



Happinet / 7552

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Research Coverage Report by Shared Research Inc.

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How to read a Shared Research report: This report begins with the trends and outlook section, which discusses the company's most recent earnings. First-time readers should start at the business section later in the report.

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Key financial data

| Income statement (JPYmn) | FY03/09 | FY03/10 | FY03/11 | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 | FY03/18 |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Est. |
| Total sales | 166,778 | 194,246 | 190,891 | 198,021 | 176,757 | 206,867 | 217,232 | 187,274 | 174,059 | 180,000 |
| YoY | -1.3% | 16.5% | -1.7% | 3.7% | -10.7% | 17.0% | 5.0% | -13.8% | -7.1% | 3.4% |
| Gross profit | 19,990 | 22,467 | 22,326 | 25,007 | 22,501 | 24,039 | 26,152 | 21,997 | 21,971 | |
| YoY | 9.2% | 12.4% | -0.6% | 12.0% | -10.0% | 6.8% | 8.8% | -15.9% | -0.1% | |
| GPM | 12.0% | 11.6% | 11.7% | 12.6% | 12.7% | 11.6% | 12.0% | 11.7% | 12.6% | |
| Operating profit | 2,137 | 2,327 | 2,855 | 4,855 | 2,973 | 3,888 | 5,056 | 3,450 | 3,698 | 4,200 |
| YoY | 47.3% | 8.9% | 22.7% | 70.1% | -38.8% | 30.8% | 30.0% | -31.8% | 7.2% | 13.6% |
| OPM | 1.3% | 1.2% | 1.5% | 2.5% | 1.7% | 1.9% | 2.3% | 1.8% | 2.1% | 2.3% |
| Recurring profit | 2,322 | 2,513 | 3,013 | 5,032 | 3,081 | 3,917 | 5,124 | 3,497 | 3,479 | 4,000 |
| YoY | 48.0% | 8.2% | 19.9% | 67.0% | -38.8% | 27.1% | 30.8% | -31.8% | -0.5% | 15.0% |
| RPM | 1.4% | 1.3% | 1.6% | 2.5% | 1.7% | 1.9% | 2.4% | 1.9% | 2.0% | 2.2% |
| Net income | 1,135 | 1,179 | 1,376 | 2,458 | 2,011 | 2,466 | 4,049 | 2,359 | 2,040 | 2,500 |
| YoY | - | 3.9% | 16.7% | 78.6% | -18.2% | 22.6% | 64.2% | -41.7% | -13.5% | 22.5% |
| Net margin | 0.7% | 0.6% | 0.7% | 1.2% | 1.1% | 1.2% | 1.9% | 1.3% | 1.2% | 1.4% |
| Per share data (JPY) | | | | | | | | | | |
| Shares issued ('000, year end) | 12,025 | 12,025 | 12,025 | 24,050 | 24,050 | 24,050 | 24,050 | 24,050 | 24,050 | |
| EPS | 48.8 | 52.3 | 61.3 | 109.7 | 89.8 | 109.4 | 178.9 | 104.1 | 92.3 | 113.1 |
| EPS (fully diluted) | - | - | - | 109.6 | 89.6 | 108.1 | 176.2 | 102.2 | 90.4 | |
| Dividend per share | 15.0 | 15.00 | 15.00 | 27.50 | 22.50 | 24.75 | 28.50 | 30.00 | 35.00 | 30.00 |
| Book value per share | 799.5 | 846.4 | 883.7 | 972.1 | 1,036.2 | 1,128.3 | 1,293.0 | 1,364.8 | 1,464.8 | |
| Balance sheet (JPYmn) | | | | | | | | | | |
| Cash and cash equivalents | 5,463 | 6,312 | 8,220 | 12,359 | 10,155 | 9,996 | 15,867 | 11,412 | 11,605 | |
| Total current assets | 44,864 | 40,140 | 41,039 | 48,269 | 47,930 | 47,025 | 52,449 | 44,905 | 48,975 | |
| Tangible fixed assets | 1,952 | 1,668 | 1,555 | 1,392 | 1,110 | 1,342 | 688 | 753 | 777 | |
| Intangible fixed assets | 4,488 | 3,836 | 3,132 | 1,715 | 985 | 446 | 854 | 1,086 | 1,005 | |
| Investment and other assets | 3,355 | 3,405 | 2,780 | 2,946 | 2,976 | 5,065 | 5,900 | 10,047 | 10,579 | |
| Total fixed assets | 9,797 | 8,910 | 7,468 | 6,054 | 5,072 | 6,854 | 7,443 | 11,887 | 12,361 | |
| Total assets | 54,661 | 49,050 | 48,507 | 54,323 | 53,003 | 53,879 | 59,893 | 56,793 | 61,337 | |
| Notes and accounts payable | 20,748 | 19,832 | 20,204 | 23,042 | 22,672 | 20,099 | 20,118 | 18,282 | 21,550 | |
| Short-term debt | 5,520 | 2,460 | - | - | - | - | - | - | - | |
| Total current liabilities | 33,171 | 27,436 | 25,837 | 29,617 | 26,883 | 25,036 | 26,957 | 21,817 | 25,188 | |
| Long-term debt | 430 | 30 | - | - | - | - | - | - | - | |
| Total fixed liabilities | 3,305 | 2,651 | 2,867 | 2,909 | 2,829 | 3,148 | 3,355 | 3,621 | 3,837 | |
| Total liabilities | 36,476 | 30,088 | 28,704 | 32,527 | 29,713 | 28,185 | 30,312 | 25,438 | 29,026 | |
| Net assets | 18,184 | 18,962 | 19,802 | 21,795 | 23,289 | 25,694 | 29,580 | 31,355 | 32,311 | |
| Total interest-bearing debt | 5,950 | 2,490 | - | - | - | - | - | - | - | |
| Cash flow statement (JPYmn) | | | | | | | | | | |
| Cash flows from operating activities | 951 | 6,232 | 5,083 | 4,609 | -1,505 | 2,547 | 6,658 | 978 | 3,055 | |
| Cash flows from investing activities | -851 | -391 | -315 | -50 | -108 | -87 | -158 | -4,752 | -1,107 | |
| Cash flows from financing activities | -975 | -4,481 | -2,852 | -421 | -588 | -2,618 | -628 | -677 | -1,754 | |
| Financial ratios | | | | | | | | | | |
| ROA (RP-based) | 4.5% | 4.8% | 6.2% | 9.8% | 5.7% | 7.3% | 9.0% | 6.0% | 5.9% | |
| ROE | 6.2% | 6.3% | 7.1% | 11.8% | 8.9% | 10.1% | 14.8% | 7.8% | 6.5% | |
| Equity ratio | 33.3% | 38.7% | 40.8% | 40.1% | 43.9% | 47.7% | 49.4% | 55.2% | 52.7% | |

Source: Shared Research based on company data

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

Note: Per share data adjusted for the 2-for-1 stock split on December 1, 2011. Per share data is retroactively restated.

Note: Net income from FY03/16 onward refers to net income attributable to parent company shareholders.

Recent updates

Highlights

On **August 30, 2017**, Shared Research updated the report following interviews with Happinet Corporation.

On **August 9, 2017**, the company announced earnings results for Q1 FY03/18; see the results section for details.

For corporate releases and developments more than three months old, please refer to the News and topics section.

Trends and outlook

Quarterly results

| Cumulative (JPYmn) | FY03/17 | | | | FY03/18 | | | | FY03/18 | | FY03/18 | |
|-----------------------|---------|--------|---------|---------|---------|----|----|----|---------|---------|---------|---------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | % of 1H | 1H Est. | % of FY | FY Est. |
| Sales | 32,757 | 72,448 | 133,902 | 174,059 | 35,150 | | | | 45.6% | 77,000 | 19.5% | 180,000 |
| YoY | -12.2% | -13.7% | -10.7% | -7.1% | 7.3% | | | | | 6.3% | | 3.4% |
| Gross profit | 4,312 | 9,537 | 17,139 | 21,971 | 4,582 | | | | | | | |
| YoY | -14.4% | -10.1% | 0.0% | -0.1% | 6.3% | | | | | | | |
| GPM | 13.2% | 13.2% | 12.8% | 12.6% | 13.0% | | | | | | | |
| SG&A expenses | 4,160 | 8,693 | 13,869 | 18,273 | 4,133 | | | | | | | |
| YoY | -2.3% | -0.9% | -0.4% | -1.5% | -0.6% | | | | | | | |
| SG&A-to-sales ratio | 12.7% | 12.0% | 10.4% | 10.5% | 11.8% | | | | | | | |
| Operating profit | 152 | 844 | 3,270 | 3,698 | 449 | | | | 37.4% | 1,200 | 10.7% | 4,200 |
| YoY | -80.5% | -54.1% | 1.8% | 7.2% | 195.4% | | | | | 42.2% | | 13.6% |
| OPM | 0.5% | 1.2% | 2.4% | 2.1% | 1.3% | | | | | 1.6% | | 2.3% |
| Recurring profit | 95 | 741 | 3,090 | 3,479 | 392 | | | | 35.6% | 1,100 | 9.8% | 4,000 |
| YoY | -88.0% | -60.1% | -5.0% | -0.5% | 312.6% | | | | | 48.4% | | 15.0% |
| RPM | 0.3% | 1.0% | 2.3% | 2.0% | 1.1% | | | | | 1.4% | | 2.2% |
| Net income | -26 | 329 | 1,793 | 2,040 | 177 | | | | 25.3% | 700 | 7.1% | 2,500 |
| YoY | - | -72.2% | -15.1% | -13.5% | - | | | | | 112.8% | | 22.5% |
| Net margin | - | 0.5% | 1.3% | 1.2% | 0.5% | | | | | 0.9% | | 1.4% |

| Quarterly (JPYmn) | FY03/17 | | | | FY03/18 | | | |
|----------------------|---------|--------|--------|--------|---------|----|----|----|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Sales | 32,757 | 39,691 | 61,454 | 40,157 | 35,150 | | | |
| YoY | -12.2% | -15.0% | -6.9% | 7.8% | 7.3% | | | |
| Gross profit | 4,312 | 5,225 | 7,602 | 4,832 | 4,582 | | | |
| YoY | -14.4% | -6.2% | 16.3% | -0.4% | 6.3% | | | |
| GPM | 13.2% | 13.2% | 12.4% | 12.0% | 13.0% | | | |
| SG&A expenses | 4,160 | 4,533 | 5,176 | 4,404 | 4,133 | | | |
| YoY | -2.3% | 0.4% | 0.3% | -4.6% | -0.6% | | | |
| SG&A-to-sales ratio | 12.7% | 11.4% | 8.4% | 11.0% | 11.8% | | | |
| Operating profit | 152 | 692 | 2,426 | 428 | 449 | | | |
| YoY | -80.5% | -34.6% | 76.3% | 80.6% | 195.4% | | | |
| OPM | 0.5% | 1.7% | 3.9% | 1.1% | 1.3% | | | |
| Recurring profit | 95 | 646 | 2,349 | 389 | 392 | | | |
| YoY | -88.0% | -39.2% | 68.5% | 58.1% | 312.6% | | | |
| RPM | 0.3% | 1.6% | 3.8% | 1.0% | 1.1% | | | |
| Net income | -26 | 355 | 1,464 | 247 | 177 | | | |
| YoY | - | -50.3% | 58.1% | -0.4% | - | | | |
| Net margin | - | 0.9% | 2.4% | 0.6% | 0.5% | | | |

Source: Shared Research based on company data

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

Note: Three-month quarterly figures are calculated as the cumulative figures minus the previous quarter's cumulative figures.

Note: Net income refers to net income attributable to parent company shareholders.

Seasonality: The Toys business typically accounts for 40% of annual sales and 60% 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.

Performance by segment

| Segments (cumulative) (JPYmm) | FY03/17 | | | | FY03/18 | | | |
|----------------------------------|---------|--------|---------|---------|---------|----|----|----|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Sales | 32,757 | 72,448 | 133,902 | 174,059 | 35,150 | | | |
| YoY | -12.2% | -13.7% | -10.7% | -7.1% | 7.3% | | | |
| Toys | 14,300 | 31,585 | 59,433 | 73,725 | 13,450 | | | |
| YoY | -6.0% | -9.1% | -4.8% | -4.1% | -5.9% | | | |
| Visual and Music | 8,138 | 16,516 | 25,801 | 34,890 | 7,944 | | | |
| YoY | -5.4% | -4.8% | -10.0% | -9.1% | -2.4% | | | |
| Videogames | 5,832 | 14,302 | 33,476 | 44,793 | 9,263 | | | |
| YoY | -27.3% | -29.2% | -20.5% | -10.4% | 58.8% | | | |
| Amusement | 4,487 | 10,045 | 15,190 | 20,649 | 4,492 | | | |
| YoY | -17.8% | -14.0% | -9.5% | -6.2% | 0.1% | | | |
| Segment profit | 152 | 844 | 3,270 | 3,698 | 449 | | | |
| YoY | -80.5% | -54.1% | 1.8% | 7.2% | 195.4% | | | |
| Toys | 284 | 768 | 2,827 | 3,044 | 300 | | | |
| YoY | -46.6% | -38.9% | 9.6% | 6.9% | 5.6% | | | |
| Visual and Music | -54 | 146 | 358 | 418 | 89 | | | |
| YoY | - | 1.4% | 14.7% | -10.3% | - | | | |
| Videogames | -129 | -36 | 249 | 384 | 61 | | | |
| YoY | - | - | 982.6% | - | - | | | |
| Amusement | 345 | 642 | 889 | 1,281 | 305 | | | |
| YoY | -39.8% | -44.4% | -32.1% | -22.5% | -11.6% | | | |
| Adjustments | -292 | -675 | -1,054 | -1,430 | -306 | | | |
| Segments (quarterly) (JPYmm) | FY03/17 | | | | FY03/18 | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Sales | 32,757 | 39,691 | 61,454 | 40,157 | 35,150 | | | |
| YoY | -12.2% | -15.0% | -6.9% | 7.8% | 7.3% | | | |
| Toys | 14,300 | 17,285 | 27,848 | 14,292 | 13,450 | | | |
| YoY | -6.0% | -11.5% | 0.5% | -0.9% | -5.9% | | | |
| Visual and Music | 8,138 | 8,378 | 9,285 | 9,089 | 7,944 | | | |
| YoY | -5.4% | -4.3% | -17.9% | -6.4% | -2.4% | | | |
| Videogames | 5,832 | 8,470 | 19,174 | 11,317 | 9,263 | | | |
| YoY | -27.3% | -30.5% | -12.5% | 43.4% | 58.8% | | | |
| Amusement | 4,487 | 5,558 | 5,145 | 5,459 | 4,492 | | | |
| YoY | -17.8% | -10.7% | 0.8% | 4.4% | 0.1% | | | |
| Segment profit | 152 | 692 | 2,426 | 428 | 449 | | | |
| YoY | -80.5% | -34.6% | 76.3% | 80.6% | 195.4% | | | |
| Toys | 284 | 484 | 2,059 | 217 | 300 | | | |
| YoY | -46.6% | -33.1% | 55.6% | -19.3% | 5.6% | | | |
| Visual and Music | -54 | 200 | 212 | 60 | 89 | | | |
| YoY | - | 65.3% | 26.2% | -61.0% | - | | | |
| Videogames | -129 | 93 | 285 | 135 | 61 | | | |
| YoY | - | - | 290.4% | - | - | | | |
| Amusement | 345 | 297 | 247 | 392 | 305 | | | |
| YoY | -39.8% | -48.9% | 59.4% | 14.3% | -11.6% | | | |
| Adjustments | -292 | -383 | -379 | -376 | -306 | | | |

Source: Shared Research based on company data

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

Note: Three-month quarterly figures are calculated as the cumulative figures minus the previous quarter's cumulative figures.

