BRIDGE REPORT
ブリッジレポート

Bridge Report HAPPINET CORPORATION (7552)

Kazuhiko Note, President

Company	HAPPINET CORPORATION
Code No.	7552
Exchange	First Section, TSE
Industry	Wholesale (Commerce)
President	Kazuhiko Note
HQ Address	Komagata CA Bldg., 2-4-5 Komagata, Taito-ku, Tokyo 111-0043
Business	A comprehensive entertainment trading company of toys, visual and music software, video games, and amusement products. Also HAPPINET leverages its optimal distribution system to provide high value added distribution services. The Company also boasts of strengths in planning and creation of original toys and video contents.
Year End	March
URL	http://www.happinet.co.jp/english/index.html

— Stock Information —

Share Price	Shares Outstanding (ex. Treasury Shares)		Market Cap.	ROE (actual)	Trading Unit
¥719	22,402,370 shares		¥16.107 billion	7.5%	100 shares
DPS (Est.)	Dividend Yield (Est.)	EPS (Est.)	PER (Est.)	BPS (actual)	PBR (actual)
¥33.75	3.1%	¥71.42	10.0x	¥939.25	0.7x

* Share price as of closing on December 1, 2011. A 2 for 1 stock split was conducted on December 1, 2011.

* Due to the stock split, dividend yield is based on the calculation of a midterm dividend of ¥11.25 per share (Actual ¥22.5) and a yearend dividend of ¥11.25 per share.

— Consolidated Earnings Trends — (Units: Million Yen)

Fiscal Year	Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend (¥)
March 2008	168,958	1,451	1,569	-1,490	-	40.00
March 2009	166,778	2,137	2,322	1,135	97.64	30.00
March 2010	194,246	2,327	2,513	1,179	104.60	30.00
March 2011	190,891	2,855	3,013	1,376	122.56	30.00
March 2012 Est.	192,000	3,100	3,200	1,600	71.42	33.75

* Estimates are those of the Company. A 2 for 1 stock split was conducted in December 2011.

This Bridge Report presents HAPPINET CORPORATION's earnings results for the first half of fiscal year March 2012.

1. **Company Overview**
2. **First Half of Fiscal Year March 2012 Earnings Results**
3. **Fiscal Year March 2012 Earnings Estimates**
4. **Conclusions**

Key Points

・During the first half of fiscal year March 2012, sales and ordinary income rose by 4.0% and 84.2% year-over-year respectively. Increases in sales of character products for male children in the toys business and the amusement business were factors behind this strong earnings performance. On the back of reductions in inventory liquidation losses resulting from strict inventory controls and stronger sales, operating income grew by 86.8% year-over-year and exceeded initial estimates of a 71.6% increase.

・Full year earnings estimates remain unchanged with sales and ordinary income expected to grow by 0.6% and 6.2% year-over-year respectively. On December 1, HAPPINET conducted a two for one stock split, and projects a yearend dividend of ¥11.25 per share.

・While first half earnings exceeded estimates by a large margin, HAPPINET has left its full year earnings estimates unchanged ahead of the busy year end gift buying season. While we acknowledge the Company's decision to adopt a conservative strategy towards estimates, it appears that the potential for a positive surprise in full year earnings is strong given the endeavors that HAPPINET is currently promoting and its new product lineup, including various visual contents.

1. Company Overview

HAPPINET CORPORATION is a comprehensive intermediary distributor operating in the realm of entertainment products. The Company conducts operations in a wide range of business realms spanning toys, visual and music contents, video games, amusement products (Capsule toys, card games, others), and other product areas in addition to planning and creating original toy products and visual contents. Consequently, HAPPINET exceeds the normal bounds of intermediary distributors (Trading firm) and also focuses some of its efforts upon developing its E-commerce business as well. As of the end of fiscal year March 2011 (FY3/11), NAMCO BANDAI Holdings Inc. was the top shareholder with 2.94 million shares or 24.5% of total shares issued.

