LAST UPDATE【2016/7/8】

Happinet | 7552 |

Research Report by Shared Research Inc.

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Key financial data

Income Statement (JPYmn)	FY03/09 Cons.	FY03/10 Cons.	FY03/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Est.
Total Sales	**166,778**	**194,246**	**190,891**	**198,021**	**176,757**	**206,867**	**217,232**	**187,274**	**190,000**
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	17.0%	5.0%	-13.8%	1.5%
Gross Profit	**19,990**	**22,467**	**22,326**	**25,007**	**22,501**	**24,039**	**26,152**	**21,997**	
YoY	9.2%	12.4%	-0.6%	12.0%	-10.0%	6.8%	8.8%	-15.9%	
GPM	12.0%	11.6%	11.7%	12.6%	12.7%	11.6%	12.0%	11.7%	
Operating Profit	**2,137**	**2,327**	**2,855**	**4,855**	**2,973**	**3,888**	**5,056**	**3,450**	**4,000**
YoY	47.3%	8.9%	22.7%	70.1%	-38.8%	30.8%	30.0%	-31.8%	15.9%
OPM	1.3%	1.2%	1.5%	2.5%	1.7%	1.9%	2.3%	1.8%	2.1%
Recurring Profit	**2,322**	**2,513**	**3,013**	**5,032**	**3,081**	**3,917**	**5,124**	**3,497**	**4,000**
YoY	48.0%	8.2%	19.9%	67.0%	-38.8%	27.1%	30.8%	-31.8%	14.4%
RPM	1.4%	1.3%	1.6%	2.5%	1.7%	1.9%	2.4%	1.9%	2.1%
Net Income	**1,135**	**1,179**	**1,376**	**2,458**	**2,011**	**2,466**	**4,049**	**2,359**	**2,600**
YoY	-	3.9%	16.7%	78.6%	-18.2%	22.6%	64.2%	-41.7%	10.2%
Net Margin	0.7%	0.6%	0.7%	1.2%	1.1%	1.2%	1.9%	1.3%	1.4%
Per Share Data (JPY)									
Number of Shares (thousands)	12,025	12,025	12,025	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	114.6
EPS (Fully Diluted)	-	-	-	109.6	89.6	108.1	176.2	102.2	
Dividend Per Share	15.0	15.00	15.00	27.50	22.50	24.75	28.50	30.00	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	
Balance Sheet (JPYmn)									
Cash and Equivalents	5,463	6,312	8,220	12,359	10,155	9,996	15,867	11,412	
Total Current Assets	**44,864**	**40,140**	**41,039**	**48,269**	**47,930**	**47,025**	**52,449**	**44,905**	
Tangible Fixed Assets, net	1,952	1,668	1,555	1,392	1,110	1,342	688	753	
Other Fixed Assets	3,355	3,405	2,780	2,946	2,976	5,065	5,900	10,047	
Intangible Assets	4,488	3,836	3,132	1,715	985	446	854	1,086	
Total Assets	**54,661**	**49,050**	**48,507**	**54,323**	**53,003**	**53,879**	**59,893**	**56,793**	
Notes and Accounts Payable	20,748	19,832	20,204	23,042	22,672	20,099	20,118	18,282	
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**	
Long-Term Debt	430	30	-	-	-	-			
Total Fixed Liabilities	**3,305**	**2,651**	**2,867**	**2,909**	**2,829**	**3,148**	**3,355**	**3,621**	
Total Liabilities	**36,476**	**30,088**	**28,704**	**32,527**	**29,713**	**28,185**	**30,312**	**25,438**	
Net Assets	**18,184**	**18,962**	**19,802**	**21,795**	**23,289**	**25,694**	**29,580**	**31,355**	
Interest-Bearing Debt	5,950	2,490	-	-	-	-	-	-	
Cash Flow Statement (JPYmn)									
Operating Cash Flow	951	6,232	5,083	4,609	-1,505	2,547	6,658	978	
Investment Cash Flow	-851	-391	-315	-50	-108	-87	-158	-4,752	
Financing Cash Flow	-975	-4,481	-2,852	-421	-588	-2,618	-628	-677	
Financial Ratios									
ROA	4.5%	4.8%	6.2%	9.8%	5.7%	7.3%	9.0%	6.0%	
ROE	6.2%	6.3%	7.1%	11.8%	8.9%	10.1%	14.8%	7.8%	
Equity Ratio	33.3%	38.7%	40.8%	40.1%	43.9%	47.7%	49.4%	55.2%	

Source: Shared Research based on company data
Figures may differ from company materials due to differences in rounding methods.
Per share data adjusted for the 2-for-1 stock split on December 1, 2011. Per share data is retroactively restated.
*Net income from FY03/16 onward refers to "net income attributable to parent company shareholders."