Note: Figures larger than 1,000% are represented as a dash (-)

Toys segment

| (JPYmm) | FY03/17 | FY03/18 |
|-------------------|---------|---------|
| | Q1 | Q1 |
| Sales | 14,300 | 13,450 |
| YoY | -6.0% | -5.9% |
| Bandai | 6,400 | 6,000 |
| YoY | - | -6.1% |
| % of total | 45.2% | 45.1% |
| TAKARA TOMY | 1,400 | 1,500 |
| YoY | - | 7.8% |
| % of total | 9.9% | 11.4% |
| Happinet original | 400 | 200 |
| YoY | - | -45.2% |
| % of total | 3.2% | 1.9% |
| Other | 5,900 | 5,500 |
| YoY | - | -6.1% |
| % of total | 41.7% | 41.6% |
| Segment profit | 284 | 300 |
| YoY | -46.6% | 5.6% |
| OPM | 2.0% | 2.2% |

Source: Shared Research based on company data

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

Visual and Music segment

| (JPYmn) | FY03/17 | | FY03/18 | |
|----------------|---------|--|---------|--|
| | Q1 | | Q1 | |
| Sales | 8,138 | | 7,944 | |
| YoY | -5.4% | | -2.4% | |
| Visual | 6,200 | | 6,500 | |
| YoY | - | | 4.5% | |
| % of total | 77.0% | | 82.4% | |
| Wholesale | 5,200 | | 5,300 | |
| YoY | - | | 1.9% | |
| % of total | 63.9% | | 66.7% | |
| Manufacturers | 1,000 | | 1,200 | |
| YoY | - | | 17.2% | |
| % of total | 13.1% | | 15.7% | |
| Music | 1,800 | | 1,300 | |
| YoY | - | | -25.4% | |
| % of total | 23.0% | | 17.6% | |
| Segment profit | -54 | | 89 | |
| YoY | - | | - | |
| OPM | - | | 1.1% | |

Source: Shared Research based on company data

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

Videogames segment

| (JPYmn) | FY03/17 | | FY03/18 | |
|-------------------|---------|--|---------|--|
| | Q1 | | Q1 | |
| Sales | 5,832 | | 9,263 | |
| YoY | -27.3% | | 58.8% | |
| Nintendo products | 4,300 | | 7,600 | |
| YoY | - | | 76.7% | |
| % of total | 73.9% | | 82.2% | |
| SIE products | 1,200 | | 1,500 | |
| YoY | - | | 19.8% | |
| % of total | 22.2% | | 16.8% | |
| Others | 200 | | 0 | |
| YoY | - | | -56.9% | |
| % of total | 3.9% | | 1.0% | |
| Segment profit | -129 | | 61 | |
| YoY | - | | - | |
| OPM | - | | 0.7% | |

Source: Shared Research based on company data

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

*SIE is Sony Interactive Entertainment Inc.

Amusement segment

| (JPYmn) | FY03/17 | | FY03/18 | |
|----------------|---------|--|---------|--|
| | Q1 | | Q1 | |
| Sales | 4,487 | | 4,492 | |
| YoY | -17.8% | | 0.1% | |
| Capsule toys | 2,200 | | 2,400 | |
| YoY | - | | 7.6% | |
| % of total | 49.5% | | 53.5% | |
| Card games | 1,800 | | 1,600 | |
| YoY | - | | -10.8% | |
| % of total | 40.1% | | 37.2% | |
| Other | 400 | | 400 | |
| YoY | - | | 3.4% | |
| % of total | 10.4% | | 9.3% | |
| Segment profit | 345 | | 305 | |
| YoY | -39.8% | | -11.6% | |
| OPM | 7.7% | | 6.8% | |

Source: Shared Research based on company data

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

Q1 FY03/18 results

- ▷ Sales: JPY35.2bn (+7.3% YoY)
- ▷ Operating profit: JPY449mn (+195.4%)
- ▷ Recurring profit: JPY392mn (+312.6%)
- ▷ Net income*: JPY177mn (net loss of JPY26mn in the previous year)

*Net income refers to net income attributable to parent company shareholders.

Sales and operating profit increased as sales were robust in the Videogames segment, and internally managed products were a hit in the Visual and Music segment.

While the videogame industry has been recovering due to the launch of Nintendo Switch and other products, other industries in which the company operates are going through a difficult time, due to such factors as the declining birth rate and diversifying consumer needs in the toy industry and a slowdown in the market for packaged products owing to the popularity of software downloads in the visual and music industries.

Toys

In the Toys segment, sales fell 5.9% YoY to JPY13.5bn and segment profit increased 5.6% to JPY300mn.

Sales of Bandai's *Kamen Rider Ex-Aid* and *Ultraman Orb*-related products were robust, but not enough to boost the market and sales were down YoY as a result. The company is strengthening its range of hobby items such as plastic models as one of its medium-term management plan strategies.

Broken down by manufacturer, sales of Bandai products totaled JPY6.0bn (-6.1% YoY) for a share of 45.1% of the total (versus 45.2% in Q1 FY03/17). Sales of Tomy products were JPY1.5bn (+7.8% YoY) for a share of 11.4% (9.9%) and sales of its own products were JPY200mn (-45.2%) for a share of 1.9% (3.2%).

Sales of the toy and hobby segment of Bandai Namco Holdings Inc. came to JPY42.8bn (-11.0% YoY) in Q1 FY03/18. According to Bandai Namco materials, merchandise sales were brisk for mainstay IP such as the Kamen Rider, Super Sentai, and Precure series. Domestic sales of Yokai Watch-related products totaled JPY800mn versus JPY2.3bn in Q1 FY03/17.

Sales of the Japan segment of Tomy came to JPY32.4bn (+18.0% YoY) in Q1 FY03/18. Beyblade Burst performed strongly as well as mainstay IP Licca-chan and novel egg-and-hatchling pet toy *Umarete Woomo* ("Hatchimals" in English).

Profits were up thanks to efforts to reduce SG&A expenses. Measures to improve the efficiency of logistics proved effective.

Visual and Music

In the Visual and Music segment, sales fell 2.4% YoY to JPY7.9bn and segment profit was JPY89mn (segment loss of JPY54mn in the previous year).

Sales at the company declined YoY amid ongoing weakness in the overall market for packaged products. In the Visual subsegment, sales of the wholesale business were JPY5.3bn (+1.9% YoY) and sales of the manufacturing business were JPY1.2bn (+17.2%), while sales of the Music subsegment came to JPY1.3bn (-25.4%).

Segment profit benefited from a reactionary gain after booking an investment loss in a movie the company produced a year earlier and the earning contribution of exhibition revenue and sales of the DVD released in July 2017 of *Kiseki: Ano Hi no Sobito*, an internally managed movie that became a hit (released in January 2017 at theaters).

Videogames

In the Videogames segment, sales rose 58.8% YoY to JPY9.3bn, with segment profit of JPY61mn (segment loss of JPY129mn in FY03/16).

By manufacturer, sales of Nintendo products were JPY7.6bn (+76.7% YoY) and sales of Sony Interactive Entertainment products were JPY1.5bn (+19.8%).

Sales of Nintendo Switch units and Mario Kart 8 Deluxe software released in March 2017 were robust, resulting in higher sales and segment profit.

Amusement

In the Amusement segment, sales rose 0.1% YoY to JPY4.5bn, while segment profit declined 11.6% to JPY305mn.

While sales of Kamen Rider-related products, both capsule toys and children's card game machines, were robust, it was not enough to boost the market. Sales of capsule toys totaled JPY2.4bn (+7.6% YoY) and sales of card games were JPY1.6bn (-10.8%).

Profits declined due to expenses associated with the renewal of children's card game machines.

For details on previous quarterly and annual results, please refer to the Historical performance section.

Full-year company forecasts

| (JPYmn) | FY03/17 | | | FY03/18 | | |
|-------------------------|---------------|----------------|----------------|---------------|----------------|----------------|
| | 1H Act. | 2H Act. | FY Act. | 1H Est. | 2H Est. | FY Est. |
| Sales | 72,448 | 101,611 | 174,059 | 77,000 | 103,000 | 180,000 |
| CoGS | 62,911 | 89,177 | 152,088 | | | |
| Gross profit | 9,537 | 12,434 | 21,971 | | | |
| GPM | 13.2% | 12.2% | 12.6% | | | |
| SG&A expenses | 8,693 | 9,580 | 18,273 | | | |
| SG&A-to-sales ratio | 12.0% | 9.4% | 10.5% | | | |
| Operating profit | 844 | 2,854 | 3,698 | 1,200 | 3,000 | 4,200 |
| OPM | 1.2% | 2.8% | 2.1% | 1.6% | 2.9% | 2.3% |
| Recurring profit | 741 | 2,738 | 3,479 | 1,100 | 2,900 | 4,000 |
| RPM | 1.0% | 2.7% | 2.0% | 1.4% | 2.8% | 2.2% |
| Net income | 329 | 1,711 | 2,040 | 700 | 1,800 | 2,500 |
| Net margin | 0.5% | 1.7% | 1.2% | 0.9% | 1.7% | 1.4% |

Source: Shared Research based on company data

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

Note: Net income refers to net income attributable to parent company shareholders.

| (JPYmn) | FY03/17 | | | FY03/18 |
|------------------|---------|---------|---------|---------|
| | 1H Act. | 2H Act. | FY Act. | FY Est. |
| Sales | 72,448 | 101,611 | 174,059 | 180,000 |
| YoY | -13.7% | -1.6% | -7.1% | 3.4% |
| Toys | 31,585 | 42,140 | 73,725 | 75,000 |
| YoY | -9.1% | 0.0% | -4.1% | 1.7% |
| Visual and Music | 16,516 | 18,374 | 34,890 | 37,000 |
| YoY | -4.8% | -12.6% | -9.1% | 6.0% |
| Videogames | 14,302 | 30,491 | 44,793 | 46,000 |
| YoY | -29.2% | 2.3% | -10.4% | 2.7% |
| Amusement | 10,045 | 10,604 | 20,649 | 22,000 |
| YoY | -14.0% | 2.6% | -6.2% | 6.5% |
| Segment profit | 844 | 2,854 | 3,698 | 4,200 |
| YoY | -54.1% | 76.9% | 7.2% | 13.6% |
| Toys | 768 | 2,276 | 3,044 | 3,250 |
| YoY | -38.9% | 43.0% | 6.9% | 6.8% |
| OPM | 2.4% | 5.4% | 4.1% | 4.3% |
| Visual and Music | 146 | 272 | 418 | 550 |
| YoY | 1.4% | -15.5% | -10.3% | 31.6% |
| OPM | 0.9% | 1.5% | 1.2% | 1.5% |
| Videogames | -36 | 420 | 384 | 450 |
| YoY | - | - | - | 17.2% |
| OPM | -0.3% | 1.4% | 0.9% | 1.0% |
| Amusement | 642 | 639 | 1,281 | 1,350 |
| YoY | -44.4% | 28.3% | -22.5% | 5.4% |
| OPM | 6.4% | 6.0% | 6.2% | 6.1% |
| Adjustments | -675 | -755 | -1,430 | -1,400 |

Source: Shared Research based on company data

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

For FY03/18, the company forecasts sales of JPY180bn (+3.4% YoY), operating profit of JPY4.2bn (+13.6%), recurring profit of JPY4.0bn (+14.9%), and net income attributable to parent company shareholders of JPY2.5bn (+22.5%).

In FY03/18, the final year of the company's seventh medium-term management plan, Happinet intends to add new merchandises to its product lineup and cultivate new sales channels in order to expand market share at each of its businesses. It plans to streamline operations for better productivity, sell products that are exclusively distributed by Happinet, and in turn improve profitability. It intends to achieve further growth by venturing to build new entertainment businesses, including through alliances with other companies. It also plans to leverage the content development capability of Broccoli Co., Ltd. (an affiliate through a capital alliance conducted in November 2015), integrate Broccoli's contents with its optimal logistics platform, and jointly develop new contents, while cultivating new customer base and distribution channels.

Initiatives for each segment and earnings assumptions:

Toys segment

Sales are expected to reach JPY75.0bn (+1.7% YoY), and operating profit JPY3.3bn (+6.8% YoY)

This segment generates about half of its sales from Bandai products (Bandai products comprised 51.0% of sales in FY03/17). Bandai Namco Holdings (TSE1:7832) expects that sales of its Toys and Hobby segment will see an 11.3% YoY increase in FY03/18. By character (Domestic Toy and Hobby), Kamen Rider products are expected bring in JPY20.0bn (-2.0% YoY). But the company expects an increase in sales related to Super Sentai, Anpanman, and PreCure.

For this segment, Happinet will strengthen sales of hobby items, such as plastic models, and those of products that the company exclusively distributes. The company is in talks with manufacturers and potential clients over hobby products, believing that its market share for these items has room for further growth. In addition, the company plans to handle more items such as character apparel and costumes to offer a variety of products to its existing customers. These will be available at stores alongside toys.

Happinet plans to put on the market in early August 2017 a new original product, *Chicchana Tenori Monkey Hugmin*, which is a small electronic pet equipped with the latest technology. The company will distribute this toy at nationwide toy shops, through online shops, and at toy sections at volume discounters, electronics shops, and variety goods stores. The product features the latest technology previously reserved for large toy robots. The company has managed to condense the technology and create a palm-sized (about 13cm in length) product that won a 2017 Japan Toy Award for excellence in the innovative category.

The company will further strengthen its inventory control and review operations and personnel allocations as it continues to make efforts to increase profits.