Suppliers: About 700 companies
Toys, DVDs and CDs, video-games, capsule toys, card games

Retail Shops: About 35,000 (About 1,500 different operating companies)
Consumer Electronics Shops
GMS
Internet Sales
Convenience Stores
Secondary Wholesalers
Specialty Toy Shops

<Business Segments, Group Structure>

HAPPINET's business can be divided into the toy, visual and music, video game, and amusement businesses, which accounted for 36.2%, 30.3%, 24.3%, and 9.2% of FY3/11 sales respectively. By sales channel, specialized consumer electronics and camera shop mass retailers accounted for 34.2% of FY3/11 sales, mass retailers 19.3%, E-commerce 12.7%, convenience stores 11.2% and others 22.6%. The HAPPINET Group is comprised of seven consolidated subsidiaries and one non-consolidated subsidiary.

Toy Business	HAPPINET CORPORATION (Toy & Hobby Division, Convenience Stores Business Division, Original Toy Development Division) Happinet Marketing Corporation	Industry's largest wholesaler, handling about 80% of Bandai's total toy business (Bandai products account for 54.2% of HAPPINET's total transactions)
Visual and Music Business	HAPPINET CORPORATION (Pictures Division) Happinet Pictures & Music Corporation	One of industry's largest wholesaler, video software accounting for just under 70%, of which 10% are products developed in-house and the remaining 60% are wholesale.
Video Game Business	HAPPINET CORPORATION (Video Game Division) MORI GAMES CO., LTD.	The only wholesaler that deals with all domestic manufacturers of home use video games. PlayStation related products (PS3, PSP) accounts for 38%, Nintendo related (Wii, DS, 3DS) 32%, and other products 30%.
Amusement Business	Happinet Vending Service Corporation	Operation of automated toy vending machines and provision of amusement facility product sales, the industry's largest amusement vendor with 60% market share.

<Corporate History>

In 1968, the current Chairman of the Board and CEO Hiroshi Kawai resigned from Bandai Co., Ltd. and started a toy wholesale business as an individual (Later to become incorporated as a company called Tosho Ltd. in 1969). In 1991 Tosho changed its name to HAPPINET along with the absorption of two Bandai affiliated wholesale companies and launched full scale operations as a Bandai distributor. Since then, HAPPINET has expanded the range of its businesses to include video games (Began dealing in PlayStation in 1994), DVDs (Turned a wholesaler into a subsidiary to deal in DVDs in 1999), capsule toys and card games (In 2007 two companies turned into subsidiaries), and CDs (Turned a wholesaler into a subsidiary to deal with CDs and DVDs in 2009) in response to declining birthrates, diversification of games and toys, and other changes in the market. During 2002 to 2003, two toy wholesalers were turned into subsidiaries to expand the product lineup to include products manufactured by toy makers other than Bandai. HAPPINET is currently one of the most representative toy distributors in the industry.

2. First Half of Fiscal Year March 2012 Earnings Results

(1) Consolidated Earnings (Units: Million Yen)

	1H FY3/11	Share	1H FY3/12	Share	YY Change	Initial Est.	Divergence
Sales	85,090	100.0%	88,508	100.0%	+4.0%	86,000	+2.9%
Gross Income	10,404	12.2%	11,874	13.4%	+14.1%	-	-
SG&A	9,164	10.8%	9,557	10.8%	+4.3%	-	-
Operating Income	1,240	1.5%	2,316	2.6%	+86.8%	1,350	+71.6%
Ordinary Income	1,314	1.5%	2,422	2.7%	+84.2%	1,400	+73.0%
Net Income	712	0.8%	1,526	1.7%	+114.2%	750	+103.5%

* Figures include reference figures calculated by Investment Bridge Co., Ltd. Actual results may differ (applies to all tables in this report)