Recent updates

Highlights

On **July 8, 2016,** Shared Research updated the report following interviews with Happinet Corporation

On **May 13, 2016**, the company announced full-year earnings results for FY03/16; 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

Quarterly Performance	FY03/15				FY03/16				FY03/16	
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY	FY Est.
Sales	40,039	93,437	174,327	217,232	37,300	83,993	150,028	187,274	101.2%	185,000
YoY	10.7%	6.9%	5.4%	5.0%	-6.8%	-10.1%	-13.9%	-13.8%		-14.8%
Gross Profit	5,559	12,016	20,717	26,152	5,035	10,606	17,145	21,997		
YoY	10.7%	11.4%	10.2%	8.8%	-9.4%	-11.7%	-17.2%	-15.9%		
GPM	13.9%	12.9%	11.9%	12.0%	13.5%	12.6%	11.4%	11.7%		
SG&A	4,728	9,653	15,568	21,095	4,256	8,769	13,931	18,547		
YoY	7.1%	4.6%	5.3%	4.7%	-10.0%	-9.2%	-10.5%	-12.1%		
SG&A / Sales	11.8%	10.3%	8.9%	9.7%	11.4%	10.4%	9.3%	9.9%		
Operating Profit	831	2,362	5,149	5,056	779	1,837	3,213	3,450	104.5%	3,300
YoY	37.6%	52.3%	28.0%	30.0%	-6.3%	-22.2%	-37.6%	-31.8%		-34.7%
OPM	2.1%	2.5%	3.0%	2.3%	2.1%	2.2%	2.1%	1.8%		1.8%
Recurring Profit	863	2,413	5,219	5,124	794	1,857	3,251	3,497	106.0%	3,300
YoY	40.6%	52.8%	28.5%	30.8%	-8.0%	-23.1%	-37.7%	-31.8%		-35.6%
RPM	2.2%	2.6%	3.0%	2.4%	2.1%	2.2%	2.2%	1.9%		1.8%
Net Income	928	1,814	3,995	4,049	471	1,185	2,111	2,359	109.7%	2,150
YoY	256.9%	31.9%	52.3%	64.2%	-49.2%	-34.7%	-47.2%	-41.7%		-46.9%
NPM	2.3%	1.9%	2.3%	1.9%	1.3%	1.4%	1.4%	1.3%		1.2%

Quarterly Performance	FY03/15				FY03/16			
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	40,039	53,398	80,890	42,905	37,300	46,693	66,035	37,246
YoY	10.7%	4.3%	3.6%	3.6%	-6.8%	-12.6%	-18.4%	-13.2%
Gross Profit	5,559	6,457	8,701	5,435	5,035	5,571	6,539	4,852
YoY	10.7%	12.0%	8.5%	3.9%	-9.4%	-13.7%	-24.8%	-10.7%
GPM	13.9%	12.1%	10.8%	12.7%	13.5%	11.9%	9.9%	13.0%
SG&A	4,728	4,925	5,915	5,527	4,256	4,513	5,162	4,616
YoY	7.1%	2.3%	6.6%	3.0%	-10.0%	-8.4%	-12.7%	-16.5%
SG&A / Sales	11.8%	9.2%	7.3%	12.9%	11.4%	9.7%	7.8%	12.4%
Operating Profit	831	1,531	2,787	-93	779	1,058	1,376	237
YoY	37.6%	61.7%	12.7%	-	-6.3%	-30.9%	-50.6%	-
OPM	2.1%	2.9%	3.4%	-	2.1%	2.3%	2.1%	0.6%
Recurring Profit	863	1,550	2,806	-95	794	1,063	1,394	246
YoY	40.6%	60.6%	13.0%	-	-8.0%	-31.4%	-50.3%	-
RPM	2.2%	2.9%	3.5%	-	2.1%	2.3%	2.1%	0.7%
Net Income	928	886	2,181	54	471	714	926	248
YoY	256.9%	-20.5%	74.8%	-	-49.2%	-19.4%	-57.5%	359.3%
NPM	2.3%	1.7%	2.7%	0.1%	1.3%	1.5%	1.4%	0.7%

Source: Shared Research based on company data
Figures may differ from company materials due to differences in rounding methods.
*Net income from FY03/16 onwards refers to net income attributable to parent company shareholders.