Visual and Music segment

Sales are expected to be JPY37.0bn (+6.0% YoY), and operating profit JPY550mn (+31.6% YoY)

In the visual manufacturing section, *Kiseki: Ano Hi no Sobito*, an internally managed movie released in theaters in FY03/17, generated revenue of JPY1.5bn. The company expects the movie to contribute to earnings in FY03/18 thanks to its box-office distribution and the DVD release slated for July 2017. Happinet owns the distribution rights to this movie as well. In the visual wholesale section, the company will release DVDs for popular films such as Rouge One: A Star Wars Story and animated movie *Kimi No Na Wa*.

In the visual wholesale section, the company will strengthen its manufacturing and sales capabilities. The company will host more live events and promote various goods and CDs at these events. The company established Happinet Live Entertainment LLC in February 2016 (now Happinet Live Emotion LLC). Since then, manufacturers that had previously conducted such events themselves are now approaching Happinet, asking to handle both distribution and these events for them. Such requests are expected to further increase in the future.

The company also wants to boost profits in the visual manufacturing section by creating a business model that ensures increased sales of internally made movies or movies in which it has invested.

Videogame segment

Sales are expected to be JPY46.0bn (+2.7% YoY), and operating profit JPY450mn (+17.2% YoY)

Happinet will propose and provide appropriate support for each sales channel to maximize Nintendo Switch sales. The company will also optimize its distribution and services in cooperation with Nintendo Sales Co., Ltd. As for Nintendo Switch software, Happinet plans to handle many popular titles such as the Splatoon 2 and Super Mario Odyssey series.

The company's original products include *Junisai* (means 12-year old) series. Although this series still remains steady, the company plans to release a new game title for young girls toward the year-end shopping season. Happinet is developing an original title under a new category with a view to releasing the product in Q3.

With respect to profits, sales of new software titles, which are more profitable than hardware, are expected to contribute to the company's earnings. These titles will be used for Nintendo Switch, a console that was put on the market in Q4 FY03/16. The company further plans to improve profitability by expanding sales of exclusively distributed products and game peripherals.

Amusement segment

Sales are expected to be JPY22.0bn (+6.5% YoY), and operating profit JPY1.4bn (+5.4% YoY)

The company will install vending machines for capsule toys at airports, train stations, and other public transportation facilities as it did in FY03/17 and cater to inbound tourists, part of an effort to create a business model that leads to the establishment of more sales channels. Happinet will at the same time expand sales of its original products in cooperation with Broccoli Co., Ltd., an equity-method affiliate. The company will also review its existing locations for the machines to further improve their profitability. However, spending on the machines themselves is expected to decline slightly YoY.

Medium-term outlook

Medium-term plan

In May 2015 Happinet unveiled its seventh medium-term business plan for FY03/16 to FY03/18. This is an indication of the company's strategy and it has not established target figures. The company said it plans to further grow and expand its intermediate distribution business and also make choices for and focus on its manufacturing business.

Midterm measures for intermediate distribution

As a basic strategy, the company will aim for further growth and expansion, leveraging its strengths as an intermediate distributor.

Toys segment

As an intermediate distributor, the company chiefly handles toys, vending machine toys in capsules, and card games from among Bandai's commercial products but says that despite similar sales areas, items such as plastic models, miscellaneous goods, and toys that come with candy are limited in volume and amount. The company intends to expand its business area during the three-year midterm period with a focus on hobby items such as plastic models.

Visual and Music segment

The company plans to leverage its strength of having information on both manufacturers and retailers, and intends to expand its market share. Specifically, Shared Research speculates that the company intends to expand market share by taking on sales promotion activities for visual and music software manufacturers through consignments or transfers.

The company also plans to aim for low cost operations to improve profit ratios and will reduce expenses by unifying online newly proposed works of music, details on new productions, incoming and outgoing information, and information on sales promotions.

Videogame segment

Based on an understanding that the market for packaged products continues to remain sluggish, the company intends to leverage its low cost operations and diverse sales channels, forge closer ties with manufacturers, and boost its lineup of exclusively distributed products which bring in high profit ratios.

Amusement segment

The company is looking to leverage its nationwide network to develop new locations and create new businesses. While it has set up vending machines for toys mainly at volume sellers and shopping malls in the past, it hopes to boost sales by setting up the machines at different locations, such as venues for live events and at train stations.

The company would also like to promote efficiency by introducing IT to gain an understanding of timings for replacing products, which had conventionally been done physically through human efforts.

Medium-term plan for the manufacturing industry

The company will focus on certain manufacturing industries, creating markets in which it is at an advantage and attempt to improve profitability in toys, videos, and games.

The company manufactured and sold original toys related to a TV animation show for boys during FY03/15 but had not achieved expected results. In the three-year period it hopes to change this to a stable business by expanding its market share in categories for original toys, which are highly profitable. It aims to establish a profit base via products that will sell for more than a year, products that appeal to a range of customers, and efficient production and sales. It will focus efforts on traditional categories such as RC products that are not swayed by changing trends.

As to the production of visual products, the company will produce work, mainly animations, which it will manage. It said that even as the market for video software packages contracts, it expects core users to support animations and that a stable market will

be secured. In order to create a structure that will enable it to cope with changes in the market environment, the company said it would focus its investments on products that it manages, chiefly animations, through joint development with external partners.

The company established a production department for game software in FY03/15 and launched Nintendo 3DS software for school-aged girls; “Junisai: Honto no Kimochi (Twelve Years Old: True Feelings)” and “Dolly Kanon” and sold a total of about 100,000 units. Besides developing game software for girls under its “Puchi Koi” brand, it plans to develop series in the game software segment for school girls, where there is little competition, in the hope that it will contribute to profits.

Other

The business alliance with Broccoli may impact the company’s earnings in the medium-term. Details are outlined below.

Business alliance with Broccoli

On November 20, 2015, the company announced a business alliance with Broccoli Co. Ltd. Happinet also made payment on December 9, 2015 for a third-party allotment of 11mn Broccoli shares in the amount of JPY4.1bn, to acquire a 25.15% of total issued shares. Broccoli is now an equity-method affiliate of Happinet.

On November 2016, Happinet and Broccoli established a new label “b-sound” and announced that Broccoli would plan and produce new contents while Happinet would distribute them.

Alliance particulars

- ▶ Development of content, planning, production, and sales of animation, games, card-based games, CDs, goods, figures, and related supplies, sharing of related activities / expertise, and cooperating to realize more sophisticated business management expertise mainly involving content.
- ▶ In order to maximize the value of content developed by Broccoli, Broccoli will utilize information about market trends and needs held by Happinet and the two firms will cooperate in developing high-quality, original content.
- ▶ In order to maximize the sales of animation, games, card-based games, CDs, goods, figures, and related supplies produced by Broccoli, Broccoli will plan and produce novel products well suited for market needs and Happinet will promote sales using the Happinet Group distribution platform.
- ▶ Cooperate with sales promotions and event management for content and products developed and produced by Broccoli.
- ▶ Discuss streamlining measures for distribution functions held by Broccoli, with consideration given to Broccoli using Happinet distribution functions in the future.
- ▶ Discuss mutual personnel exchanges to realize the alliance objectives.

As an equity-method affiliate of the company, Broccoli’s results are reflected in consolidated operating results from Q4 FY03/16 onward, and resulted in a JPY22mn equity-method loss. FY02/16 earnings forecasts for Broccoli were sales of JPY6.2bn (down 0.9% YoY), operating profit of JPY900mn (down 38.8% YoY), recurring profit of JPY900mn (down 39.4% YoY), and net income of JPY600mn (down 33.7% YoY).

Business

Description

Leading intermediary distributor for toys, DVDs, CDs and videogames. The company buys goods from makers and distributes to retailers, managing inventories and handling orders/shipments. Segments comprise Toys (42.4% of FY03/17 sales), Visual and Music (20.0%), Videogames (25.7%), and Amusement (11.9%).

The group is a major distributor for toys, DVDs, CDs, and holds about 60% market share for capsule toy machine operation and sales, according to the company.

Segment sales and profit

| (JPYmn) | FY03/10 Act. | FY03/11 Act. | FY03/12 Act. | FY03/13 Act. | FY03/14 Act. | FY03/15 Act. | FY03/16 Act. | FY03/17 Act. |
|---------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Sales | 194,246 | 190,891 | 198,021 | 176,757 | 206,867 | 217,232 | 187,274 | 174,059 |
| YoY | 16.5% | -1.7% | 3.7% | -10.7% | 17.0% | 5.0% | -13.8% | -7.1% |
| Toy | 65,654 | 69,104 | 77,313 | 74,660 | 76,821 | 93,270 | 76,874 | 73,725 |
| YoY | 6.2% | 5.3% | 11.9% | -3.4% | 2.9% | 21.4% | -17.6% | -4.1% |
| % of sales | 33.8% | 36.2% | 39.0% | 42.2% | 37.1% | 42.9% | 41.0% | 42.4% |
| Visual and Music | 67,838 | 57,759 | 55,719 | 44,810 | 42,955 | 43,372 | 38,367 | 34,890 |
| YoY | 85.5% | -14.9% | -3.5% | -19.6% | -4.1% | 1.0% | -11.5% | -9.1% |
| % of sales | 34.9% | 30.3% | 28.1% | 25.4% | 20.8% | 20.0% | 20.5% | 20.0% |
| Video Game | 44,372 | 46,447 | 42,704 | 36,839 | 63,609 | 56,448 | 50,009 | 44,793 |
| YoY | -12.1% | 4.7% | -8.1% | -13.7% | 72.7% | -11.3% | -11.4% | -10.4% |
| % of sales | 22.8% | 24.3% | 21.6% | 20.8% | 30.7% | 26.0% | 26.7% | 25.7% |
| Amusement | 16,381 | 17,579 | 22,282 | 20,447 | 23,481 | 24,140 | 22,023 | 20,649 |
| YoY | -8.6% | 7.3% | 26.8% | -8.2% | 14.8% | 2.8% | -8.8% | -6.2% |
| % of sales | 8.4% | 9.2% | 11.3% | 11.6% | 11.4% | 11.1% | 11.8% | 11.9% |
| Segment profit | 2,327 | 2,855 | 4,855 | 2,973 | 3,888 | 5,056 | 3,450 | 3,698 |
| YoY | 8.9% | 22.7% | 70.0% | -38.8% | 30.8% | 30.0% | -31.8% | 7.2% |
| Toy | 1,865 | 2,321 | 3,009 | 2,055 | 2,710 | 4,279 | 2,848 | 3,044 |
| YoY | 87.2% | 24.4% | 29.6% | -31.7% | 31.8% | 57.9% | -33.4% | 6.9% |
| % of segment profit | 50.4% | 55.8% | 48.6% | 47.7% | 52.6% | 65.5% | 57.9% | 59.4% |
| Visual and Music | 253 | -656 | 448 | 309 | 307 | 202 | 466 | 418 |
| YoY | -81.0% | - | - | -31.0% | -0.7% | -34.3% | 130.7% | -10.3% |
| % of segment profit | 6.8% | -15.8% | 7.2% | 7.2% | 6.0% | 3.1% | 9.5% | 8.2% |
| Video Game | 1,035 | 1,156 | 936 | 678 | 79 | 254 | -43 | 384 |
| YoY | -15.2% | 11.7% | -19.0% | -27.6% | -88.2% | 217.9% | - | - |
| % of segment profit | 28.0% | 27.8% | 15.1% | 15.7% | 1.5% | 3.9% | -0.9% | 7.5% |
| Amusement | 544 | 1,340 | 1,801 | 1,265 | 2,053 | 1,796 | 1,652 | 1,281 |
| YoY | - | 146.3% | 34.4% | -29.8% | 62.4% | -12.5% | -8.0% | -22.5% |
| % of segment profit | 14.7% | 32.2% | 29.1% | 29.4% | 39.9% | 27.5% | 33.6% | 25.0% |
| Adjustments | -1,371 | -1,307 | -1,341 | -1,335 | -1,263 | -1,475 | -1,473 | -1,430 |

Source: Shared Research based on company data
 Figures may differ from company materials due to differences in rounding methods.

Toys

42.4% of FY03/17 consolidated sales; 59.4% of operating profit (before adjustments)

In this segment, Happinet generates earnings buying products (toys) from toy makers and selling them to retailers.

It 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. Major toy manufacturers are shown in the following table. Happinet handles about 90% of Bandai's toy distribution in Japan, Japan's largest toy manufacturer.

Toys: main manufacturers

| | FY03/10 | FY03/11 | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| (JPYmn) | Act. | Act. | Act. | Act. | Act. | Act. | Act. | Act. |
| Total | 65,654 | 69,104 | 77,313 | 74,660 | 76,821 | 93,270 | 76,874 | 73,725 |
| YoY | 6.2% | 5.3% | 11.9% | -3.4% | 2.9% | 21.4% | -17.6% | -4.1% |
| Bandai | 32,700 | 37,400 | 42,300 | 38,800 | 40,700 | 55,400 | 41,900 | 37,600 |
| YoY | 13.1% | 14.4% | 13.1% | -8.3% | 5.0% | 35.8% | -24.2% | -10.4% |
| % of total | 49.8% | 54.1% | 54.7% | 52.0% | 53.1% | 59.4% | 54.6% | 51.0% |
| TAKARA TOMY | 5,000 | 7,000 | 6,300 | 5,300 | 4,200 | 4,100 | 4,900 | 7,000 |
| YoY | 4.2% | 40.0% | -10.0% | -15.9% | -21.6% | -1.6% | 20.4% | 41.6% |
| % of total | 7.6% | 10.1% | 8.1% | 7.1% | 5.5% | 4.5% | 6.5% | 9.6% |
| Happinet original | 1,400 | 1,400 | 2,200 | 2,500 | 2,000 | 1,900 | 1,500 | 1,700 |
| YoY | 16.7% | 0.0% | 57.1% | 13.6% | -17.7% | -8.1% | -16.3% | 10.6% |
| % of total | 2.1% | 2.0% | 2.8% | 3.3% | 2.7% | 2.0% | 2.1% | 2.4% |
| Other | 18,400 | 23,100 | 26,400 | 27,900 | 29,700 | 31,800 | 28,200 | 27,200 |
| YoY | -5.6% | 25.5% | 14.3% | 5.7% | 6.5% | 6.9% | -11.1% | -3.6% |
| % of total | 28.0% | 33.5% | 34.1% | 37.4% | 38.7% | 34.1% | 36.8% | 37.0% |

Source: Shared Research based on company data
 Figures may differ from company materials due to differences in rounding methods.
 From FY03/11, other makers are included in the others segment.

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. These toys are different in nature from automobiles or consumer electronics, which usually remain in production for an extended period of time. Toymakers must adjust their production based on demand forecasts and produce items within a limited time frame. 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, forecast demand, 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.

For toys, annual inventory disposal is 1–2% of annual sales. Annual inventory write-off amounts are trending lower, however. This positive trend is due to the company's heightened efforts to maintain inventory levels to match product sales. The company is also working more closely with retailers, providing product-specific sales data to help forecast trends. In addition to controlling store inventories, this information helps to drive sales promotions, and keeping a lid on inventory disposal levels is indispensable in improving the company's profit ratio.