First Half Sales, Ordinary Income Grew by 4.0%, 84.2%

Sales during the first half grew by 4.0% year-over-year to ¥88.50 billion. The visual and music, and video game businesses encountered difficult operating conditions due to stagnation in the package market resulting from the diffusion of broad band and a lack of hit products. However strong demand for “Kamen Rider Fourze,” “Kaizoku Sentai Gokaiger” and other male child character products allowed the amusement business to grow. With regards to profits, the contribution of the amusement business, which boasts of a high marginal profit ratio, favorable sales, and reductions in inventory liquidation losses (Fell from ¥930 to ¥690 million) allowed gross margins to improve. While labor (Rose from ¥3.19 to ¥3.35 billion) and other SG&A expenses rose, operating income grew by 86.8% year-over-year to ¥2.31 billion. A decline in the corporate tax rate arising from tax affect accounting also allowed net income to rise strongly.

Compared with initial estimates, the success of hit products contributed to stronger than expected sales in the toy and amusement business segments. With regards to profits, higher than expected sales, and strict measures relating to product returns and inventory control allowed the visual and music business segment to record a better than expected improvement in its earnings.

(2) Business Segment Trends

Sales, Operating Income by Business Segment (Units: Million Yen)

	1H FY3/11	Share	1H FY3/12	Share	YY Change
Toy	30,376	35.7%	34,092	38.5%	+12.2%
Visual and Music	27,509	32.3%	26,702	30.2%	-2.9%
Video Game	18,703	22.0%	16,492	18.6%	-11.8%
Amusement	8,500	10.0%	11,220	12.7%	+32.0%
Total Sales	85,090	100.0%	88,508	100.0%	+4.0%
Toy	860	69.3%	1,249	53.9%	+45.2%
Visual and Music	80	6.5%	338	14.6%	+323.1%
Video Game	410	33.1%	404	17.5%	-1.6%
Amusement	502	40.5%	989	42.7%	+96.9%
Adjustments	-613	-49.5%	-664	-28.7%	-
Total Operating Income	1,240	100.0%	2,316	100.0%	+86.8%

Toy Business

Sales and operating income grew by 12.2% and 45.2% year-over-year to ¥34.09 and ¥1.24 billion respectively. Bandai’s “Kamen Rider Fourze,” “Kaizoku Sentai Gokaiger” and other male child character products trended favorably. The higher sales and reductions in inventory liquidation losses (Fell from ¥360 to ¥310 million) allowed profit margins to improve from 2.8% to 3.7%. At the end of the first half, a reduction in inventories of 400 million from the end of the previous first half to ¥3.0 billion allowed inventory turnover ratio to improve from 21.7 times at the end of the previous first half to 25.7 times.

By product supplier, Bandai (Accounted for 52.7% of total sales) products rose by 13.3% year-over-year to ¥17.9 billion, and while still a small portion of total sales, HAPPINET’s original in-house products grew by 38.5% year-over-year to ¥900 million. At the same time TOMY COMPANY, LTD. (TAKARA-TOMY) (Accounted for 8.6% of total sales) products fell by 19.6% year-over-year to ¥2.9 billion. Products from other makers rose by 20.1% year-over-year to ¥12.1 billion.

Visual and Music Business

While sales declined by 2.9% year-over-year to ¥26.70 billion, operating income grew by 323.1% year-over-year to ¥330 million. By product area, visual products rose by 1.9% year-over-year to ¥18.6 billion, while music products fell by 12.6% year-over-year to ¥8.0 billion. Furthermore, the in-house product group (Including sales of products for which sole marketing rights have been acquired, contents for which the rights to turn into video-grams has been acquired, and products for which capital has been invested) sales rose by 10.8% year-over-year to ¥3.3 billion, and the wholesale group grew by 0.1% year-over-year to ¥15.2 billion. Along with the diffusion of broad band and contents distribution over the Internet, the package market stagnated with both visual and music contents suffering. Growth in the high profitability in-house product group, including the hit movie "The King's Speech," and the Business Structural Reform of the CD group allowed profit margins to improve by a large margin.