Seasonality

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

Performance by segment

Performance by segment (cumulative)	FY03/15				FY03/16			
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	40,039	93,437	174,327	217,232	37,300	83,993	150,028	187,274
YoY	10.7%	6.9%	5.4%	5.0%	-6.8%	-10.1%	-13.9%	-13.8%
Toys	16,411	39,479	74,911	93,270	15,219	34,742	62,458	76,874
YoY	13.4%	23.8%	22.9%	21.4%	-7.3%	-12.0%	-16.6%	-17.6%
Visual and Music	10,454	21,376	32,379	43,372	8,601	17,352	28,660	38,367
YoY	4.2%	0.4%	-2.0%	1.0%	-17.7%	-18.8%	-11.5%	-11.5%
Videogames	7,094	19,939	48,571	56,448	8,018	20,212	42,116	50,009
YoY	8.8%	-13.5%	-10.6%	-11.3%	13.0%	1.4%	-13.3%	-11.4%
Amusement	6,079	12,643	18,464	24,140	5,459	11,686	16,792	22,023
YoY	18.1%	13.4%	7.7%	2.8%	-10.2%	-7.6%	-9.1%	-8.8%
Segment profit	831	2,362	5,149	5,056	779	1,837	3,213	3,450
YoY	37.6%	52.3%	28.0%	30.0%	-6.3%	-22.2%	-37.6%	-31.8%
Toys	584	1,663	4,258	4,279	532	1,256	2,579	2,848
YoY	155.0%	195.4%	59.7%	57.9%	-8.9%	-24.5%	-39.4%	-33.4%
Visual and Music	97	145	27	202	23	144	312	466
YoY	0.0%	-61.5%	-91.4%	-34.2%	-76.3%	-0.7%	-	130.7%
Videogames	-114	-61	427	254	-58	-50	23	-43
YoY	-	-	21.7%	221.5%	-	-	-94.6%	-
Amusement	551	1,264	1,475	1,796	573	1,154	1,309	1,652
YoY	0.7%	6.2%	-10.1%	-12.5%	4.0%	-8.7%	-11.3%	-8.0%
Adjustment	-287	-648	-1,037	-1,475	-292	-667	-1,011	-1,473
Performance by segment (quarterly)	**FY03/15**				**FY03/16**			
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	40,039	53,398	80,890	42,905	37,300	46,693	66,035	37,246
YoY	10.7%	4.3%	3.6%	3.6%	-6.8%	-12.6%	-18.4%	-13.2%
Toys	16,411	23,068	35,432	18,359	15,219	19,523	27,716	14,416
YoY	13.4%	32.5%	21.9%	15.6%	-7.3%	-15.4%	-21.8%	-21.5%
Visual and Music	10,454	10,922	11,003	10,993	8,601	8,751	11,308	9,707
YoY	4.2%	-3.1%	-6.1%	10.7%	-17.7%	-19.9%	2.8%	-11.7%
Videogames	7,094	12,845	28,632	7,877	8,018	12,194	21,904	7,893
YoY	8.8%	-22.3%	-8.4%	-15.4%	13.0%	-5.1%	-23.5%	0.2%
Amusement	6,079	6,564	5,821	5,676	5,459	6,227	5,106	5,231
YoY	18.1%	9.4%	-2.8%	-10.5%	-10.2%	-5.1%	-12.3%	-7.8%
Segment profit	831	1,531	2,787	-93	779	1,058	1,376	237
YoY	37.6%	61.7%	12.7%	-	-6.3%	-30.9%	-50.6%	-
Toys	584	1,079	2,595	21	532	724	1,323	269
YoY	155.0%	223.1%	23.3%	-51.2%	-8.9%	-32.9%	-49.0%	-
Visual and Music	97	48	-118	175	23	121	168	154
YoY	0.0%	-82.9%	-	-	-76.3%	152.1%	-	-12.0%
Videogames	-114	53	488	-173	-58	8	73	-66
YoY	-	341.7%	53.9%	-	-	-84.9%	-85.0%	-
Amusement	551	713	211	321	573	581	155	343
YoY	0.7%	10.9%	-53.2%	-22.1%	4.0%	-18.5%	-26.5%	6.9%
Adjustment	-287	-361	-389	-438	-292	-375	-344	-462

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

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 video game 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 year-on-year 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.

Videogame segment

In the Videogame 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 year-on-year drop.

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

Full-year company forecasts

Full-year forecast (JPYmn)	FY03/16 1H Act.	FY03/16 2H Act.	FY03/16 FY Act.	FY03/17 1H Est.	FY03/17 2H Est.	FY03/17 FY Est.
Sales	**83,993**	**103,281**	**187,274**	**80,000**	**110,000**	**190,000**
CoGS	73,386	91,891	165,277			
Gross profit	**10,606**	**11,391**	**21,997**			
GPM	12.6%	11.0%	11.7%			
SG&A	8,769	9,778	18,547			
SG&A / Sales	10.4%	9.5%	9.9%			
Operating profit	**1,837**	**1,613**	**3,450**	**1,500**	**2,500**	**4,000**
OPM	2.2%	1.6%	1.8%	1.9%	2.3%	2.1%
Recurring profit	**1,857**	**1,640**	**3,497**	**1,500**	**2,500**	**4,000**
RPM	2.2%	1.6%	1.9%	1.9%	2.3%	2.1%
Net income	**1,185**	**1,174**	**2,359**	**1,000**	**1,600**	**2,600**
Net margin	1.4%	1.1%	1.3%	1.3%	1.5%	1.4%

Source: Shared Research based on company data
Figures may differ from company materials due to differences in rounding methods.
*Net income from FY03/16 onward refers to net income attributable to parent company shareholders.