The company carries out monthly disposal of inventory, but differences in the accuracy of predictions give corresponding variations in losses on disposal of inventory, and fluctuations of 1% in GPM.

Toy earnings

| | FY03/10 | FY03/11 | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 |
|--------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| (JPYmn) | Act. | Act. | Act. | Act. | Act. | Act. | Act. | Act. |
| Sales | 65,654 | 69,104 | 77,313 | 74,660 | 76,821 | 93,270 | 76,874 | 73,725 |
| YoY | 6.2% | 5.3% | 11.9% | -3.4% | 2.9% | 21.4% | -17.6% | -4.1% |
| Segment profit | 1,865 | 2,321 | 3,009 | 2,055 | 2,710 | 4,279 | 2,848 | 3,044 |
| YoY | 87.2% | 24.5% | 29.6% | -31.7% | 31.9% | 57.9% | -33.4% | 6.9% |
| OPM | 2.8% | 3.4% | 3.9% | 2.8% | 3.5% | 4.6% | 3.7% | 4.1% |
| Losses on inventory write-offs | 1,100 | 1,100 | 1,300 | 1,300 | 1,000 | 1,600 | 1,800 | 700 |
| % of sales | 1.7% | 1.6% | 1.7% | 1.7% | 1.3% | 1.7% | 2.3% | 0.9% |
| Inventory | 2,100 | 2,200 | 2,300 | 2,400 | 2,400 | 2,300 | 2,200 | 2,700 |
| Inventory turnover | 22.7 | 31.3 | 33.6 | 30.7 | 31.0 | 38.7 | 33.6 | 29.6 |

Source: Shared Research based on company data
 Figures may differ from company materials due to differences in rounding methods.

According to Happinet, it is a major intermediary distributor of toys, holding a 30% market share. 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. Distributors began to need advanced information and logistics systems in order to keep up with the growing size of retailers, and Happinet rose to meet the needs of the changing business environment. Additionally, Shared Research notes that growth in toy sales by Bandai Co., Ltd., a subsidiary of Bandai Namco Holdings (TSE1: 7832) that holds 24.5% of Happinet stock has led Happinet to become the largest company in the industry.

Shared Research 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 animations. 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. The 41th series, *Uchu Sentai Kyu Ranger*, aired in 2017.

In the 30-minute *Super Sentai* program, a team of three to nine 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. New characters and items are added during the year based on interest in the TV program, and Bandai merchandises all the transforming items, weapons, and robots. All super hero toys are ready for Christmas when sales peak.

Bandai Sales by Character (Domestic Toy and Hobby)

| | FY03/10 | FY03/11 | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 |
|--------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| (JPYbn) | Act. | Act. | Act. | Act. | Act. | Act. | Act. | Act. |
| Youkai Watch | - | - | - | - | 1.4 | 55.2 | 30.8 | 9.3 |
| Mobile Suit Gundam | 14.4 | 13.4 | 15.6 | 16.5 | 18.4 | 22.9 | 25.8 | 26.4 |
| Kamen Rider | 17.5 | 23.0 | 28.3 | 27.1 | 22.3 | 20.6 | 15.7 | 20.4 |
| Super Sentai | 10.5 | 9.2 | 13.0 | 9.6 | 14.4 | 11.3 | 7.8 | 8.8 |
| Anpanman | 8.4 | 8.6 | 9.6 | 10.0 | 10.3 | 8.1 | 9.4 | 10.6 |
| Precure series | 11.9 | 12.5 | 10.7 | 10.6 | 9.8 | 6.5 | 6.6 | 7.5 |
| Dragon Ball | 3.3 | 2.7 | 4.4 | 4.8 | 6.4 | 5.8 | 11.6 | 10.3 |
| Aikatsu! | - | - | - | 1.5 | 13.0 | 8.6 | 2.6 | 2.6 |
| Ultraman | 3.1 | 2.8 | 1.8 | 2.0 | 3.2 | 2.6 | 2.7 | 3.1 |

Source: Shared Research based on company data

Visual and Music

20.0% FY03/17 consolidated sales; 8.2% of operating profit (before adjustments)

This segment comprises the visual wholesale section (63.8% of segment sales in FY03/17), the visual manufacturing section (12.8%), and the music section (23.4%).

Visual and Music earnings

| (JPYmn) | FY03/10 Act. | FY03/11 Act. | FY03/12 Act. | FY03/13 Act. | FY03/14 Act. | FY03/15 Act. | FY03/16 Act. | FY03/17 Act. |
|----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Total | 67,838 | 57,759 | 55,719 | 44,810 | 42,955 | 43,372 | 38,367 | 34,890 |
| YoY | 85.5% | -14.9% | -3.5% | -19.6% | -4.1% | 1.0% | -11.5% | -9.1% |
| Visual | 42,500 | 40,300 | 39,600 | 31,500 | 31,600 | 33,000 | 29,500 | 26,700 |
| YoY | 16.4% | -5.2% | -1.7% | -20.3% | 0.1% | 4.4% | -10.4% | -9.5% |
| % of total | 62.6% | 69.8% | 71.1% | 70.5% | 73.6% | 76.1% | 77.1% | 76.6% |
| Wholesale | 36,800 | 34,400 | 33,600 | 25,900 | 25,200 | 26,000 | 24,800 | 22,200 |
| YoY | 26.5% | -6.5% | -2.3% | -22.8% | -2.7% | 3.3% | -4.9% | -10.2% |
| % of total | 54.2% | 59.6% | 60.3% | 58.0% | 58.8% | 60.2% | 64.7% | 63.8% |
| Maker | 5,700 | 5,800 | 5,900 | 5,600 | 6,300 | 6,900 | 4,700 | 4,400 |
| YoY | -23.0% | 1.8% | 1.7% | -5.1% | 13.3% | 8.7% | -31.2% | -5.8% |
| % of total | 8.4% | 10.0% | 10.6% | 12.5% | 14.8% | 15.9% | 12.4% | 12.8% |
| Music | 25,200 | 17,400 | 16,100 | 13,200 | 11,300 | 10,300 | 8,700 | 8,100 |
| YoY | - | -31.0% | -7.5% | -18.0% | -14.3% | -8.5% | -15.3% | -7.7% |
| % of total | 37.1% | 30.1% | 28.9% | 29.5% | 26.4% | 23.9% | 22.9% | 23.4% |
| Segment profit | 253 | -656 | 448 | 309 | 307 | 202 | 466 | 418 |
| YoY | -81.0% | -359.3% | -168.3% | -31.0% | -0.6% | -34.2% | 130.7% | -10.3% |
| OPM | 0.4% | -1.1% | 0.8% | 0.7% | 0.7% | 0.5% | 1.2% | 1.2% |

Source: Shared Research based on company data
 Figures may differ from company materials due to differences in rounding methods.

Visual wholesale section

Happinet generates earnings from buying DVDs from content manufacturers and selling them to retailers. The company said that intermediary distributors like itself seldom need to hold substantial inventories compared with toymakers since orders from retailers are delivered in a week. As wholesalers do not shoulder much inventory risk, GPMS 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. 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 rights concerning existing videograms and then makes and sells the 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 (e.g., 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/distributing movie content to consumers). DVD 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—i.e., 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. In addition to profits related to box office revenue by stake, based on the conditions for investing in a production partnership, the company obtains videogram rights to the movie, and will therefore sell that videogram as DVD content to obtain sales and profits corresponding to sales volumes.

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 gains earnings from buying CDs from music content makers and selling them to retailers. As in its visual wholesale section, the company does not shoulder much inventory risk. Therefore, GPM is lower than in the toy wholesaling business.

The company buys goods from big music software manufacturers 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 manufacturers are able to force retailers to observe a certain retail price for music software. As product discounting does not occur, 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 accepting these returns.

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.

In this segment, the company established Happinet Live Entertainment LLC (Now Happinet Live Emotion LLC) in February 2016 jointly with Yokochi Planning Co. Ltd., which specializes in live event planning and operations. The company began event and live performance operations and sales of related merchandise in the idol music market. As a result, many manufacturers that had previously conducted such events themselves are now approaching Happinet, asking the company to handle both distribution and these events for them.

Videogames

25.7% of FY03/17 consolidated sales; 7.5% of operating profit (before adjustments)

Happinet generates profits by buying videogame consoles and game software from manufacturers and distributing these to shops. This segment has the lowest GPM 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 Interactive Entertainment Inc. (a subsidiary of Sony [TSE1: 6758]), and Microsoft Corp. It is the only wholesaler handling all consumer game consoles available in Japan. Following the consolidation of Toys Union—a distributor of Nintendo products—in FY03/14, Nintendo products accounted for approximately 70% of sales in FY03/17, with Sony Interactive Entertainment Inc. products next, at about 20%. The company distributes products to major online retailers and consumer electronics chains.

Shared Research estimates the company's share of Nintendo's game-related sales at around 25%, making it the second largest distributor of Nintendo products. The company is virtually the sole distributor of Sony Interactive Entertainment Inc videogames, and has an exclusive distribution agreement in Japan with Microsoft.

Videogame sales breakdown

| (JPYmn) | FY03/10 Act. | FY03/11 Act. | FY03/12 Act. | FY03/13 Act. | FY03/14 Act. | FY03/15 Act. | FY03/16 Act. | FY03/17 Act. |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Total | 44,372 | 46,447 | 42,704 | 36,839 | 63,609 | 56,448 | 50,009 | 44,793 |
| YoY | -12.1% | 4.7% | -8.1% | -13.7% | 72.7% | -11.3% | -11.4% | -10.4% |
| Nintendo (stationary) | 6,400 | 4,700 | 3,200 | 4,400 | 10,700 | 9,000 | 12,300 | 8,600 |
| YoY | 52.4% | -26.6% | -31.9% | 37.5% | 142.4% | -15.3% | 36.6% | -30.1% |
| % of total | 14.4% | 10.1% | 7.5% | 11.9% | 16.9% | 16.2% | 24.9% | 19.2% |
| Nintendo (portable) | 10,300 | 9,900 | 10,400 | 14,200 | 40,300 | 35,600 | 26,700 | 22,600 |
| YoY | 7.3% | -3.9% | 5.1% | 36.7% | 182.8% | -8.3% | -27.5% | -15.4% |
| % of total | 23.2% | 21.3% | 24.4% | 38.7% | 63.4% | 65.5% | 53.6% | 50.5% |
| Nintendo (other) | - | - | - | - | - | - | 1,200 | 2,300 |
| YoY | - | - | - | - | - | - | - | 91.7% |
| % of total | - | - | - | - | - | - | 2.4% | 5.1% |
| PlayStation (stationary) | 6,900 | 6,000 | 6,800 | 5,300 | 4,800 | 3,100 | 3,400 | 5,700 |
| YoY | 3.0% | -13.0% | 13.3% | -22.1% | -9.1% | -34.8% | 11.3% | 67.6% |
| % of total | 15.6% | 12.9% | 15.9% | 14.4% | 7.6% | 5.6% | 7.0% | 12.7% |
| PlayStation (portable) | 8,000 | 11,600 | 12,200 | 7,100 | 4,700 | 4,300 | 4,400 | 4,000 |
| YoY | -22.3% | 45.0% | 5.2% | -41.8% | -33.1% | -9.4% | 3.0% | -9.1% |
| % of total | 18.0% | 25.0% | 28.6% | 19.3% | 7.5% | 7.7% | 8.9% | 8.9% |
| Others | 12,500 | 14,000 | 9,800 | 5,600 | 2,900 | 2,800 | 1,500 | 1,000 |
| YoY | -35.6% | 12.0% | -30.0% | -42.2% | -48.8% | -1.9% | -2.5% | -33.3% |
| % of total | 28.2% | 30.1% | 22.9% | 15.4% | 4.6% | 5.0% | 5.6% | 2.2% |
| Segment profit | 1,035 | 1,156 | 936 | 678 | 79 | 254 | -43 | 384 |
| YoY | -15.2% | 11.7% | -19.0% | -27.6% | -88.3% | 221.5% | - | - |
| OPM | 2.3% | 2.5% | 2.2% | 1.8% | 0.1% | 0.4% | - | 0.9% |
| Losses on inventory write-offs | - | - | 100 | 100 | 800 | 300 | 500 | 100 |
| % of sales | - | - | 0.2% | 0.3% | 1.3% | 0.5% | 1.0% | 0.2% |

Source: Shared Research based on company data
 Figures may differ from company materials due to differences in rounding methods.

Happinet creates and sells original game software but profit impact is small (FY03/17).

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— we feel this may provide an opportunity for the company to increase volume handled and its market share.

Amusement

11.9% of FY03/17 consolidated sales; 25.0% of operating profit (before adjustments)

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

Amusement sales breakdown

| (JPYmn) | FY03/10 Act. | FY03/11 Act. | FY03/12 Act. | FY03/13 Act. | FY03/14 Act. | FY03/15 Act. | FY03/16 Act. | FY03/17 Act. |
|----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Total | 16,381 | 17,579 | 22,282 | 20,447 | 23,481 | 24,140 | 22,023 | 20,649 |
| YoY | -8.6% | 7.3% | 26.8% | -8.2% | 14.8% | 2.8% | -8.8% | -6.2% |
| Capsule toys | - | - | - | - | - | 10,100 | 10,300 | 9,400 |
| YoY | - | - | - | - | - | - | 2.0% | -8.7% |
| % of total | - | - | - | - | - | 42.1% | 47.1% | 45.8% |
| Card games | - | - | - | - | - | 10,500 | 9,300 | 9,100 |
| YoY | - | - | - | - | - | - | -11.4% | -2.2% |
| % of total | - | - | - | - | - | 43.6% | 42.3% | 44.4% |
| Other | - | - | - | - | - | 3,400 | 2,300 | 2,000 |
| YoY | - | - | - | - | - | - | -32.4% | -13.0% |
| % of total | - | - | - | - | - | 14.3% | 10.6% | 9.8% |
| Segment profit | 544 | 1,340 | 1,801 | 1,265 | 2,053 | 1,796 | 1,652 | 1,281 |
| YoY | - | 146.3% | 34.4% | -29.8% | 62.3% | -12.5% | -8.0% | -22.5% |
| OPM | 3.3% | 7.6% | 8.1% | 6.2% | 8.7% | 7.4% | 7.5% | 6.2% |

Source: Shared Research based on company data
 Figures may differ from company materials due to differences in rounding methods.

Toy vending machine section

The company installs vending machines at major retail and electronics stores and shopping malls, from which it sells capsule toys. It purchases vending machines from Bandai. This format is close to the retail industry, and therefore has the highest GPM of all the company's businesses.

