-31.2%
Net Income	-	-	-	1,100	832
YoY	-	-	-	-	-24.4%

Source: Company data, SR Inc. Research

Figures may differ from company materials due to differences in rounding methods.



## Strengths and weaknesses

---

### Strengths

- **Growing market share amid sector shakeout.** Since the mid 1990s, the company used M&A activities to take advantage of industry reshuffling among toy distributors, thus enlarging its sales and the scope of its operations. This increased the company's sales and broadened the scope of its operations, with the result that the company enjoys a 30% share of the toy wholesale market (December 2013 company estimate). Also, in the visual media and music and video game businesses, the company may be able to expand in the medium term by employing its financial firepower as the market shrinks and these industries rearrange themselves. The company had cash and deposits totalling JPY10.2bn as of end FY03/13. There was no interest-bearing debt.
- **Business diversification leading to stable earnings.** SR understands that faddish toy demand makes for big fluctuations in sales. If a distributor is dependent on a particular manufacturer its earnings will be greatly affected by the sales of that manufacturer's products. But Happinet trades with many domestic toy manufacturers, and does not depend solely on Bandai as a supplier. Furthermore, the company has diversified into other fields like video games, movies, and music. Thus the company's profits may be described as stable.
- **Solid relationship with Bandai.** SR believes that Bandai will continue to have a stable domestic toy business. This belief is based on the broad, intergenerational popularity of its products—mainly its character toys portfolio—and its capabilities in developing new character toys. Namco Bandai Holdings Inc, Bandai's parent company, is Happinet's largest shareholder with a 25% stake, and Happinet distributes about 80% of Bandai toys sold in Japan (company estimate, December 2013). We assume the company will continue to enjoy the benefits of doing business with Bandai.

### Weaknesses

- **Limited scope to add value, create profit opportunities.** Happinet is chiefly an intermediary distributor, buying from manufacturers and selling to retailers. Hence there is little scope to add value by adapting products. Thus the company must accept low gross profit margins, particularly in its visual media and music and video games businesses. We see limited potential for it to lift sales under its own steam through new products and store openings.
- **Scant track record developing original products.** Happinet aims to unlock new opportunities for profit by developing non-distribution businesses—mainly rolling out original products. Yet SR understands that the company has scant track record of developing products in-house, especially toys, and it has few distinctive products. For the copyright-holders of popular animations and the like, an incentive exists to pursue merchandising deals with established toy makers where success is more likely. As a debutant therefore the company may struggle to land toy merchandising rights for popular characters.
- **Shrinking markets.** SR believes that Happinet's markets will shrink over the medium and long term. Toys sales will suffer from Japan's aging population while sales of visual media and music will be pummelled by online distribution. The company's large market shares in these types of product mean that it is unlikely to be able to escape the impact of these changes on its sales.



## Market and value chain

### Overview

#### Japan's toy market

**Stable market, should remain so.** According to the National Institute of Population and Social Security Research (IPSS), the number of people in Japan aged 0-14 decreased from 18.1mn in 2002 to 16.7mn in 2011 (down 1% per year). The market for a basket of eight types of toy expanded from JPY310.5bn in 2002 to JPY325.1bn in 2011. Dividing market size by the number of people aged 0-14, spending per head increased from JPY17,200 in 2002 to JPY19,500 in 2011 (up 1.6% per year).

The company stated that toy prices are trending upward, due to the addition of new features, such as electronic parts. Increasing prices mean the toys market still provides stable opportunities for profit.

Domestic Toy Market and Population	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Market of 8 toy items (billion yen)	310.5	323.2	316.2	317.1	312.9	319.1	320.5	319.0	326.2	325.1
Population at ages of 0-14 (thousand)	18,102	17,905	17,734	17,521	17,434	17,292	17,176	17,010	16,803	16,705
Average Purchase price of 8 toy items (yen)	17,153	18,051	17,830	18,098	17,948	18,454	18,660	18,754	19,413	19,461

\* The eight toy items are electronic toys, models, toys for boys, toys for girls, analog games, seasonal and miscellaneous toys, educational toys, and stuffed toys.  
Video games are not included.