As of April 1, 2011, HAPPINET implemented the Business Structural Reform including the transfer of its visual and music contents sales function to its subsidiary Happinet Pictures and Music Corporation (previous corporate name, WINT CORPORATION). Specifically, corporate return rates were reestablished and Happinet Pictures and Music implemented strict measures to raise the awareness of inventories within the Company and to focus its efforts upon hit products (Among 17,000 new CD titles sold every year, 95% of sales are derived from only about 5,000 of these new titles).

Return Rate	
Visual and Music Business	1H FY3/11: 9.1% ⇒ 1H FY3/12: 6.3%
Only for the former WINT CORPORATION	1H FY3/11: 12.4% ⇒ 1H FY3/12: 5.5%
Inventory Value	
Visual and Music Business	1H FY3/11: ¥3.4 billion ⇒ 1H FY3/12: ¥2.1 billion
Inventory Turnover Ratio	
Visual and Music Business	1H FY3/11: 17.4 times ⇒ 1H FY3/12: 22.3 times

Video-game Business

Sales and operating income fell by 11.8% and 1.6% year-over-year to ¥16.49 billion and ¥400 million respectively. Amidst weakness in the market overall, a lack of hit products led to declines in sales of both hardware and software. However, products for which HAPPINET maintains sole distributorship rights with high profit margins trended strongly, allowing operating income to fall by a smaller margin than sales.

By product type, sales of PlayStation 3 (PS3) and PlayStation Portable (PSP) rose by 14.6% and 68.4% year-over-year to ¥2.6 billion and ¥5.3 billion (Accounting for 16.3% and 32.4% of this segment's sales) respectively. At the same time sales of Wii and Nintendo DS fell by 44.1% and 81.3% year-over-year to ¥1.1 billion and ¥800 million respectively, while sales of Nintendo 3DS reached ¥1.8 billion (No sales in the previous term, accounting for 11.2% of this segment's sales). Also other sales fell by 28.3% year-over-year to ¥4.6 billion (Accounting for 27.9% of this segment's sales).

Amusement Business

Sales and operating income rose by 32.0% and 96.9% year-over-year to ¥11.22 billion and ¥980 million respectively. Capsule toy automated vending machine sales of "Kamen Rider OOO," "ONE PIECE," "Kaizoku Sentai Gokaiger" and other male child character products trended favorably. At the same time card game machines "Kamen Rider Battle Ganbaride," "Dragon Ball Heroes," and new chassis "GUNDAM TRYAGE" trended strongly.

At the end of the first half of the current term, inventories increased by ¥500 million to ¥1.3 billion from the end of the previous first half (¥800 million). This increase in inventories is a reflection of deliberate efforts to correct the shortage of products seen at the end of the previous fiscal year due to over aggressive inventory controls. The actual inventory turnover ratio remains the same as in the previous first half at 18.2 times, and is a rational buildup of inventories based on the strong sales.

(3) Sales Channels

(Units: Million Yen)

	1H FY3/11	Share	1H FY3/12	Share	YY Change
Specialty Stores (incl. Consumer Electronics, Camera Mass Retailers)	295	34.7%	284	32.1%	-3.6%
Mass Retailers	151	17.9%	169	19.2%	+11.7%
E-commerce	105	12.4%	124	14.0%	+17.5%
Convenience Stores	95	11.2%	109	12.4%	+14.8%
Suburban Stores	78	9.3%	83	9.5%	+6.3%
Wholesalers	87	10.2%	76	8.6%	-12.1%
Department Stores	6	0.7%	5	0.6%	-12.3%
Others	30	3.6%	31	3.6%	+3.1%
Total	850	100.0%	885	100.0%	+4.0%

Strong sales of Amazon.com and Rakuten helped to boost sales of E-commerce, and strong sales of capsule toys to convenience stores, the largest group of retail stores, contributed to double digit growth in sales to mass retailers.