Capsule toys retail at between JPY100-JPY500 (including tax). The vending machines work thus: a capsule toy comes out when the customer inserts coins and turns the crank in the middle of the machine. The toys 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 contents of the capsule.

At end May 2017, the company had about 180,000 machines nationwide.

Capsule-toy vending machines



Source: Shared Research based on 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 unable to turn a profit. When operating toy vending machines, staff members still need to visit machine sites to monitor sales, refill capsules, and collect the money. 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 anime characters, in major retail and electronics stores. As in the toy vending machine section, GPM is 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 (includes tax) 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 May 2017, the company operates card games including Dragon Ball, Kamen Rider, Yokai Watch, and Mobile Suit Gundam. The company in November 2016 began to install machines that combine the features of card game machines for Disney characters and machines for capsule toys. These two features operate in conjunction with each other in the same machine.

Card game machine



Card game/capsule machine



Source: Company data

Group companies

Happinet Group includes Happinet Corp and four consolidated subsidiaries. In particular, Happinet Marketing Corp and MAXGAMES Corporation have a big impact on consolidated performance, each accounting for more than 10% of group sales. In November 2015, the company entered into a capital and business alliance with Broccoli Co., Ltd., including the underwriting of new Broccoli shares issued through a third-party allocation, making Broccoli an equity-method affiliate as of December 2015.

Consolidated subsidiaries

Happinet Marketing Corp. (100% owned)

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

| (JPYmn) | FY03/10 | FY03/11 | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 |
|------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| | Act. | Act. | Act. | Act. | Act. | Act. | Act. | Act. |
| Sales | 31,350 | 31,531 | 32,236 | 31,527 | 32,395 | 38,383 | 34,217 | 32,715 |
| YoY | -3.3% | 0.6% | 2.2% | -2.2% | 2.8% | 18.5% | -10.9% | -4.4% |
| Recurring profit | 597 | 818 | 950 | 773 | 980 | 1,917 | 989 | 1,047 |
| YoY | 99.7% | 37.0% | 16.1% | -18.6% | 26.8% | 95.6% | -48.4% | 5.9% |
| Net income | 349 | 473 | 517 | 465 | 586 | 1,164 | 633 | 681 |
| YoY | 95.0% | 35.5% | 9.3% | -10.1% | 26.0% | 98.6% | -45.6% | 7.6% |

Source: Shared Research based on company data
Figures may differ from company materials due to differences in rounding methods.

MAXGAMES Corporation (100% owned)

Sells videogame consoles and videogames.

| (JPYmn) | FY03/10 | FY03/11 | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 |
|------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| | Act. | Act. | Act. | Act. | Act. | Act. | Act. | Act. |
| Sales | - | - | - | 35,357 | 31,868 | 43,622 | 41,546 | 34,670 |
| YoY | - | - | - | - | -9.9% | 36.9% | -4.8% | -16.6% |
| Recurring profit | - | - | - | 393 | -158 | 309 | 199 | 179 |
| YoY | - | - | - | - | - | - | -35.6% | -10.1% |
| Net income | - | - | - | 194 | -296 | 164 | 120 | 92 |
| YoY | - | - | - | - | - | - | -26.8% | -23.3% |

Source: Shared Research based on company data
Figures may differ from company materials due to differences in rounding methods.
On July 1, 2014, Happinet merged subsidiaries Toys Union and Mori Games, and changed the name of the new company to MAXGAMES Corporation.

Happinet Vending Service Corporation (100% owned)

Operates toy vending machines.

Happinet Logistics Service Corporation (100% owned)

Handles logistics business for group companies.

Equity-method affiliates

Broccoli Co., Ltd. (25.15% ownership)

Plans and produces content (anime, games, music, video, card games), and plans, produces and sells character goods.

| (JPYmn) | FY02/13 | FY02/14 | FY02/15 | FY02/16 | FY02/17 |
|------------------|---------|---------|---------|---------|---------|
| | Act. | Act. | Act. | Act. | Act. |
| Sales | 4,372 | 6,786 | 6,256 | 6,429 | 5,692 |
| YoY | - | 55.2% | -7.8% | 2.8% | -11.5% |
| Recurring profit | 833 | 2,150 | 1,484 | 989 | 728 |
| YoY | - | 158.1% | -31.0% | -33.4% | -26.4% |
| Net income | 877 | 1,908 | 904 | 622 | 479 |
| YoY | - | 117.6% | -52.6% | -31.2% | -23.0% |

Source: Shared Research based on company data
Figures may differ from company materials due to differences in rounding methods.

Strengths and weaknesses

Strengths

- ▶ **Business diversification leading to stable earnings.** Shared Research 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 videogames, movies, and music. Thus its profits may be described as stable.
- ▶ **Solid relationship with Bandai.** Shared Research thinks 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. Bandai Namco Holdings Inc., Bandai's parent company, is Happinet's largest shareholder with a 25% stake, and Happinet distributes about 90% of Bandai toys sold in Japan (company estimate). 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 videogames 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 Shared Research 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. Given this, Shared Research thinks that as a debutant, the company may struggle to land toy merchandising rights for popular characters.
- ▶ **Shrinking markets.** Shared Research thinks 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 pummeled 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

According to the Statistics Bureau (Population Census), the number of people in Japan aged 0-14 decreased from 17.4mn in 2006 to 15.8mn in 2016 (average annual decline of 1.0%). The market for eight types of toys grew from JPY312.9bn in 2006 to an estimated JPY351.4bn in 2016, maintaining an average annual increase of 1.2%.

Dividing market size by the number of people aged 0–14, spending per head increased from JPY17,950 in 2006 to JPY22,270 in 2016 (up by an average of 2.2 % per year).

According to the company, 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 profits.

Domestic toy market and population

| Domestic toy market and population | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Market of 8 toy items (JPYbn) | 312.9 | 319.1 | 320.5 | 319.0 | 326.2 | 325.1 | 316.1 | 315.9 | 342.1 | 346.7 | 351.4 |
| Population at ages of 0-14 ('000) | 17,434 | 17,292 | 17,176 | 17,010 | 16,839 | 16,705 | 16,548 | 16,390 | 16,233 | 15,945 | 15,780 |
| Average purchase price of 8 toy items (JPY) | 17,950 | 18,450 | 18,660 | 18,750 | 19,370 | 19,460 | 19,100 | 19,270 | 21,070 | 21,740 | 22,270 |

Note: 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. Videogames are not included.

Source: Shared Research based on data from Yano Research Institute Ltd., National Institute of Population and Social Security Research (IPSS), and the Statistics Bureau's Population Census

The IPSS predicts that the population of children in Japan (0-14 years old) will have decreased to 14.1mn by 2025, due to declining birth rates and the shift toward late marriage. With a rate of decline averaging 1.3% per year since 2016, this would mean potential purchasers of toys were decreasing faster than the rate of decline between 2006 and 2016, when the number fell by an average of 1.0% annually.

Shared Research thinks the toys market will shrink as Japan's aging population leads to a decreasing target demographic for toys. However, Shared Research also thinks 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

The visual media market (cell and rental markets excluding paid video distribution) continues to contract, shrinking at an average annual rate of 5.0% between 2006 and 2016.

Video software market

| Video software market (JPYbn) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|-------------------------------|-------|-------|-------|--------|--------|-------|-------|-------|-------|-------|-------|
| Total | 669.5 | 664.2 | 630.1 | 574.1 | 530.7 | 502.1 | 480.2 | 461.5 | 439.0 | 417.5 | 400.2 |
| YoY | -0.1% | -0.8% | -5.1% | -8.9% | -7.6% | -5.4% | -4.4% | -3.9% | -4.9% | -4.9% | -4.1% |
| Software for sale | 326.4 | 303.8 | 283.2 | 267.4 | 263.5 | 247.9 | 241.3 | 243.1 | 228.7 | 223.4 | 217.1 |
| YoY | 4.5% | -6.9% | -6.8% | -5.6% | -1.5% | -5.9% | -2.7% | 0.7% | -5.9% | -2.3% | -2.8% |
| Software for rental | 343.1 | 360.4 | 346.9 | 306.7 | 267.2 | 254.2 | 238.9 | 218.4 | 210.3 | 194.1 | 183.1 |
| YoY | -4.1% | 5.0% | -3.7% | -11.6% | -12.9% | -4.9% | -6.0% | -8.6% | -3.7% | -7.7% | -5.7% |

Source: Shared Research based on Japan Video Association

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

We believe that the market has been shrinking not because the average customer is reducing purchases or unit prices are falling but because of a drop in the number of software purchasers. According to a report released by the Japan Video Software Association, purchases of video software have been falling, although there has not been a significant decline in the average number of discs purchased by each customer or the average amount spent by each customer.

Video software purchasing ratio, average number of discs purchased, average spending

| Video software purchasing survey | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|----------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Purchase rate (%) | 31.4 | 21.2 | 21.6 | 19.3 | 16.3 | 18.2 | 16.7 | 18.2 |
| Average total purchases (titles) | 4.6 | 5.5 | 3.9 | 3.8 | 5.0 | 4.2 | 4.2 | 3.9 |
| Average total spend (JPY) | 17,923 | 23,370 | 15,706 | 14,720 | 18,004 | 17,745 | 19,370 | 18,827 |

Source: Shared Research based on Japan Video Association

Note: Purchase Rate: the percentage of total respondents that had purchased video software. The total number of respondents differs per year.

The spread of pay-video distribution hurts sales of visual media. According to the Digital Content Association of Japan, the domestic market of pay-video (video on demand) distribution expanded from JPY76.2bn in 2010 to JPY163.6bn in 2016.

Video on Demand (VOD) market

| Video on Demand (VOD) market | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|------------------------------|------|------|-------|-------|-------|-------|-------|
| VOD market (JPYbn) | 76.2 | 82.6 | 101.6 | 123.0 | 125.5 | 141.0 | 163.6 |
| YoY | - | 8.4% | 23.0% | 21.1% | 2.0% | 12.4% | 16.0% |

Source: Shared Research based on Digital Content Association of Japan

Shared Research 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 of people aged 15 to 64 will decrease by 0.6% a year from 76.0mn in 2016 to 71.7mn in 2025.

Music content

The paid music distribution market is on a downward trend after peaking in 2007 in both volume and value terms.

Record production and paid distribution music

| Record production and paid music distribution | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|-------|--------|--------|--------|-------|--------|--------|--------|-------|-------|--------|
| Total (JPYbn) | 405.1 | 408.8 | 386.6 | 340.6 | 311.0 | 283.7 | 282.0 | 240.2 | 230.1 | 229.7 | 230.6 |
| YoY | 0.9% | 0.9% | -5.4% | -11.9% | -8.7% | -8.8% | -0.6% | -14.8% | -4.2% | -0.2% | 0.4% |
| Music software sales value (excl. music video; JPYbn) | 351.6 | 333.3 | 296.1 | 249.6 | 225.0 | 211.7 | 227.7 | 198.5 | 186.4 | 182.6 | 177.7 |
| YoY | -4.2% | -5.2% | -11.2% | -15.7% | -9.9% | -5.9% | 7.6% | -12.8% | -6.1% | -2.0% | -2.7% |
| Paid distribution of music | 53.5 | 75.5 | 90.5 | 91.0 | 86.0 | 72.0 | 54.3 | 41.7 | 43.7 | 47.1 | 52.9 |
| YoY | 56.0% | 41.2% | 20.0% | 0.5% | -5.5% | -16.3% | -24.5% | -23.2% | 4.8% | 7.8% | 12.3% |
| Total (mn) | 666 | 732 | 727 | 682 | 651 | 567 | 490 | 407 | 369 | 348 | 320 |
| YoY | 15.3% | 9.9% | -0.7% | -6.2% | -4.5% | -12.9% | -13.6% | -16.9% | -9.3% | -5.7% | -8.0% |
| Music software sales volume (excl. music video; mn) | 298 | 267 | 248 | 214 | 210 | 200 | 218 | 191 | 172 | 170 | 161 |
| YoY | -3.9% | -10.4% | -7.1% | -13.7% | -1.9% | -4.8% | 9.0% | -12.4% | -9.9% | -1.2% | -5.3% |
| Paid distribution of music (mn) | 368 | 465 | 479 | 468 | 441 | 367 | 272 | 216 | 197 | 178 | 159 |
| YoY | 37.4% | 26.3% | 3.1% | -2.3% | -5.7% | -16.8% | -26.0% | -20.5% | -8.8% | -9.6% | -10.7% |

Source: Shared Research based on "The Recording Industry of Japan" by the Recording Industry Association of Japan

According to the Recording Industry Association of Japan's survey of music media users, the percentage of the population who pay for music content is declining, particularly among respondents aged 20 to 49. Reasons increasingly include satisfaction with current holdings, tight budgets, and satisfaction with video distribution websites and apps.

Shared Research expects that—as with visual media—the music content market will continue to decline given free distribution sites and a falling number of buyers.

Japan's game market

Nintendo launched the Family Computer System (later released as the Nintendo Entertainment System (NES) in America) in 1983, and the overall market for home videogame 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.

Shipments of Domestic Home Videogame Consoles

| (JPYbn) | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|----------|-------|-------|-------|--------|--------|--------|-------|-------|--------|--------|--------|
| Value | 398.5 | 553.3 | 591.9 | 534.2 | 454.1 | 425.8 | 402.8 | 395.8 | 409.5 | 373.4 | 330.2 |
| YoY | 15.6% | 38.8% | 7.0% | -9.7% | -15.0% | -6.2% | -5.4% | -1.7% | 3.5% | -8.8% | -11.6% |
| Software | 234.3 | 311.3 | 288.6 | 301.3 | 252.5 | 259.1 | 237.9 | 220.2 | 253.7 | 235.6 | 194.9 |
| YoY | -0.6% | 32.9% | -7.3% | 4.4% | -16.2% | 2.6% | -8.2% | -7.4% | 15.2% | -7.1% | -17.3% |
| Hardware | 164.2 | 242.0 | 303.3 | 232.9 | 201.6 | 166.7 | 164.9 | 175.6 | 155.8 | 137.8 | 135.3 |
| YoY | 50.8% | 47.4% | 25.3% | -23.2% | -13.4% | -17.3% | -1.1% | 6.5% | -11.3% | -11.6% | -1.8% |

Source: Shared Research based on CESA data

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.

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.

| (JPYbn) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---------|-------|------|-------|--------|------|-------|--------|------|-------|-------|--------|
| Value | 30.5 | 30.5 | 28.5 | 24.9 | 25.9 | 30.1 | 27.0 | 27.8 | 31.9 | 31.1 | 27.7 |
| YoY | -9.0% | 0.0% | -6.6% | -12.6% | 4.2% | 16.0% | -10.3% | 3.0% | 14.7% | -2.5% | -10.9% |

Source: Shared Research based on Japan Toy Association

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 diablo block toys being the most famous. For FY05/16 Kawada reported annual sales of JPY26bn (per Kawada's website), compared with JPY23.6bn in FY05/15. Happinet sells much more volume than Kawada and their products are different, so they are not competitors.