(JPYmn)	FY03/16 FY Act.	FY03/17 FY Est.
Sales	187,274	190,000
YoY	-13.8%	1.5%
Toys	76,874	78,000
YoY	-17.6%	1.5%
Visual and Music	38,367	38,000
YoY	-11.5%	-1.0%
Videogames	50,009	50,000
YoY	-11.4%	0.0%
Amusement	22,023	24,000
YoY	-8.8%	9.0%
Segment profit	3,450	4,000
YoY	-31.8%	15.9%
Toys	2,848	2,900
YoY	-33.4%	1.8%
OPM	3.7%	3.7%
Visual and Music	466	500
YoY	130.9%	7.3%
OPM	1.2%	1.3%
Videogames	-43	300
YoY	-	-
OPM	-0.1%	0.6%
Amusement	1,652	1,700
YoY	-8.0%	2.9%
OPM	7.5%	7.1%
Adjustments	-1,473	-1,400

Forecasts for FY03/17 call for sales of JPY190.0bn (+1.5% YoY), operating profit of JPY4.0bn (+15.9% YoY), recurring profit of JPY4.0bn (+14.4% YoY), and net income attributable to parent company shareholders of JPY2.6bn (+10.2% YoY).
*Net income for FY03/16 onwards refers to "net income attributable to parent company shareholders."

Toys

The company expects sales of JPY78.0bn (+1.5% YoY), and segment profit of JPY2.9bn (+1.8% YoY).

Approximately half of the sales in this industry comprise Bandai products, and Bandai Namco Holdings, Inc. (TSE: 7832) forecasts a 1.7% YoY increase in sales of toy and hobby products for FY03/17. By character (domestic toy and hobby), Happinet expects sales to fall 61.0% YoY to JPY12.0bn for "Yokai Watch" products, but increased sales for Kamen Rider, Super Sentai, and Aikatsu!.

Happinet's policy is to expand exclusively distributed products, improve sales floor proposals, and expand sales of peripheral toy products. Additionally, the company aims to aggressively explore new sales channels to develop new markets. For internally developed products, the company is focusing efforts on products that are not based upon characters nor influenced by fads.

A rise in sales, and improved inventory management this year—compared to the last two years, which saw losses on disposal of inventory (JPY1.6bn for FY03/15, and JPY1.8bn for FY03/16) jump due to one-time causes—means the company expects a rise in operating profit.

Visual and Music

The company anticipates sales of JPY38.0bn (-1.0% YoY), and segment profit of JPY500mn (+7.3% YoY).

The expected drop in sales reflects ongoing weakness in the packaged products market as more users switch to downloading content, but the company plans to temper this decline by increasing market share and expanding into new channels.

In the distribution business the company aims to continue acting as a sales agent for visual content production and carrying out commissioned distribution in the medium term. Happinet is working to develop new sales channels at large volume retailers, shopping malls, and carts in expressway service areas. As in FY03/16, it plans to acquire high-margin, exclusively distributed animated DVD box sets to improve profit margins.

Based on the medium-term plan, in the content business the company is concentrating investments in priority markets. In FY03/17, it will focus on internally managed products, mainly animations. The company will invest in managing "Regalia," premiering in July 2016, and "Flip Flappers," premiering in October 2016, and other such content handled by production companies or directors with records of producing hits.

The company expects a rise in operating profit, by increasing in sales of exclusively distributed products (with relatively high-margins), and containing investment loss.

Videogames

The company expects sales of JPY50.0bn (-0.0% YoY), and segment profit of JPY300mn (JPY43mn segment loss in FY03/16).

The company expects the packaged product market to continue to be flat, and expects sales of the Nintendo 3DS series game software and the new videogame consoles to reflect this trend. Nintendo planned to release the Nintendo 3DS game software "Yokai Watch 3 Sushi/Tempura" in July 2016, and "Pokémon Sun and Moon" at the end of 2016. It also planned to premier the new console, Nintendo NX, in March 2017.

For titles developed by Happinet, following "Junisai: Honto no Kimochi" (Twelve Years Old: True Feelings) released in March 2015, Happinet also plans to release "Junisai: Love Diary" (Twelve Years Old: Love Diary) in August 2016. It will continue to develop game software targeting girls.

In the previous year, the company booked a loss due to disposal of excess inventory of JPY500mn (the result of missing sales forecasts for exclusively distributed products), in addition to sluggish performance of Happinet-developed products.

This year, however, it expects to hold down losses on disposal of inventory and return to profitability.

Amusement

The company expects sales of JPY24.0bn (+9.0% YoY) and segment profit of JPY1.7bn (+2.9% YoY).

In toy vending machines, continuing from FY03/16 Happinet will grow sales by holding events in train stations and other high-visibility locations. Broccoli Co., Ltd. was made an equity-method affiliate in November 2015 through a stock acquisition, and Happinet hopes to expand its exclusively distributed products through this partnership.

In addition to increased sales, the company expects to hold down inventory valuation loss, the cause of lower operating profit in FY03/16.