Source: Data from Yano Research Institute Ltd. and the National Institute of Population and Social Security Research, SR Inc. Research

The IPSS predicts that the population of children in Japan (0-14 years old) will have decreased to 13.2mn by 2025, due to declining birth rates and the shift toward late marriage. With a rate of decline averaging 1.6% per year, this would mean potential purchasers of toys were decreasing faster than the rate of decline between 2002 and 2011.

SR believes that the toys market will shrink as Japan's aging population leads to a decreasing target demographic for toys. However, SR also believes that the rate of this shrinkage will remain slow as long as toy manufacturers continue to raise toy prices by adding value to their products.

#### Japan's visual media market

**Visual media sales continue to trend south.** A fall in per-head buying amount against the backdrop of stable unit prices prompted the market to contract.

Video Software Market	2005	2006	2007	2008	2009	2010	2011	2012
Software for Sale	312.4	326.4	303.8	283.2	267.4	263.5	247.9	241.3
Software for Rental	357.8	343.1	360.4	346.9	306.7	267.2	254.2	238.9
Total	670.2	669.5	664.2	630.1	574.1	530.7	502.1	480.2

(billion Yen)

Source: Data from the Japan Video Association, SR Inc. Research

Reasons for falling purchase amount (per 2012 Japan Video Software Association survey): fewer good titles, slimmer household budgets, and the popularity of free online video and file-sharing software. The spread of pay-video distribution hurt sales of visual media. According to the Digital Content Association of Japan, the domestic market of pay-video distribution expanded from JPY76.2bn in 2010 to JPY82.6bn in 2011 and JPY101.6bn in 2012. SR forecasts that the visual media market will continue to decline in the face of free online video, the spread of pay-video distribution and the expected fall in the number of



people aged 15-64 (the main buyers). Importantly, the National Institute of Population and Social Security Research estimates that the number people aged 15 to 64 will decrease by 10% a year from 78,996,000 in 2013 to 70,845,000 in 2025.

**Music content**

**The paid music distribution market has contracted after peaking in 2007** in both volume and value terms.

Record Production and Pay Distribution Music	2005	2006	2007	2008	2009	2010	2011	2012
Music Software Sales Value (billion yen) exl. Music Video	367	352	333	296	250	225	212	228
Pay Distribution of Music (billion yen)	34	53	75	91	91	86	72	54
<b>Total</b>	<b>401</b>	<b>405</b>	<b>409</b>	<b>387</b>	<b>341</b>	<b>311</b>	<b>284</b>	<b>282</b>
Music Software Sales Volume (million units) exl. Music Video	310	298	267	248	214	210	200	218
Pay Distribution of Music (million times)	268	368	465	479	468	441	367	272
<b>Total (million units/times)</b>	<b>578</b>	<b>666</b>	<b>732</b>	<b>727</b>	<b>682</b>	<b>651</b>	<b>567</b>	<b>490</b>

Source: "The Recording Industry of Japan" by the Recording Industry Association of Japan, SR Inc. Research

According to the Recording Industry Association of Japan's survey of music media users, respondents who bought less music software said they are satisfied with current holdings, face a tight budget, and like free online content. As with visual media, the music content market should continue to decline given free distribution sites and a falling number of buyers.

**Japan's game market**

**Game console market in the doldrums...** Nintendo launched the Family Computer System (later released as the Nintendo Entertainment System (NES) in America) in 1983, and the overall market for home video game consoles peaked at JPY760bn in 1997. The market, spearheaded by Nintendo and Sony Computer Entertainment, remained on a downtrend through 2005, dancing to the beat of new consoles and major game releases. Between 2005 and 2007 the market recovered given new portable game consoles including Nintendo's Wii and Sony's PlayStation 3. The market thereafter has been anemic. The game market is now impacted by the popularity of smartphones and online (including social media) games in tandem with new consoles. Since 2010 online gaming has mushroomed yet the game console market remains in the doldrums.