Strategy

The company's strategy is two-pronged. First, increasing sales by grabbing market share even though the overall pie will continue to get smaller as society ages; and second, selling more products developed in-house that command wider margins.

Market share expansion

Shared Research predicts that the main markets for the products dealt with by the company—toys, videogames, visual media, and music—will contract given Japan's ageing society and the spread of Internet transactions. The spread of online videogames such as social games, and the spread of download sales for visual and music software, as well as sites which offer free visuals have in fact been impacting the contraction of the market for software packages.

The contracting market for the company's products is not something that is welcome for its short-term results. However, as reorganization has been underway for intermediate distribution since the late 1990s, the company has continued to expand its sales capacity through acquisitions (see "Historical performance"). Shared Research believes that as reorganization proceeds among intermediate distributors specializing in visual and musical software and videogames, there will be significant room for the company to expand its transactions.

Moreover, the company has indicated that in its seventh medium-term plan which takes effect from FY03/16, it will spread its areas of business to plastic models, miscellaneous goods, and toys sold with candy, which have been limited in transaction volume in the past.

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 2015. Shared Research thinks 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 December 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. Shared Research thinks that handling software makers' sales promotion and distribution functions is a potential money spinner.

Videogames: also scope for expansion

The company consolidated Toys Union (currently Maxgames Corporation) as a subsidiary in July 2013. According to the company, this acquisition means its share of the Nintendo-related market was 25%, making it the second largest distributor of Nintendo-related products.

Nintendo Sales is the largest distributor of Nintendo products. In January 2016, Nintendo acquired 70.0% of JESNET (FY07/15 sales of JPY57.1bn), making it a consolidated subsidiary. Nintendo also acquired the videogame wholesale business of AJIOKA Co Ltd (FY06/16 sales of JPY38.7bn). JESNET was renamed Nintendo Sales in April 2017.

Nintendo Sales and Happinet have a combined domestic market share of almost 100% for Nintendo products. According to Happinet, the company plans to form a partnership with Nintendo Sales.

Originally developed products: increased sales

The company aims to expand sales of original products developed in-house and exclusive products which offer high rates of profitability. Based on its relevant policies, the company developed and sold during its sixth midterm period from FY03/13 character toys related to animation shows for boys but had been unable to achieve the results that it had hoped for.

In its seventh medium-term plan starting in FY03/16, the company plans to make fresh considerations from the ground up for products which it develops and hopes to improve profitability by focusing on markets where it has an advantage. Specifically, this includes increases in the variety of formats of its toys so they can be used for various characters; products related to television

shows which have been on the air for long periods of time; the development of game software for school-aged girls; and visuals and music, chiefly animations which it has managed.

Historical performance

Historical financial statements

Full-year FY03/17 results

- ▷ Sales: JPY174.1bn (-7.1% YoY)
- ▷ Operating profit: JPY3.7bn (+7.2%)
- ▷ Recurring profit: JPY3.5bn (-0.5%)
- ▷ Net income*: JPY2.0bn (-13.5%)

*Net income refers to net income attributable to parent company shareholders.

The industries that the company deals in are going through a difficult time, such as the declining birth rate and diversifying consumer needs in the toy industry, and the increasing prominence of smartphone-based games and video and music download software overshadowing packaged items and hard copies in the video, music, and videogame industries.

Sales were down, but operating profit finished higher YoY as profits showed signs of improvement in response to the company's effort to reduce losses on inventory disposal. Promotion of high-margin products distributed exclusively by Happinet also contributed to higher operating profit. Recurring profit fell below operating profit after Happinet booked a JPY283mn equity-method loss as part of non-operating expenses. The investment loss arising from equity-method accounting was due to the impact of Broccoli Co., Ltd. (25.15% stake), which became an equity-method affiliate through the underwriting of a third-party share allocation in December 2015. Initiatives are proceeding in conjunction with equity-method affiliate Broccoli Co., Ltd., including the establishment of new label "b-sound" and the implementation of campaigns aimed at convenience stores, to create a synergistic effect.

Toys

In the Toys segment, sales fell 4.1% YoY to JPY73.7bn and segment profit increased 6.9% to JPY3.0bn.

Sales of Bandai's character merchandise such as *Kamen Rider Ex-Aid* were robust, but not enough to boost the market and sales were down YoY as a result.

Sales of Bandai products were JPY37.6bn (-10.4% YoY), or 51.0% of overall sales (54.6% in FY03/16), while those of Tomy products reached JPY7.0bn (+41.6% YoY), or 9.6% (6.5% in FY03/16). Sales of original items were JPY1.7bn (+10.6% YoY), or 2.4% (2.1% in FY03/16). Sales of other manufacturers' products were JPY27.2bn (-3.6% YoY), or 37.0% (36.8% in FY03/16).

At Bandai Namco Holdings, sales in the Toy and Hobby segment in FY03/17 were JPY193.2bn (-6.4% YoY). According to documents from Bandai Namco Holdings, sales fell YoY because of a decline in sales of Yokai Watch products, which drove the domestic Toy and Hobby business in FY03/16. However, sales of standard intellectual property items, such as Kamen Rider and PreCure products, remained robust. Domestic sales of Yokai Watch merchandise at Bandai Namco Holdings were JPY9.3bn (JPY30.8bn in FY03/16).

In contrast, at Tomy, FY03/17 sales in the Japan segment were JPY131.8bn (+21.5% YoY). Sales of toys related to Beyblade Burst and Duel Masters were robust. *Umarete Woomo* ("Hatchimals" in English), a toy egg that hatches a magical creature, was also popular during the year-end shopping season

A reduction in losses from the disposal of inventory contributed to higher profits. Losses on inventory disposal declined to JPY700mn from JPY1.8bn in FY03/16. While in FY03/16 the company failed to anticipate the slow demand for Yokai Watch products and booked large disposal losses, in FY03/17, it succeeded in booking higher profits owing to accurate demand forecasts for Kamen Rider and Super Sentai, and efforts to control inventory levels.

Visual and Music

In the Visual and Music segment, sales fell 9.1% YoY to JPY34.9bn and segment profit 10.3% to JPY418mn.

The wholesale section had sales of JPY22.2bn (-10.2% YoY), the visual manufacturing section JPY4.4bn (-5.8% YoY), and the music section JPY8.1bn (-7.7% YoY).

While the period saw some blockbuster films like Shin Godzilla, sales at the company declined YoY amid ongoing weakness in the overall market for packaged products. Segment profit also fell due to Q1 losses from certain proprietary products.

Kiseki: Ano Hi no Sobito, an internally managed movie released in theaters, generated revenue of JPY1.5bn. The company expects the movie to contribute to earnings in FY03/18 thanks its box-office distribution and the DVD release slated for July 2017.

Videogames

In the Videogames segment, sales fell 10.4% YoY to JPY44.8bn, with segment profit of JPY384mn (segment loss of JPY43mn in FY03/16).

By manufacturer, Nintendo products generated sales of JPY33.8bn (-16.5% YoY), Sony Interactive Entertainment products JPY9.9bn (+24.8% YoY), and products from other manufacturers JPY1.0bn (-33.6% YoY).

Sales of Nintendo Switch and PlayStation 4 units and related merchandise were robust, but increasing prominence of smartphone games and downloaded software resulted in lower sales. Thanks to strong sales of software distributed exclusively by Happinet and shrinking losses on inventory disposal, the segment achieved a profit. Losses on inventory disposal declined to JPY100mn from JPY500mn in FY03/16.

Although Nintendo Switch did contribute to sales, the contribution took place only in Q4. Sales of Nintendo consoles were JPY5.2bn for FY03/17 (-17.6% YoY). Nintendo Switch's contribution to profits was limited during FY03/17 because the profitability of hardware tends to be lower than that of software. According to Happinet, however, the Nintendo Switch console remains highly popular and is difficult to get ahold of. The company expects to benefit from sales of hardware and profits from software in FY03/18.

Amusement

In the Amusement segment, sales declined 6.2% YoY to JPY20.6bn, while segment profit declined 22.5% to JPY1.3bn.

The company conducted event sales at locations with strong customer draw, but the lack of hit products led to lower sales. Sales of toys in capsules were JPY9.4bn (-8.6% YoY) while those of card games came to be JPY9.1bn (-1.7% YoY).

Profit fell because sales declined even as the company spent JPY550mn for new chassis for children's card game machines.

Q3 FY03/17 results

- ▷ Sales: JPY133.9bn (-10.7% YoY)
- ▷ Operating profit: JPY3.3bn (+1.8%)
- ▷ Recurring profit: JPY3.1bn (-5.0%)
- ▷ Net income*: JPY1.8bn (-15.1%)

*Net income refers to net income attributable to parent company shareholders.

Recurring profit fell below operating profit after Happinet booked a JPY237mn equity-method loss (a non-operating expense). The equity-method loss was due to the impact of Broccoli Co., Ltd. (25.15% stake), which became an equity-method affiliate after Happinet underwrote Broccoli shares through a private placement in December 2015.

The industries that the company deals in are going through a difficult time, such as the declining birth rate and diversifying consumer needs in the toy industry, and the increasing prominence of smartphone-based games and video and music download software overshadowing packaged items and hard copies in the video, music, and videogame industries.

Sales were down, but profits showed some improvement as careful inventory management helped to reduce losses on disposal of inventory, and sales of high-margin exclusive distribution and proprietary products were robust, so operating profit was higher YoY. Investment loss at an equity-method affiliate caused a decline in recurring profit and net income attributable to parent company shareholders. Efforts are proceeding in conjunction with equity-method affiliate Broccoli Co., Ltd., including the establishment of new label “b-sound” and the implementation of campaigns aimed at convenience stores, to create a synergistic effect.

Toys

In the Toys segment, sales fell 4.8% YoY to JPY59.4bn and segment profit increased 9.6% to JPY2.8bn.

Centered chiefly on characters from *Bandai's Kamen Rider Ex-Aid*, *Doubutsu Sentai Zyuohger*, and *Maho Girls PreCure!*, sales were robust during the prime year-end shopping rush, but were not enough to cover for the disappointing results through Q2, so cumulative Q3 sales were down YoY.

At Bandai, sales in the Toy and Hobby segment in cumulative Q3 FY03/17 were JPY146.0bn (-9.9% YoY). According to documents from Bandai Namco Holdings, Inc., owing to a decrease in sales of Yokai Watch products, which drove sales in 1H FY03/16, the company booked lower sales YoY, but centered chiefly on characters from *Bandai's Kamen Rider Ex-Aid*, *Doubutsu Sentai Zyuohger*, and *Maho Girls PreCure!*, sales were robust during the prime year-end shopping rush.

In contrast, at Tomy, cumulative Q3 FY03/17 sales in the Japan segment were JPY104.6bn (+24.2% YoY). Sales of toys related to Beyblade Burst and Duel Masters were robust.

A significant reduction in losses from the disposal of inventory in cumulative Q3 FY03/17 contributed to higher profits. While in Q3 FY03/16 the company failed to anticipate the slow demand for Yokai Watch products and booked large disposal losses, in cumulative Q3 FY03/17, it succeeded in booking higher profits owing to accurate demand forecast for Kamen Rider and Super Sentai, and efforts to control inventory levels.

Visual and Music

In the Visual and Music segment, sales fell 10.0% YoY to JPY25.8bn and segment profit rose 14.7% to JPY358mn.

The drop in sales reflected ongoing weakness in the overall market for packaged products. The segment profit growth stemmed from robust sales of high-margin proprietary packaged products and sales from the distribution of original products.

In the content business, sales to online video distribution service providers grew from Q2. These service providers stream movies that were previously managed internally (mainly Japanese films) by Happinet as well as foreign films for which the company has distribution rights. Each online video distribution service provider aggressively purchases previously made videos in order to expand titles that have exclusive rights. The company stated that most of the past movie products for which it sold broadcasting rights have already depreciated, and those products have high profit margins.

Further, *Kiseki: Ano hi no sobito*, an internally managed movie that was released in theaters, has been a hit, and the company expects this movie to contribute to earnings in FY03/18 following box-office distribution and its release on DVD.

In the distribution business, the company is planning to release hit products on DVD, such as *Shin Godzilla (Godzilla Resurgence)* in Q4 FY03/17 and the animated movie, *Your Name* in FY03/18.

Videogames

In the Videogames segment, sales fell 20.5% YoY to JPY33.5bn, with segment profit of JPY249mn (segment profit of JPY23mn in Q3 FY03/16).

Sales of Nintendo 3DS game *Pokemon Sun and Moon* and PlayStation 4 units and related merchandise were robust, but the overall market continued to shrink in the face of the increasing prominence of smartphone games and downloaded software, resulting in lower sales. Thanks to strong sales of software distributed exclusively by Happinet and shrinking losses on disposal of inventory, the segment achieved a profit.

Nintendo was planning to launch a new videogame console, Nintendo Switch, in March 2017. The impact on earnings in FY03/17 is expected to be limited, with the contribution to sales and profits (including from sales of game software) to emerge from FY03/18.

Amusement

In the Amusement segment, sales declined 9.5% YoY to JPY15.2bn, while segment profit declined 32.1% to JPY889mn.

The company promoted measures to improve event sales and the sales environment of locations with strong customer draw. Vending machines for toys in capsules and children's card game machines saw some hit products, but these were unable to cover for the decline seen in 1H, so cumulative Q3 sales still ended lower YoY. Profits were also down YoY due to spending on new chassis for children's card games.

Other

Revision of FY03/17 year-end dividend

A JPY5 per share commemorative dividend has been added to the JPY15 ordinary year-end dividend, for a total of JPY20. This is on top of a JPY15 per share dividend paid at the end of 1H, for a total of JPY35 for FY03/17 (JPY30 in ordinary dividends and JPY5 commemorative dividend).

1H FY03/17 results

- ▷ Sales: JPY72.4bn (-13.7% YoY)
- ▷ Operating profit: JPY844mn (-54.1%)
- ▷ Recurring profit: JPY741mn (-23.1%)
- ▷ Net loss*: JPY329mn (-72.2%)

*Net income/loss refers to net income/loss attributable to parent company shareholders

Recurring profit fell below operating profit after Happinet booked a JPY142mn equity method loss (a non-operating expense). The equity method loss was due to the impact of Broccoli Co., Ltd. (25.15% stake), which became an equity affiliate after Happinet underwrote Broccoli shares through a private placement in December 2015.

The industries that the company deals in are going through a difficult time, such as the declining birth rate and diversifying consumer needs in the toy industry, and the increasing prominence of smartphone-based games and video and music download software overshadowing packaged items and hard copies in the video, music, and videogame industries.