(4) Financial Position and Cash Flow

At the end of the first half of the current term, total assets grew by ¥1.88 billion from the end of the previous term to ¥50.39 billion. Due to a large improvement in cash flow, cash and equivalents increased along with growth in accounts receivables and inventories accompanying higher sales. At the same time, amortization of intangible fixed assets declined. Furthermore the increase in inventories is attributed to seasonal factors, with strict inventory controls contributing to a decline in product returns of ¥1.31 billion from ¥8.19 billion at the end of the previous first half. Accounts payables and net assets also grew.

With regards to cash flow, increases in profits and payables combined with restrained growth in inventories to allow operating cash flow to grow by a large margin. This contributed to an increase in free cash flow from ¥470 million in the previous first half to ¥2.06 billion in the current first half. And while financing cash flow turned negative due to the payment of dividends, cash and equivalents managed to grow by ¥1.88 billion from the end of the previous term to ¥10.10 billion at the end of the current first half.

Financial Position

(Units: Million Yen)

	FY3/11	1H FY3/12		FY3/11	1H FY3/12
Cash	8,220	10,109	Payables	20,204	21,518
Receivables	23,206	23,655	Unpaid Taxes	1,038	804
Inventories	6,436	6,880	Current Liabilities	25,837	26,408
Current Assets	41,039	43,500	Retirement Reserves	1,630	1,697
Tangible Fixed Assets	1,555	1,461	Fixed Liabilities	2,867	2,930
Intangible Fixed Assets	3,132	2,749	Net Assets	19,802	21,053
Investments, Others	2,780	2,680	Total Liabilities, Net Assets	48,507	50,392
Fixed Assets	7,468	6,891	Total Interest Bearing Liabilities	-	-

Cash Flow

(Units: Million Yen)

	1H FY3/11	1H FY3/12	YY Change	
Operating Cash Flow	660	2,124	+1,463	+221.7%
Investing Cash Flow	-190	-64	+125	-
Free Cash Flow	470	2,060	+1,590	+338.3%
Financing Cash Flow	-174	-170	+4	-
Cash and Equivalents at Term End	6,601	10,109	+3,507	+53.1%

3. Fiscal Year March 2012 Earnings Estimates

(1) Consolidated Earnings (Units: Million Yen)

	FY3/11	Share	FY3/12 Est.	Share	YY Change
Sales	190,891	100.0%	192,000	100.0%	+0.6%
Gross Income	22,326	11.7%	22,500	11.7%	+0.8%
SG&A	19,471	10.2%	19,400	10.1%	-0.4%
Operating Income	2,855	1.5%	3,100	1.6%	+8.6%
Ordinary Income	3,013	1.6%	3,200	1.7%	+6.2%
Net Income	1,376	0.7%	1,600	0.8%	+16.2%

Full Year Earnings Estimates Remain Unchanged, Sales, Ordinary Income to Grow by 0.6%, 6.2%

Due to the seasonality of earnings resulting from the peak sales season occurring at the end of the calendar year, HAPPINET has chosen to maintain its outstanding earnings estimates. In order to expand its shareholder base and increase liquidity, HAPPINET conducted a two for one stock split on December 1. Along with this stock split, a dividend of ¥22.5 per share had been expected to be paid at the end of the fiscal year, but has been revised down to ¥11.25 per share (A full year dividend of ¥33.75 when combined with the first half dividend payment of ¥22.5 per share, in real terms a full year dividend increases by ¥15 per share from the previous term after the impact of the stock split has been considered).