Shipments of Home Video Game Consoles	2005	2006	2007	2008	2009	2010	2011	2012
Value (billion yen)	399	553	592	534	454	426	403	396
YoY	15.6%	38.8%	7.0%	-9.7%	-15.0%	-6.2%	-5.4%	-1.7%
Software (billion yen)	234	311	289	301	253	259	238	220
YoY	-0.6%	32.9%	-7.3%	4.4%	-16.2%	2.6%	-8.2%	-7.4%
Hardware (billion yen)	164	242	303	233	202	167	165	176
YoY	50.8%	47.4%	25.3%	-23.2%	-13.4%	-17.3%	-1.1%	6.5%

Source: CESA data, SR Inc. Research



...with smartphones/online social gaming the culprit. The package game software market is likely to contract due to migration to smartphones and online gaming. Yes, game consoles may be a sunset sector but some sunsets last a long time. Bedrock demand should stay firm given key advantages: low price next to smartphones and PCs, internet access is not needed, software borrowing/lending is possible, and software once bought is free to use (online gaming requires ongoing payments).

## Japanese capsule toy market

**Uptrend.** The size of the capsule toy market has hovered between JPY25bn and JPY35bn for the past 10 years. In 2007 Happinet scrapped unprofitable machines and thereafter the market enjoyed a gradual uptrend. The company said demand is solid but dependent on providing popular products. Kamen Rider toys buoyed 2011 sales.

Capsule Toy Market Size	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Value (billion yen)	31.0	33.0	33.5	30.5	30.5	28.5	24.9	25.9	30.1	27.0
YoY	19.2%	6.5%	1.5%	-9.0%	0.0%	-6.6%	-12.6%	4.2%	16.0%	-10.3%

Source: The Japan Toy Association's survey of the size of the toy market data, SR Inc. Research

## Competition

- **Limited competition.** Happinet said that it and Kawada are among the major distributors operating nationwide with a variety of toy manufacturers, and that it is the only company handling a range of products from toys to visual and music products. Kawada distributes original products like block toys and educational toys, with diablock block toys being the most famous. For FY05/13 Kawada reported annual sales of JPY21.7bn (per Kawada's website). Happinet sells much more volume than Kawada and their products are different, so they are not competitors.

## Strategy

The company's strategy comprises: 1) increasing sales by grabbing market share even though the overall pie will continue to get smaller as society ages; and 2) selling more in-house products that command wider margins.

### Market share expansion

SR thinks that the company's main markets—toys, video games, visual media, and music—will contract given Japan's ageing society and more internet use. Given this dynamic since the mid 1990s Happinet has expanded through M&A. SR sees this strategy continuing to bear fruit.

### Visual and music: scope for expansion

Happinet said that direct transactions between visual/music content makers and retailers topped 50% of overall distribution of visual media and music in the year to end March 2013. SR believes that the curtailment of content sold at bricks and mortar stores may cause visual and music software makers to shift part of their sales promotion and distribution operations to intermediary distributors like Happinet in the future. In August 2009 the company and Nikkatsu Corp, a movie producer, agreed that Happinet will become a comprehensive seller of Nikkatsu's visual package products. Bandai Visual (a Namco Bandai subsidiary) began to shift some of its sales operations to Happinet in July 2010. SR believes that handling software makers' sales promotion and distribution functions is a potential money spinner.



## **Video-game: also scope for expansion**

The company consolidated Toys Union as a subsidiary in July 2013. Toys Union handles Nintendo products, racking up sales of JPY35.3bn in FY03/13.

Putting Toys Union under its umbrella should boost Happinet's Nintendo sales to more than JPY50bn and its share of the Nintendo-related market to 25%. This places Happinet at a level equivalent to the second largest distributor of Nintendo-related products. Given the contracting overall market, other distributors may leave the market at an increasing rate, implying opportunities for Happinet to grab market share.

## **Original products: increase sales**

The company aims to expand sales of original products developed in-house and exclusive products, in a bid to increase profitability. SR believes the company is likely to join hands with publishers and TV broadcasters to produce and broadcast original programs, in tandem with creating and selling character toys.

## **Other information**

---

### **History**

---

- 1969** Incorporated as Tosho Ltd (Tosho becomes a stock company in 1972).
- 1972** Starts full-scale transactions with Popy (now Bandai).
- 1991** Company name changes to Happinet Corp with absorption of Dairin Corp and Seiko Corp (integration of Bandai-affiliated toy distributors).

In 1991 Toys"R"Us entered Japan. At that time small toy stores were key outlets for toys in Japan, with distributors serving retailers. Yet Toys"R"Us with its strong selling power started direct transactions with toy makers. Bandai continued to do business with big toy stores and small/medium-sized shops through wholesalers. Yet at the same time it did business with Toys"R"Us and big retailers through Happinet.