Group sales and profits faced headwinds, as the distribution business did not have hit products to drive the market, despite improved earnings in the manufacturing business.

Toys

In the Toys segment, sales fell 9.1% YoY to JPY31.6bn and segment profit declined 38.9% to JPY768mn.

Sales of Bandai's products decreased, and sales of Tomy's products increased.

Sales of Bandai's products in this segment were JPY15.4bn (-18.9% YoY). The ratio of Bandai's product sales to the total segment sales decreased by 6.0pp YoY to 48.9%. At Bandai, sales in the Toy and Hobby segment in 1H FY03/17 declined 12.3% YoY. Sales for some cartoon character-based products, such as Bandai's Maho Girls PreCure and Kamen Rider Ghost, were steady. According to documents from Bandai Namco Holdings, Inc., however, sales of Yokai Watch products, which drove its sales in 1H FY03/16, were JPY6.0bn (JPY23.3bn in 1H FY03/16).

In contrast, sales of Tomy products in this segment were JPY3.0bn (+61.2% YoY). Sales of Tomy products accounted for 9.7% of the total segment sales, a 4.3pp increase from 1H FY03/16. At Tomy, sales in 1H FY03/17 in its Japan segment increased 21.6% YoY.

Based on the medium-term business plan, the company undertook measures to increase exclusively distributed products, improve sales floor proposals, and expand sales of peripheral toy products. However, these measures had only a small impact on the company's 1H results.

Although clearance sale losses narrowed to JPY340mn (compared to JPY520 in 1H FY03/16), profits fell due to a drop in gross profit resulting from decreased sales.

Visual and Music

In the Visual and Music segment, sales fell 4.8% YoY to JPY16.5bn and segment profit rose 1.6% to JPY146mn.

The drop in sales reflected ongoing weakness in the overall market for packaged products, as more users switch to downloading off the internet. Although the company booked investment losses on some proprietary products in Q1, segment profit growth in Q2 FY03/17 stemmed from robust sales of high-margin proprietary work, especially anime products.

Videogames

In the Videogames segment, sales fell 29.2% YoY to JPY14.3bn, with segment loss of JPY36mn (segment loss of JPY50mn in 1H FY03/16).

The increasing prominence of smartphone games and downloaded software continued to negatively impact the market for packaged products, resulting in lower sales.

Sales for Nintendo-related products, which account for more than 70% of the total sales in this segment, were JPY10.1bn (-35.2% YoY). The ratio of sales for Nintendo-related products to total segment sales decreased by 6.5pp to 71.2%. Nintendo is planning to launch a new videogame console, Nintendo Switch, in March 2017, and as such, sales of present Wii U software were lackluster.

Clearance sale losses narrowed to JPY20mn (compared to JPY140 in 1H FY03/16), resulting in decreased losses.

Amusement

In the Amusement segment, sales declined 14.0% YoY to JPY10.0bn, while segment profit declined 44.4% to JPY642mn.

The company promoted measures to improve event sales and the sales environment of locations with strong customer draw, but vending machines for toys in capsules and children's card game machines did not have any hit products compared to in 1H FY03/16, resulting in lower sales and profits. According to documents from Bandai Namco Holdings, Inc., the number of digital cards sold was 104mn units (120mn units during 1H FY03/16).

Profits were down due to an investment associated with new chassis for card game machines in addition to lower sales.

Others: Share buyback

Between August 25, 2016 and September 1, 2016, in Q2, Happinet repurchased a total of 1,000,000 shares (4.41% of total outstanding shares, which excludes treasury shares) worth JPY1.1bn.

Q1 FY03/17 results

- ▷ Sales: JPY32.8bn (-12.2% YoY)
- ▷ Operating profit: JPY152mn (-80.5% YoY)
- ▷ Recurring profit: JPY95mn (-88.0% YoY)
- ▷ Net loss: JPY26mn (net income of JPY471mn in Q1 FY03/16)

Recurring profit fell below operating profit after Happinet booked a JPY93mn equity-method loss as part of non-operating expenses. The investment loss arising from equity-method accounting was due to the impact of Broccoli Co., Ltd. (25.15% stake), which became an equity-method affiliate through the underwriting of a third-party share allocation in December 2015.

The industries that the company deals in are going through a difficult time, such as the declining birth rate and diversifying consumer needs in the toy industry, and the increasing prominence of smartphone-based games and video and music download software over packaged items and hard copies in the video, music, and videogame industries.

Group sales and profits were sluggish, as the distribution business did not have products to drive the market, and in the content business there were no hits among the company's original titles, which have high margins.

Toys

In the Toys segment, sales fell 6.0% YoY to JPY14.3bn and segment profit declined 46.6% to JPY284mn.

Happinet stated that demand in the domestic toy market was the same level as Q1 FY03/16. In terms of transactions with major toy makers, sales of Bandai's products were the same level as Q1 FY03/16, but sales of Tomy's products increased. At Bandai, sales in the toy and hobby segment declined 15.1% YoY; Bandai comprises more than half of sales in Happinet's Toys segment. In contrast, at Tomy (less than 10% of sales in the Toys segment), sales in its Japan segment increased 26.5% YoY.

At Bandai, the company's mainstay of the segment, sales of toys related to "Magician Pretty Cure" and "Kamen Rider Ghost" were strong. According to documents from Bandai Namco Holdings, Inc., sales of Yokai Watch products, which drove its sales in Q1 FY03/16, contributed JPY2.2bn to Bandai Namco Holdings' sales (JPY9.7bn in Q1 FY03/16).

Due to the above results, sales in the Toys segment declined YoY, pushing down profits.

Based on the medium-term plan, the company undertook measures to expand exclusively distributed products, improve sales floor proposals, and expand sales of peripheral toy products. However, these measures had only a small impact on the company's Q1 results.

Although Bandai's Maho Girls Precure and Kamen Rider Ghost toys were robust, the segment booked lower sales and profits.

Visual and Music

In the Visual and Music segment, sales fell 5.4% YoY to JPY8.1bn and segment loss was JPY54mn (segment profit of JPY23mn in Q1 FY03/16).

The drop in sales reflected ongoing weakness in the overall market for packaged products, as more and more users switch to downloading off the internet. The segment loss stemmed from booking investment losses on some proprietary products. Profits in the distribution business increased YoY due to efforts to cut SG&A expenses. Profits in the content business declined as the company booked investment losses from its proprietary products.

In the content business, in line with the medium-term plan, the company is concentrating investments in markets in which it is competitive and will focus on internally managed products, mainly animations. The company will invest in managing "Regalia," which is set to restart airing in September 2016, and "Flip Flappers," which will premiere in October 2016, and other such content handled by production companies or directors with a track record of producing hits.

Videogames

In the Videogames segment, sales fell 27.3% YoY to JPY5.8bn, with segment loss of JPY129mn (segment loss of JPY58mn in Q1 FY03/16).

The increasing prominence of smartphone games and download software continued to negatively impact the market for packaged products, and without hit products to stimulate the market, sales and profits were down.

Nintendo is planning to launch a new videogame console, Nintendo NX, in March 2017, and as such, sales of present Wii U software were lackluster. New Nintendo 3DS game software are slated for release: "Yokai Watch 3 Sushi/Tempura" in July 2016, and "Pokémon Sun and Moon" at the end of 2016. The company expects these products to contribute to its results from Q2.

Amusement

In the Amusement segment, sales declined 17.8% YoY to JPY4.5bn, while segment profit declined 39.8% to JPY345mn.

The company promoted measures to revitalize existing locations and event sales in new locations. Still, due to a lack of children's card game and toy vending machine products to boost sales in comparison to the previous year, both sales and profits were down. According to documents from Bandai Namco Holdings, Inc., the number of digital cards sold was 46mn units (58mn units during Q1 FY03/16). As a result, both sales and profits in this segment were down.

FY03/16 results

- ▷ Sales: JPY187.3bn (-13.8% YoY)
- ▷ Operating profit: JPY3.5bn (-31.8% YoY)
- ▷ Recurring profit: JPY3.5bn (-31.8% YoY)
- ▷ Net income attributable to parent company shareholders: JPY2.4bn (-41.7% YoY)

The industries that the company deals in are going through a difficult time, such as the declining birth rate and diversifying consumer needs in the toy industry, and the increasing prominence of smartphone-based games and video and music download software over packaged items and hard copies in the video, music, and videogame industries.

Although sales and profits at the company's manufacturing businesses saw improvement by concentrating investment on predominant markets, sales and profits at its distribution business were both down due to a lack of hit products during the prime year-end shopping rush.

Toys segment

In the Toys segment, sales fell 17.6% YoY to JPY76.9bn and segment profit declined 33.4% to JPY2.8bn.

Toys segment sales fell due to a lack of hit products during the year-end shopping rush. According to documents from Bandai Namco Holdings, Inc., sales shrank YoY for character products such as Kamen Rider, Super Sentai, and Aikatsu! products. Sales of Yokai Watch products (Bandai Namco Holdings, Inc.), the mainstay of sales the preceding year, contributed JPY30.8bn to sales (JPY55.2bn the preceding year).

A drop in profits was the result of a reduction in gross profit from lower sales, combined with a loss on disposal of inventory of about JPY1.8bn from the write-off of excess inventory that exceeded the previous year (about JPY1.6bn).

Visual and Music segment

In the Visual and Music segment, sales fell 11.5% YoY to JPY38.4bn and segment profit rose 130.7% to JPY466mn.

The drop in sales reflected ongoing weakness in the overall market for packaged products, as more and more users switch to downloading off the internet.

However, lower fixed costs at its distribution division, the contribution to earnings from exclusively distributed animated DVD box set products, and an improvement in profitability at its manufacturing businesses attributable to a decline in investment loss resulted in a significant boost in segment profit.

Videogames segment

In the Videogames segment, sales fell 11.4% YoY to JPY50.0bn, with segment loss of JPY43mn (segment profit of JPY254mn in the previous year).

The increasing prominence of smartphone games and download software continued to negatively impact the market for packaged products, with a lack of hit products leading to a decrease in sales.

The segment booked a loss due to disposal of excess inventory of about JPY500mn (about JPY300mn in the previous year) resulting from a failure to meet sales forecasts for exclusively distributed products and sluggish performance of the company's original products.

Amusement segment

In the Amusement segment, sales declined 8.8% YoY to JPY22.0bn, while segment profit declined 8.0% to JPY1.7bn.

Due to a booking of inventory write-downs and a lack of products that boosted sales in comparison to the previous year, both sales and profits from children's card game machines and toy vending machines were down.

According to materials from Bandai Namco Holdings, Inc., only 233mn digital cards were sold (269mn in the previous year), marking a YoY drop.

FY03/15 results

- ▷ Sales: JPY217.2bn (+5.0% YoY)
- ▷ Operating profit: JPY5.1bn (+30.0%)
- ▷ Recurring profit: JPY5.1bn (+30.8%)
- ▷ Net income: JPY4.0bn (+64.2%)

Toys

Sales were JPY93.3bn (+21.4% YoY) and segment profit was JPY4.3bn (+57.9%).

Sales of Bandai Co., Ltd.'s character merchandise such as Yokai Watch were strong, contributing to higher sales and profits in the segment.

According to the retailer Bandai, its sales in FY03/15 for products related to Youkai Watch stood at approximately JPY55.2bn (against JPY1.4bn in the preceding period). The company said it distributes around half the products which are related to "Youkai Watch".

Sales of the Youkai Watch game software began in July 2013. Youkai Watch had been broadcasted as an animated television show since January 2014. The success of the company's cross media strategy for animations, games, and manga comics led to hits for its "Youkai Watch" game software, related toys, and capsule vending machine toys.

Disposal costs stood at JPY1.6bn (JPY1bn YoY).

Visual and Music

Sales were JPY43.4bn (+1.0% YoY) and segment profit was JPY202mn (+34.3%).

Despite ongoing weakness in the packaged product market due to the impact of online distribution, sales were strong as a result of hit products such as "Frozen." However, without any of its own high-margin hit products, the company's profits remained low.

"The Floating Castle", in which the company invested, and its own animation work "ZOIDS" contributed to profits during the preceding period.

Videogames

Sales were JPY56.4bn (-11.3% YoY) and segment profit was JPY254mn (+217.9%).

The company continued to struggle as the market for packaged products remains weak due to the impact of mobile and online games. In the previous year the company wrote down over stocked inventory such as game software and accessories (about JPY800mn), but this year there were no such write-downs, meaning, profitability improved as a result of reduced product write-downs and improved efficiency due to the consolidation of subsidiaries.

Dolly Kanon and *Junisai: Honto no Kimochi* (Twelve Years Old: True Feelings), Nintendo 3DS software games developed by the company based on manga comic series published in *Ciao*, a magazine for school-aged girls, contributed to revenues.

Amusement

Sales were JPY24.1bn (+2.8% YoY) and segment profit was JPY1.8bn (-12.5%).

Segment sales increased due to contributions from products featuring popular characters, but profits were down as the contribution to sales from high-margin digital card games continued to decline. As to profitability, while some game software and accessories which had been stocked in excess had been devaluated (approximately JPY8mn) during the preceding period, decreases in product devaluation due to the absence of such write-offs and the promotion of efficiency through means such as its consolidation of its subsidiaries resulted in improved results.

Other information

History

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.

- 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).
- 1994** Bandai buys more Happinet shares; Happinet joins the Bandai group. Happinet begins distributing PlayStation game consoles and starts distributing videogames.
- 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.
- 2014** Merges Happinet PM
- 2014** Toys Union Co., Ltd. and Mori Games Co., Ltd. merged; renamed Maxgames Corporation (presently a consolidated subsidiary)
- 2015** Creates capital business alliance with Broccoli Co., Ltd. (now an equity-method affiliate)
- 2016** Joint establishment of Happinet Live Entertainment LLC (now Happinet Live Emotion LLC).

News and topics

February 2017

On **February 9, 2017**, the company announced earnings results for Q3 FY03/17, revision of the full-year earnings forecasts, and revision of the FY03/17 year-end dividend.

Revised forecasts for full-year FY03/17 (previous forecasts in parentheses)

- ▷ Sales: JPY172.0bn (JPY190.0bn)
- ▷ Operating profit: JPY3.7bn (JPY4.0bn)
- ▷ Recurring profit: JPY3.5bn (JPY4.0bn)

▷ Net income*: JPY2.2bn (JPY2.6bn)

*Net income refers to net income attributable to parent company shareholders.

Reasons for revision

During the company's prime year-end shopping rush, sales were strong despite a lack of hit products, but this was not enough to cover for the disappointing results through Q2, so sales and profits are both expected to come in below the initial forecasts.

Revision of FY03/17 year-end dividend

A JPY5 per share commemorative dividend has been added to the JPY15 ordinary year-end dividend, for a total of JPY20. This is on top of a JPY15 per share dividend paid at the end of 1H, for a total of JPY35 for FY03/17 (JPY30 in ordinary dividends and JPY5 commemorative dividend).