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.

Video Game 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. However, as of May 2015 the company is exploring ways to remain profitable in a sluggish package market.

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 existing categories, such as RC cars.

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.

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% year-on-year), operating profit of JPY900mn (down 38.8% year-on-year), recurring profit of JPY900mn (down 39.4% year-on-year), and net income of JPY600mn (down 33.7% year-on-year).

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 (41.0% of FY03/16 sales), Visual and Music (20.5%), Videogames (26.7%), and Amusement (11.8%).

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)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Sales	166,778	194,246	190,891	198,021	176,757	206,867	217,232	187,274
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	17.0%	5.0%	-13.8%
Toy	61,813	65,654	69,104	77,313	74,660	76,821	93,270	76,874
YoY	-1.7%	6.2%	5.3%	11.9%	-3.4%	2.9%	21.4%	-17.6%
% of Total	37.1%	33.8%	36.2%	39.0%	42.2%	37.1%	42.9%	41.0%
Visual and Music	36,570	67,838	57,759	55,719	44,810	42,955	43,372	38,367
YoY	-5.1%	85.5%	-14.9%	-3.5%	-19.6%	-4.1%	1.0%	-11.5%
% of Total	21.9%	34.9%	30.3%	28.1%	25.4%	20.8%	20.0%	20.5%
Video Game	50,474	44,372	46,447	42,704	36,839	63,609	56,448	50,009
YoY	-7.4%	-12.1%	4.7%	-8.1%	-13.7%	72.7%	-11.3%	-11.4%
% of Total	30.3%	22.8%	24.3%	21.6%	20.8%	30.7%	26.0%	26.7%
Amusement	17,919	16,381	17,579	22,282	20,447	23,481	24,140	22,023
YoY	38.3%	-8.6%	7.3%	26.8%	-8.2%	14.8%	2.8%	-8.8%
% of Total	10.7%	8.4%	9.2%	11.3%	11.6%	11.4%	11.1%	11.8%
Segment profit	2,137	2,327	2,855	4,855	2,973	3,888	5,056	3,450
YoY	47.3%	8.9%	22.7%	70.0%	-38.8%	30.8%	30.0%	-31.8%
Toy	996	1,865	2,321	3,009	2,055	2,710	4,279	2,848
YoY	-24.6%	87.2%	24.4%	29.6%	-31.7%	31.8%	57.9%	57.9%
% of Total	29.1%	50.4%	55.8%	48.6%	47.7%	52.6%	65.5%	57.9%
Visual and Music	1,330	253	-656	448	309	307	202	466
YoY	3494.6%	-81.0%	-	-	-31.0%	-0.7%	-34.3%	-34.3%
% of Total	38.9%	6.8%	-15.8%	7.2%	7.2%	6.0%	3.1%	9.5%
Video Game	1,221	1,035	1,156	936	678	79	254	-43
YoY	-7.6%	-15.2%	11.7%	-19.0%	-27.6%	-88.2%	217.9%	217.9%
% of Total	35.7%	28.0%	27.8%	15.1%	15.7%	1.5%	3.9%	-0.9%
Amusement	-127	544	1,340	1,801	1,265	2,053	1,796	1,652
YoY	-	-	146.3%	34.4%	-29.8%	62.4%	-12.5%	-12.5%
% of Total	-3.7%	14.7%	32.2%	29.1%	29.4%	39.9%	27.5%	33.6%
Adjustments	-1,283	-1,371	-1,307	-1,341	-1,335	-1,263	-1,475	-1,473

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

Toys (41.0% of FY03/16 consolidated sales; 57.9% of operating profit)

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 80% of Bandai's toy distribution in Japan, Japan's largest toy manufacturer.

Toys: main manufacturers

Toy sales breakdown	FY03/09	FY03/10	FY03/11	FY03/12	FY03/13	FY03/14	FY03/15	FY03/16
(JPYmn)	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Act.
Total	61,813	65,654	69,104	77,313	74,660	76,821	93,270	76,874
YoY	-1.7%	6.2%	5.3%	11.9%	-3.4%	2.9%	21.4%	-17.6%
Bandai	28,900	32,700	37,400	42,300	38,800	40,700	55,400	41,900
YoY	-3.7%	13.1%	14.4%	13.1%	-8.3%	5.0%	35.8%	-24.2%
% of Total	46.8%	49.8%	54.1%	54.7%	52.0%	53.1%	59.4%	54.6%
TAKARA TOMY	4,800	5,000	7,000	6,300	5,300	4,200	4,100	4,900
YoY	0.0%	4.2%	40.0%	-10.0%	-15.9%	-21.6%	-1.6%	20.4%
% of Total	7.8%	7.6%	10.1%	8.1%	7.1%	5.5%	4.5%	6.5%
Happinet original	1,200	1,400	1,400	2,200	2,500	2,000	1,900	1,500
YoY	-53.8%	16.7%	0.0%	57.1%	13.6%	-17.7%	-8.1%	-16.3%
% of Total	1.9%	2.1%	2.0%	2.8%	3.3%	2.7%	2.0%	2.1%
Other	19,500	18,400	23,100	26,400	27,900	29,700	31,800	28,200
YoY	-3.0%	-5.6%	25.5%	14.3%	5.7%	6.5%	6.9%	-11.1%
% of Total	31.5%	28.0%	33.5%	34.1%	37.4%	38.7%	34.1%	36.8%
Other makers	7,300	7,900	-	-	-	-	-	-
YoY	-	8.2%	-	-	-	-	-	-
% of Total	11.8%	12.0%	-	-	-	-	-	-