Toys"R"Us introduced open pricing to Japan's retail industry. In the early 1990s many retailers set prices according to the wishes of makers. Toys"R"Us thus introduced competition and a price war began. The upshot: toy makers and retailers slashed distribution costs with a lot of intermediary business migrating to big distributors.

In the 1990s the toy wholesale industry saw a shakeout amid post-bubble sluggish consumption, direct makers/shop transactions, and big distributors controlling the market in the wake of the Toys"R"Us incursion. Happinet bought small/medium-sized distributors as they hit hard times, did more business with non-Bandai players, and began distributing non-toy products.

- 1994** Bandai buys more Happinet shares; Happinet joins the Bandai group. Happinet begins distributing PlayStation game consoles and starts distributing video games.
- 1994** Acquires Taiyo Gangu Shokai, Aichi Prefecture.
- 1995** Acquires Hiranaka, Hokkaido.
- 1999** Buys shares in Beam Entertainment Corp, advancing into DVD distribution business.
- 2001** Buys shares in Toyokuni Corp, Shizuoka Prefecture.
- 2002** Happinet JP Corp takes over the operations of Matsui Sakae Toys, a toy wholesaler in Osaka.
- 2006** Buys shares in Mori Toys, a wholesaler of Nintendo products in Osaka.
- 2007** Buys shares in Sunlink and The Apple Corporation.
- 2009** Buys shares in Wint Corp, the second largest intermediary distributor of visual media and music, advancing into CD wholesaling.
- 2013** Buys shares in Toys Union Co Ltd, a Nintendo distributor.



## Major shareholders

---

Top Shareholders	Amount Held
Namco Bandai Holdings Inc.	26.10%
Ichigo Asset Management International Pte. Ltd	10.40%
Japan Trustee Services Bank, Ltd. (Trust account)	5.00%
Yasuhiko Idaira	3.30%
Hiroshi Kawai	3.10%
Japan Trustee Services Bank, Ltd. Sumitomo Mitsui Trust Bank, Limited ReTrust Portion/SMBC Employee Pension Trust	3.00%
Kayo Kawai	2.40%
Happinet Employee's' Stockholding	1.80%
Orient Ltd.	1.70%
Sun River Inc.	1.40%

Source: Company data, SR Inc. Research

As of March 31, 2013

---





**Profile**

<b>Company</b> Happinet Corp	<b>Head office</b> Komagata CA Bldg., 2-4-5, Komagata, Taito-ku, Tokyo, Japan 111-0043
<b>Phone</b> +81-3-3847-0521	<b>Listed on</b> Tokyo Stock Exchange 1st Section
<b>Established</b> June 7, 1969	<b>Exchange listing</b> August 29, 1997
<b>Website</b> <a href="http://www.happinet.co.jp/english/index.html">http://www.happinet.co.jp/english/index.html</a>	<b>Fiscal year-end</b> March
<b>IR web</b> <a href="http://www.happinet.co.jp/english/ir/index.html">http://www.happinet.co.jp/english/ir/index.html</a>	
<b>Main consolidated segments (% of total sales)</b> Toy Business 42.2 % Visual and Music 25.4 % Video-game 20.8 % Amusement 11.6 % (March 2013)	
<b>Directors</b> Kazuhiko Note, representative director Haruo Kawashima, director Tetsuo Ishikawa, director Hideo Asatsu, director Shigeki Suzuki, director Yoshiyuki Takahashi, director Kazutomo Enomoto, director (outside director) Mariko Tokuno, Director (outside director) Kazuhiko Noda, full-time corporate auditor Syuichi Asano, corporate auditor (outside auditor) Tsutomu Araki, corporate auditor (outside auditor) Michio Akihiro, corporate auditor (outside auditor) (June 2013)	<b>Shares outstanding (including treasury shares)</b> 24,050,000 shares (March 2013)
	<b>Shareholders capital</b> JPY2.751bn (March 2013)
	<b>Main subsidiaries</b> Happinet Marketing Corp Happinet Pictures & Music Corp Toys Union Co Ltd. Mori Games Co Ltd Happinet Vending Service Corp Happinet Logistics Service Corp
	<b>Main banks</b> Sumitomo Mitsui Banking Corp Bank of Tokyo-Mitsubishi UFJ Ltd
<b>Employees (consol.)</b> 918 <b>Employees (parent)</b> 399 <b>Average age (parent)</b> 37.2 years <b>Average salary (parent)</b> JPY5.801mn (March 2013)	<b>Auditors</b> BDO Toyo & Co.