November 2016

On **November 22, 2016**, investment fund Effissimo Capital Management Pte Ltd submitted a substantial shareholding report to the Kanto Finance Bureau. The report stated it acquired 1,413,000 Happinet shares (5.87% of total outstanding shares).

October 2016

On **October 31, 2016**, the company announced the decisions from two lawsuits. On November 2, 2016, the company announced that the Tokyo District Court revised one of the verdicts. On November 9, 2016, the company announced that Software Research Associates, Inc. (SRA) filed an appeal against the company. On November 11, 2016, the company announced that it filed an appeal.

Happinet outsourced development to Software Research Associates, Inc. (SRA), and in 2005 put SRA in charge of developing a next-generation core system. However, the sales system (a feature of the core system) was not delivered within the agreed upon period. As a result, Happinet filed a lawsuit against SRA, and SRA countersued. On October 31, 2016, the Tokyo District Court announced its verdicts.

Verdict details

- ▶ Happinet shall pay SRA JPY22mn and an interest rate of 6% on the JPY22mn for each year the lawsuit was active.
- ▶ SRA shall pay Happinet JPY790mn and an interest rate of 6% on the JPY790mn for each year the lawsuit was active. The Tokyo District Court increased the fine to JPY822mn on November 1, 2016.
- ▶ SRA will pay for 75% of the litigation costs and Happinet 25%.

Appeals filed by SRA and Happinet

On November 8, 2016, SRA disagreed with the verdicts and appealed to the Tokyo High Court. The Tokyo District Court accepted a part of SRA's claims and rejected a part of the company's claims. On November 11, 2016, Happinet filed an appeal to the Tokyo High Court since it disagreed with the verdict.

September 2016

On **September 2, 2016**, the company announced the status of its share buyback program, saying that it had completed the purchase.

On September 1, Happinet acquired 58,300 of its own shares for JPY65,415,000 (on a contractual basis), completing a share buyback program adopted at a board meeting on August 24, 2016.

Number of shares acquired as of September 1, 2016 (on a contractual basis)

- ▷ Number of acquired shares: 1,000,000
- ▷ Amount spent on share buyback: JPY1,090,524,700

August 2016

On **August 24, 2016**, the company announced revisions to earnings forecast for 1H FY03/17, and acquisition of treasury stock.

Forecast revisions for 1H FY03/17 (previous forecasts in the parentheses)

- ▷ Sales: JPY71.0bn (JPY80bn)
- ▷ Operating income: JPY800mn (JPY1.5bn)
- ▷ Recurring income: JPY650mn (JPY1.5bn)
- ▷ Net income: JPY300mn (JPY1.0bn)

Reasons for the revisions

In 1H FY03/17, the company was struggling due to a lack of hit product in the mainstay distribution businesses such as the Toys and Amusement segments, and sluggish sales of seasonal products during summer. In the content business, it booked investment losses from some proprietary products in the Visual and Music segment. As a result, 1H sales and profits at all levels have been revised down significantly from the previous forecasts. For the full year of FY03/17, the company did not make revisions to forecasts, due to anticipating a sales peak season during Christmas and New Year's.

Acquisition of treasury stock

Outline of acquisition

| | |
|--------------------------------------|---|
| Type of shares to be acquired | Ordinary shares of Happinet Corporation |
| Number of shares to be acquired | Maximum of 1,000,000 shares (4.41% of shares outstanding) |
| Total value of shares to be acquired | Maximum of JPY1.5bn |
| Acquisition period | August 25, 2016–December 30, 2016 |

March 2016

On **March 10, 2016**, the company announced changes to two executive positions.

At a board of directors meeting held on March 10, 2016, the company decided on the following changes to two executive positions, effective from late June 2016.

| New position | Name | Previous position |
|--|-----------------|---|
| Executive Vice Chairman and Chief Strategy Officer (CSO) | Tetsuo Ishikawa | President and Representative Director |
| President and Chief Operating Officer (COO) | Seiichi Enomoto | Managing Executive Officer and Director |

February 2016

On **February 9, 2016**, the company announced earnings results for Q3 FY03/16 along with revisions to its full-year forecast; see the results section for details.

FY03/16 full-year forecast revisions

- ▷ Sales: JPY185bn (previously JPY200bn)
- ▷ Operating profit: JPY3.3bn (previously JPY4.5bn)
- ▷ Recurring profit: JPY3.3bn (previously JPY4.5bn)
- ▷ Net income: JPY2.2bn (previously JPY3.0bn)

Reasons for the revision

Due to the end of the year being a major shopping season, sales figures tend to be highest during that period. However, sales did not meet company forecasts. Further, although profits in the Visual and Music segment showed improvement, the company booked valuation loss on inventories in the Toys, Videogames, and Amusement segments in line with its slow year-end performance. As such, it decided to make significant downward revisions to its full-year forecast.

Launch of live entertainment business

On February 9, 2016, the company announced that it would establish Happinet Live Entertainment LLC (now Happinet Live Emotion LLC; capital: JPY10mn) with a founding date of February 12, 2016. The new LLC will be a joint venture with Naoyuki Matsunaga—the President of Yokochō Planning Co., Ltd., a company specializing in live event planning and operations—and it will enter the businesses of event and live performance operations and sales of related merchandise in the idol music market.

Figures published by the All Japan Concert & Live Entertainment Promoters Conference state that the market size for live performances has grown by 2.5 times over the past 10 years, and sales for 2014 reached JPY274.9bn. According to the company, while the number of people listening to music online has increased, music fans are also seeking out unique experiences that can only be had in a live performance venue. Sales of related merchandise and CDs are also rising.

Shared Research thinks that there are possibilities for synergies with the company’s existing businesses, such as through the use of toy vending machines to dispense related merchandise. However, it is unlikely that this venture will have a significant impact on the company’s overall earnings.

November 2015

On **November 20, 2015**, the company announced a capital and business alliance with Broccoli Co. Ltd., (JASDAQ 2706, Broccoli) including the underwriting of new Broccoli shares issued through a third-party allocation, making Broccoli an equity-method affiliate.

At a board of directors’ meeting held on November 20, 2015, the company passed a resolution to enter into a capital and business alliance (hereafter ‘alliance’) with Broccoli and underwrite a third-party issuance of new Broccoli shares.

Alliance objectives

Broccoli has a solid track record planning and producing content. It has maintained steady earnings through its core “twin engine” strategy consisting of (1) creating its own hit content, and (2) generating synergies with its own content and physical goods based on licenses received from other firms.

Happinet and Broccoli recently began discussing this alliance with the aim of mutual business development through the sharing of their respective business platforms and expertise. By building stronger ties with Broccoli through the underwriting of its third-party share allocation, Happinet aims to establish an environment better suited for the creation of exclusive and original hit products, particularly for its Visual and Music and Videogame segments. Specifically, Happinet wants to integrate its expertise and rights for the development of a wide range of products including animation, games, card games, CDs, goods, figures, and related supplies with Broccoli’s content and content development skills. Furthermore, the two firms are expected to jointly develop new content while cultivating new customer segments and distribution channels. They intend to achieve these goals by integrating (1) a logistics platform allowing for transactions with various Happinet customers (e-commerce, mass merchandisers, convenience stores, specialty stores) with (2) the ability to grasp product needs utilizing optimal logistics systems, (3) the ability to propose new products, and (4) timely, highly precise logistics systems.

Alliance particulars

Development of content, planning, production, and sales of animation, games, card-based games, CDs, goods, figures, and related supplies, sharing of related activities / expertise, and cooperating to realize more sophisticated business management expertise mainly involving content.

In order to maximize the value of content developed by Broccoli, Broccoli will utilize information about market trends and needs held by Happinet and the two firms will cooperate in developing high-quality, original content.

In order to maximize the sales of animation, games, card-based games, CDs, goods, figures, and related supplies produced by Broccoli, Broccoli will plan and produce novel products well suited for market needs and Happinet will promote sales using the Happinet Group distribution platform.

Cooperate with sales promotions and event management for content and products developed and produced by Broccoli.

Discuss streamlining measures for distribution functions held by Broccoli, with consideration given to Broccoli using Happinet distribution functions in the future.

Discuss mutual personnel exchanges to realize the alliance objectives.

Broccoli operating results and financial conditions for past three years (JPYmn)

| FY | FY02/13 | FY02/14 | FY02/15 |
|----------------------------|---------|---------|---------|
| Revenue | 4,372 | 6,786 | 6,256 |
| Operating profit | 834 | 2,151 | 1,470 |
| Recurring profit | 833 | 2,150 | 1,484 |
| Net income | 877 | 1,908 | 904 |
| EPS (JPY) | 26.83 | 58.31 | 27.64 |
| Dividend (JPY) | 6.00 | 13.00 | 6.50 |
| Net assets | 1,795 | 3,509 | 3,988 |
| Total assets | 2,687 | 4,490 | 5,236 |
| Book value per share (JPY) | 54.86 | 107.21 | 121.84 |

Number of shares acquired, acquisition price, shares held before/after acquisition

- ▷ Shares held before change: 0
- ▷ Number of shares to be acquired: 11,000,000
- ▷ Acquisition price: JPY4,059,000,000
- ▷ Shares held after change: 11,000,000 (number of voting rights: 11,000, voting rights ratio: 25.15%)

Schedule

- ▷ Signing of capital and business alliance agreement: November 20, 2015
- ▷ Start of capital and business alliance: November 20, 2015
- ▷ Payment for new share issuance: December 9, 2015 (planned)

Shared Research is currently examining the likely impacts of this alliance on Happinet’s consolidated earnings. We will promptly issue a new report if we forecast a significant impact on earnings.

Major shareholders

| Top shareholders (as of end-March 2017) | Amount held |
|--|-------------|
| NAMCO BANDAI Holdings Inc. | 27.1% |
| Tachibana Securities Co., Ltd. | 6.4% |
| Japan Trustee Services Bank, Ltd. (Trust account) | 4.1% |
| Goldman Sachs International | 3.3% |
| Japan Trustee Services Bank, Ltd. (Sumitomo Mitsui Trust Bank, Limited Re-trust Portion and SMBC Employee Pension Trust) | 3.1% |
| Yasuhiko Idaira | 2.6% |
| Japan Trustee Services Bank, Ltd. (Trust account 5) | 1.4% |
| Hiroshi Kawai | 1.4% |
| Happinet Employee Shareholding Association | 1.4% |
| Chizuko Nishimura | 1.3% |

Source: Shared Research based on company data
 Note: Excluding 2,368,110 shares of treasury stock

Profile

| | |
|---|---|
| Company | Head office |
| Happinet Corp | Komagata CA Bldg., 2-4-5, Komagata, Taito-ku, Tokyo, Japan 111-0043 |
| Phone | Listed on |
| +81-3-3847-0521 | Tokyo Stock Exchange 1st Section |
| Established | Exchange listing |
| June 7, 1969 | August 29, 1997 |
| Website | Fiscal year-end |
| http://www.happinet.co.jp/english/index.html | March |
| IR web | |
| http://www.happinet.co.jp/english/ir/index.html | |

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| | | |
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| ADJUVANT COSME JAPAN CO., LTD. | Fujita Kanko Inc. | ONO SOKKI Co., Ltd. |
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| AnGes Inc. | GCA Corporation | PIGEON CORPORATION |
| Anicom Holdings, Inc. | Grandy House Corporation | RACCOON CO., LTD. |
| Anritsu Corporation | Hakuto Co., Ltd. | RESORTTRUST, INC. |
| Apamanshop Holdings Co., Ltd. | Happinet Corporation | ROUND ONE Corporation |
| Artspark Holdings Inc. | Harmonic Drive Systems Inc. | RVH Inc. |
| AS ONE CORPORATION | Hearts United Group Co., Ltd. | RYOHIN KEIKAKU CO., LTD. |
| Ateam Inc. | IDOM Inc. | SanBio Company Limited |
| Aucfan Co., Ltd. | IGNIS LTD. | SANIX INCORPORATED |
| Axell Corporation | Inabata & Co., Ltd. | Sanrio Company, Ltd. |
| Azbil Corporation | Infomart Corporation | SATO HOLDINGS CORPORATION |
| Bell-Park Co., Ltd. | Intelligent Wave, Inc. | SBS Holdings, Inc. |
| Benefit One Inc. | istyle Inc. | Seria Co., Ltd. |
| Canon Marketing Japan Inc. | Itochu Enex Co., Ltd. | SHIP HEALTHCARE HOLDINGS, INC. |
| Carna Biosciences, Inc. | J Trust Co., Ltd | SMS Co., Ltd. |
| CERES INC. | Japan Best Rescue System Co., Ltd. | Snow Peak, Inc. |
| Chiyoda Co., Ltd. | JINS Inc. | SOURCENEXT Corporation |
| Chugoku Marine Paints, Ltd. | KAMEDA SEIKA CO., LTD. | Star Mica Co., Ltd. |
| cocokara fine Inc. | Kenedix, Inc. | SymBio Pharmaceuticals Limited |
| COMSYS Holdings Corporation | KFC Holdings Japan, Ltd. | Takashimaya Company, Limited |
| CRE, Inc. | LAC Co., Ltd. | Takihyo Co., Ltd. |
| CREEK & RIVER Co., Ltd. | Lasertec Corporation | TAMAGAWA HOLDINGS CO., LTD. |
| Daiseki Co., Ltd. | MATSUI SECURITIES CO., LTD. | TEAR Corporation |
| DIC Corporation | MEDINET Co., Ltd. | 3-D Matrix, Ltd. |
| Digital Arts Inc. | MEGANESUPER CO., LTD. | TKC Corporation |
| Digital Garage Inc. | Milbon Co., Ltd. | TOKAI Holdings Corporation |
| Don Quijote Holdings Co., Ltd. | MIRAIT Holdings Corporation | Tri-Stage Inc. |
| Dream Incubator Inc. | NAGASE & CO., LTD | VISION INC. |
| EARTH CHEMICAL CO., LTD. | NAIGAI TRANS LINE LTD. | VOYAGE GROUP, INC. |
| Elecom Co., Ltd. | NanoCarrier Co., Ltd. | WirelessGate, Inc. |
| Emergency Assistance Japan Co., Ltd. | Net One Systems Co., Ltd. | YELLOW HAT LTD. |
| en-Japan Inc. | Nichi-Iko Pharmaceutical Co., Ltd. | YUMESHIN HOLDINGS CO., LTD. |
| euglena Co., Ltd. | NIPPON PARKING DEVELOPMENT Co., Ltd. | Yushiro Chemical Industry Co., Ltd. |
| Ferrotec Holdings Corporation | Nisshinbo Holdings Inc. | ZAPPALLAS, INC. |

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