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. It takes about three months from when toys are manufactured till they are ready to be sold by retailers, due to strict procedures for managing and checking quality—after all, these are products that will be used by children.

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

Toy distribution:

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

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

Toy earnings (JPYmn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Sales	61,813	65,654	69,104	77,313	74,660	76,821	93,270	76,874
YoY	-	6.2%	5.3%	11.9%	-3.4%	2.9%	21.4%	-17.6%
Segment profit	996	1,865	2,321	3,009	2,055	2,710	4,279	2,848
YoY	-	87.2%	24.5%	29.6%	-31.7%	31.9%	57.9%	-33.4%
OPM	1.6%	2.8%	3.4%	3.9%	2.8%	3.5%	4.6%	3.7%
Losses on inventory write-offs	1,700	1,100	1,100	1,300	1,300	1,000	1,600	1,800
Losses on inventory write-offs/sales	2.8%	1.7%	1.6%	1.7%	1.7%	1.3%	1.7%	2.3%
Inventory	3,500	2,100	2,200	2,300	2,400	2,400	2,300	2,200
Inventory turnover rate	17.2	22.7	31.3	33.6	30.7	31.0	38.7	33.6

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 40th series, Doubutsu Sentai Zyuohger, aired in 2016. In the 30-minute *Super Sentai* program, a team of three to five people use special items to become superheroes wearing helmets and color-coded jumpsuits, and fight bad guys or monsters. In each episode the enemy, once defeated, is reborn as a giant monster and the heroes ride a giant robot to destroy it. Each year a TV series starts in February and a movie version is launched in August. 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)

(JPYbn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Youkai Watch	-	-	-	-	-	1.4	55.2	30.8
Mobile Suit Gundam	16.0	14.4	13.4	15.6	16.5	18.4	22.9	25.8
Kamen Rider	8.7	17.5	23.0	28.3	27.1	22.3	20.6	15.7
Super Sentai	12.0	10.5	9.2	13.0	9.6	14.4	11.3	7.8
Anpanman	9.1	8.4	8.6	9.6	10.0	10.3	8.1	9.4
Precure Series	10.5	11.9	12.5	10.7	10.6	9.8	6.5	6.6
Dragon Ball	3.7	3.3	2.7	4.4	4.8	6.4	5.8	11.6
Aikatsu!	-	-	-	-	1.5	13.0	8.6	2.6
Ultraman	4.3	3.1	2.8	1.8	2.0	3.2	2.6	2.7

Source: Shared Research based on company data

Visual and Music (20.5% FY03/16 consolidated sales; 9.5% of operating profit)

This segment comprises the visual wholesale section (64.7% of segment sales in FY03/16), the visual manufacturing section (12.4%), and the music section (22.9%).

Visual and Music earnings

Visual and music sales breakdown (JPYmn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Total	36,570	67,838	57,759	55,719	44,810	42,955	43,372	38,367
YoY	-5.1%	85.5%	-14.9%	-3.5%	-19.6%	-4.1%	1.0%	-11.5%
Visual	36,500	42,500	40,300	39,600	31,500	31,600	33,000	29,500
YoY	-5.2%	16.4%	-5.2%	-1.7%	-20.3%	0.1%	4.4%	-10.4%
% of Total	99.8%	62.6%	69.8%	71.1%	70.5%	73.6%	76.1%	77.1%
Wholsale	29,100	36,800	34,400	33,600	25,900	25,200	26,000	24,800
YoY	-2.3%	26.5%	-6.5%	-2.3%	-22.8%	-2.7%	3.3%	-4.9%
% of Total	79.6%	54.2%	59.6%	60.3%	58.0%	58.8%	60.2%	64.7%
Maker	7,400	5,700	5,800	5,900	5,600	6,300	6,900	4,700
YoY	-14.0%	-23.0%	1.8%	1.7%	-5.1%	13.3%	8.7%	-31.2%
% of Total	20.2%	8.4%	10.0%	10.6%	12.5%	14.8%	15.9%	12.4%
Music	0	25,200	17,400	16,100	13,200	11,300	10,300	8,700
YoY	-	-	-31.0%	-7.5%	-18.0%	-14.3%	-8.5%	-15.3%
% of Total	0.0%	37.1%	30.1%	28.9%	29.5%	26.4%	23.9%	22.9%
Segment profit	1,330	253	-656	448	309	307	202	466
YoY	-	-81.0%	-359.3%	-168.3%	-31.0%	-0.6%	-34.2%	130.7%
OPM	3.6%	0.4%	-1.1%	0.8%	0.7%	0.7%	0.5%	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 and CDs 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 and Bandai Visual Co Ltd's (a Namco Bandai subsidiary) sole distributor since 2010. The company distributes products to major online retailers and consumer electronics chains.