## About Shared Research Inc.

We offer corporate clients comprehensive report coverage, a service that allows them to better inform investors and other stakeholders by presenting a continuously updated third-party view of business fundamentals, independent of investment biases. Shared Research can be found on the web at <http://www.sharedresearch.jp>.

### Current Client Coverage of Shared Research Inc.:

Accretive Co., Ltd.	Fields Corp.	Onward Holdings Co., Inc.
AEON DELIGHT Co.	FreeBit Co., Ltd.	Paris Miki Holdings Inc.
Ai Holdings Corp.	Gamecard-Joyco Holdings, Inc.	Pigeon Corp.
Anritsu Corporation	GCA Savvian Corporation	Resorttrust, Inc.
Apamanshop Holdings Co., Ltd.	Grandy House Corp.	Round One Corp.
Axell Corporation	Happinet Corporation	Sanix Incorporated
BALS Corporation	Harmonic Drive Systems Inc.	Sanrio Co., Ltd.
Bell-Park Co., Ltd.	Infomart Corp.	SATO Holdings Corp.
Benefit One Inc.	Intelligent Wave Inc.	Ship Healthcare Holdings Inc.
Canon Marketing Japan Inc.	ITO EN, Ltd.	SMS Co., Ltd.
Chionne Bioscience Inc.	Japan Best Rescue Co., Ltd.	Takashimaya Co., Ltd.
Chiyoda Co., Ltd.	JIN Co., Ltd.	Takihyo Co., Ltd.
Comsys Holdings Corporation	Kenedix, Inc.	Tamagawa Holdings Co., Ltd
Creek & River Co., Ltd.	Lasertec Corp.	3-D Matrix, Ltd.
Daiseki Corp.	MAC-HOUSE Co.	TOKAI Holdings Corp.
DIC Corporation	Medinet Co., Ltd.	Verite Co., Ltd.
Digital Garage Inc.	MIRAIT Holdings Corp.	WirelessGate, Inc.
Don Quijote Co., Ltd.	mobcast inc.	Yellow Hat Ltd.
Dream Incubator Inc.	NAIGAI TRANS LINE LTD.	Yumeshin Holdings
Elecom Co.	NanoCarrier Ltd.	ZAPPALLAS, INC.
EMERGENCY ASSISTANCE JAPAN Co.	Nippon Parking Development Co., Ltd.	
en-Japan Inc.	NS Tool Co.	
FerroTec Corp.	Panasonic Information Systems Co.	

Attention: If you would like to see firms you invest in on this list, ask them to become our client, or sponsor a report yourself.

## Disclaimer

This document is provided for informational purposes only. No investment opinion or advice is provided, intended, or solicited. Shared Research Inc. offers no warranty, either expressed or implied, regarding the veracity of data or interpretations of data included in this report. Shared Research Inc. shall not be held responsible for any damage caused by the use of this report. The copyright of this report and the rights regarding the creation and exploitation of the derivative work of this and other Shared Research Reports belong to Shared Research Inc. This report may be reproduced or modified for personal use; distribution, transfer, or other uses of this report are strictly prohibited and a violation of the copyright of this report. SR Inc. officers and employees may currently, or in the future, have a position in securities of the companies mentioned in this report, which may affect this report's objectivity.

## Japanese Financial Instruments and Exchange Law (FIEL) Disclaimer

The report has been prepared by Shared Research Inc. ("SR") under a contract with the company described in this report ("the Company"). Opinions and views presented are SR's where so stated. Such opinions and views attributed to the Company are interpretations made by SR. SR represents that if this report is deemed to include an opinion by SR that could influence investment decisions in the Company, such opinion may be in exchange for consideration or promise of consideration from the Company to SR.

## Contact Details

<http://www.sharedresearch.jp>

Email: [info@sharedresearch.jp](mailto:info@sharedresearch.jp)

3-31-12 Sendagi

Bunkyo-ku Tokyo, Japan

Phone: +81 (0)3 5834-8787