(2) Business Segment Endeavors

Segment Sales, Income (Units: Million Yen)

	FY3/11	Share	FY3/12 Est.	Share	YY Change
Toy	69,104	36.2%	70,000	36.5%	+1.3%
Visual and Music	57,759	30.3%	55,000	28.6%	-4.8%
Video Game	46,447	24.3%	47,000	24.5%	+1.2%
Amusement	17,579	9.2%	20,000	10.4%	+13.8%
Total Sales	190,891	100.0%	192,000	100.0%	+0.6%
Toy	2,321	81.3%	2,300	74.2%	-0.9%
Visual and Music	-656	-23.0%	200	6.4%	-
Video Game	1,156	40.5%	1,000	32.3%	-13.5%
Amusement	1,340	47.0%	900	29.0%	-32.8%
Adjustments	-1,307	-45.8%	-1,300	-41.9%	-
Operating Income	2,855	100.0%	3,100	100.0%	+8.6%

Toy Business

Tests of "sales floor packages" have been started. These "packages" are proposed by HAPPINET and are designed to provide examples of sales space product mix leveraging the Company's strengths in toys, DVDs and CDs, kids card games, capsule toys, and other products. The first package has been launched in collaboration with a book store, with a special corner of the sales floor created to offer picture books and related products to parents and children, in addition to a corner to offer comic books and related products to students and adults. Near term sales expectations have been achieved, and HAPPINET is currently fine-tuning their inventory controls and other operational issues associated with these packages. HAPPINET also expects to continue promoting validation testing of these integrated sales spaces for "Kamen Rider Fourze" related products and magazines, and characters.

(Source: HAPPINET)

Visual and Music Business

Since the start of the second half, sales of "The Fighter" (October 4, 2011) and "Mahoro Ekimae Tada Benriken" (November 2, 2011) DVDs have been launched. In February 2012, a road show of HAPPINET's lead managed product "Afro Tanaka" (February 18) and DVD sales for "Shanghai," which features actor Ken Watanabe and is a movie for which HAPPINET has sole distributorship rights, and a popular movie called "Usagi Drop" are expected to be launched (Both on February 2).

Video-game Business

The launch of new game equipment and fortification of software lineup are expected to rejuvenate the market. Specifically, major software including "Super Mario 3D Land" for Nintendo 3DS (November 3, 2011), "Mario Kart 7" (December 1, 2011), "MONSTER HUNTER 3G" (December 10, 2011), and "ACE COMBAT 3D," (January 12, 2012) will be launched. In addition, a new terminal called "PlayStation ® Vita" and over 20 software titles for this terminal are expected to be launched. Furthermore, a sole distributorship agreement has been signed with ray-out Games CO., LTD., newly established by ray-out CO, LTD. which boasts of the number one selling smartphone jacket, for special accessories for PlayStation ® Vita (The launch of jacket, a must-have item for smart phones, specifically for PlayStation ® Vita is projected on the same day of its release date).

Amusement Business

In addition to pursuing synergies from product development linking toys and card games, HAPPINET proactively participates in and places capsule toy automated vending machines and card game equipment at various events. Placing equipment at events is a good means of achieving high inventory turnover ratios because of the large number of people attending these events, and the use of existing equipment placed at other locations can raise their operating efficiency. ¥163 million in sales are expected to derived from events during the current term (Including an event being held at the international flight passenger terminal of Haneda Airport at the yearend where equipment will be placed), and reflects a tripling of sales from the previous term (¥57 million).

4. Conclusions

HAPPINET is subject to seasonality in its earnings with a heavy bias during the second half due to the yearend gift giving season. Therefore favorable business trends in the second half could result in stronger earnings performance in the full year. At the same time, the Company's conservative estimates for the full year are acknowledged as difficulties in the yearend gift giving season could offset the margin built up from the stronger than expected first half. However, considering the various business endeavors, new products, and title lineup projected for the second half, the potential for full year earnings to exceed expectations remains high. In addition, keys to predicting the future earnings of HAPPINET will be its endeavors in the "sales floor package" of the toy business segment, and the proactive participation in various events for the amusement business segment.

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www.bridge-salon.jp/