Visual manufacturing section

Happinet invests in movie production partnerships, thus obtaining videogram rights or 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 (eg, VHS, DVD) and its packaging. Videogram rights here refer to the rights to manufacture, release, and sell this media.

The movie industry and movie production partnerships handle production, distribution, exhibition, and secondary use (renting/selling movie content to consumers). 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—ie, number of viewers multiplied by ticket prices—less expenses (cinema operators and distributors, production, and advertising). According to the company, it is difficult to predict the profitability of investing in production partnerships, because production costs, investment stake, and box-office proceeds differ from movie to movie. 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 products from music content makers and selling them to retailers. As in its visual wholesale section, the company does not shoulder much inventory risk. Therefore, 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, music content is in principle purchased without the right to returns, but 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.

Videogames (26.0% of FY03/16 consolidated sales)

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 account for approximately 80% of sales, with Sony Interactive Entertainment Inc. products next, at about 16%. 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

Videogame sales breakdown (JPYmn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Total	50,474	44,372	46,447	42,704	36,839	63,609	56,448	50,009
YoY	-7.4%	-12.1%	4.7%	-8.1%	-13.7%	72.7%	-11.3%	-11.4%
Nintendo (stand-alone)	4,200	6,400	4,700	3,200	4,400	10,700	9,100	12,400
YoY	-53.3%	52.4%	-26.6%	-31.9%	37.5%	142.4%	-15.3%	36.6%
% of Total	8.3%	14.4%	10.1%	7.5%	11.9%	16.9%	16.2%	24.9%
Nintendo (portable)	9,600	10,300	9,900	10,400	14,200	40,300	36,900	26,800
YoY	-24.4%	7.3%	-3.9%	5.1%	36.7%	182.8%	-8.3%	-27.5%
% of Total	19.0%	23.2%	21.3%	24.4%	38.7%	63.4%	65.5%	53.6%
PlayStation (stand-alone)	6,700	6,900	6,000	6,800	5,300	4,800	3,100	3,400
YoY	-23.9%	3.0%	-13.0%	13.3%	-22.1%	-9.1%	-34.8%	11.3%
% of Total	13.3%	15.6%	12.9%	15.9%	14.4%	7.6%	5.6%	7.0%
PlayStation (portable)	10,300	8,000	11,600	12,200	7,100	4,700	4,300	4,400
YoY	10.8%	-22.3%	45.0%	5.2%	-41.8%	-33.1%	-9.4%	3.0%
% of Total	20.4%	18.0%	25.0%	28.6%	19.3%	7.5%	7.7%	8.9%
Others	19,400	12,500	14,000	9,800	5,600	2,900	2,800	2,700
YoY	35.7%	-35.6%	12.0%	-30.0%	-42.2%	-48.8%	-1.9%	-2.5%
% of Total	38.4%	28.2%	30.1%	22.9%	15.4%	4.6%	5.0%	5.6%
Segment profit	1,221	1,035	1,156	936	678	79	254	-43
YoY	-7.6%	-15.2%	11.7%	-19.0%	-27.6%	-88.3%	221.5%	-
OPM	2.4%	2.3%	2.5%	2.2%	1.8%	0.1%	0.4%	-

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 (FY03/16).

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 (11.8% of FY03/16 consolidated sales; 33.6% of operating profit)

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

Amusement sales breakdown

	FY03/09	FY03/10	FY03/11	FY03/12	FY03/13	FY03/14	FY03/15	FY03/16
(JPYmn)	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Act.
Total	17,919	16,381	17,579	22,282	20,447	23,481	24,140	22,023
YoY	38.3%	-8.6%	7.3%	26.8%	-8.2%	14.8%	2.8%	-8.8%
Segment profit	-127	544	1,340	1,801	1,265	2,053	1,796	1,652
YoY	-	-	146.3%	34.4%	-29.8%	62.3%	-12.5%	-8.0%
OPM	-	3.3%	7.6%	8.1%	6.2%	8.7%	7.4%	7.5%

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 toys. It purchases vending machines and capsule toys 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 2016, the company had machines at 5,000 locations nationwide.

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

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 2016, the company operated card games based on Dragon Ball, Kamen Rider, Yokai Watch, Mobile Suit Gundam, and Aikatsu!.

Card game machine

Source: Shared Research based on company data

Group companies

Happinet Group includes Happinet Corp and four consolidated subsidiaries (end November 2014). 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.

Happinet marketing (JPYmn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Sales	32,436	31,350	31,531	32,236	31,527	32,395	38,383	34,217
YoY	-	-3.3%	0.6%	2.2%	-2.2%	2.8%	18.5%	-10.9%
Recurring profit	299	597	818	950	773	980	1,917	989
YoY	-	99.7%	37.0%	16.1%	-18.6%	26.8%	95.6%	-48.4%
Net income	179	349	473	517	465	586	1,164	633
YoY	-	95.0%	35.5%	9.3%	-10.1%	26.0%	98.6%	-45.6%

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.

MAXGAMES Corporation (JPYmn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Sales	-	-	-	-	35,357	31,868	43,622	41,546
YoY	-	-	-	-	-	-9.9%	36.9%	-4.8%
Recurring profit	-	-	-	-	393	-158	309	199
YoY	-	-	-	-	-	-	-	-35.6%
Net income	-	-	-	-	194	-296	164	120
YoY	-	-	-	-	-	-	-	-26.8%

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.

Broccoli Co. Ltd. (JPYmn)	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.	FY03/16 Act.
Sales	4,372	6,786	6,256	6,429
YoY	-	55.2%	-7.8%	2.8%
Recurring profit	833	2,150	1,484	989
YoY	-	158.1%	-31.0%	-33.4%
Net income	877	1,908	904	622
YoY	-	117.6%	-52.6%	-31.2%

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

Strengths and weaknesses

Strengths

- **Growing market share amid sector shakeout.** Since the mid-1990s, the company used M&A activities to take advantage of industry reshuffling among toy distributors, thus enlarging its sales and the scope of its operations. This increased the company's sales and broadened the scope of its operations, with the result that the company enjoys a 30% share of the toy wholesale market (December 2013 company estimate). Also, in the visual media and music and videogame businesses, the company may be able to expand in the medium term by employing its financial firepower as the market shrinks and these industries rearrange themselves. The company had cash and deposits totaling JPY10.0bn as of end FY03/14. There was no interest-bearing debt.
- **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 80% of Bandai toys sold in Japan (company estimate, November 2014). 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 National Institute of Population and Social Security Research (IPSS), the number of people in Japan aged 0-14 decreased from 17.7mn in 2004 to 16.6mn in 2014 (average annual decline of 0.6%). The market for eight types of toys contracted from JPY316.2bn in 2004 to JPY342.1bn in 2014, maintaining an average decline of 0.2%.

Dividing market size by the number of people aged 0–14, spending per head increased from JPY17,830 in 2004 to JPY20,570 in 2014 (up by an average of1.4% 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	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Market of 8 toy items (JPYbn)	317.1	312.9	319.1	320.5	319.0	326.2	325.1	316.1	315.9	342.1
Population at ages of 0-14 ('000)	17,521	17,434	17,292	17,176	17,010	16,803	16,705	16,548	16,390	16,633
Average purchase price of 8 toy items (JPY)	18,100	17,950	18,450	18,660	18,750	19,410	19,460	19,100	19,270	20,570

"* The eight toy items are electronic toys, models, toys for boys, toys for girls, analog games, seasonal and miscellaneous toys, educational toys, and stuffed toys. Video games are not included. "
Source: Shared Research based on data from Yano Research Institute Ltd. and the National Institute of Population and Social Security Research

The IPSS predicts that the population of children in Japan (0-14 years old) will have decreased to 13.2mn by 2025, due to declining birth rates and the shift toward late marriage. With a rate of decline averaging 1.8% per year since 2014, this would mean potential purchasers of toys were decreasing faster than the rate of decline between 2004 and 2014.

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. It appears a falling percentage of the population (the ratio of respondents to a questionnaire who have purchased video software) is purchasing visual media, resulting in a shrinking market.

Video software market (JPYbn)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total	670.2	669.5	664.2	630.1	574.1	530.7	502.1	480.2	461.5	439.0	417.5
YoY	-	-0.1%	-0.8%	-5.1%	-8.9%	-7.6%	-5.4%	-4.4%	-3.9%	-4.9%	-4.9%
Software for sale	312.4	326.4	303.8	283.2	267.4	263.5	247.9	241.3	243.1	228.7	223.4
YoY	-	4.5%	-6.9%	-6.8%	-5.6%	-1.5%	-5.9%	-2.7%	0.7%	-5.9%	-2.3%
Software for rental	357.8	343.1	360.4	346.9	306.7	267.2	254.2	238.9	218.4	210.3	194.1
YoY	-	-4.1%	5.0%	-3.7%	-11.6%	-12.9%	-4.9%	-6.0%	-8.6%	-3.7%	-7.7%

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

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

Source: Shared Research based on Japan Video Association
*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 JPY141.0bn in 2015.

Video on Demand (VOD) market	2010	2011	2012	2013	2014	2015
VOD market (JPYbn)	76	83	102	123	126	141
YoY	-	8.4%	23.0%	21.1%	2.0%	12.4%

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 people aged 15 to 64 will decrease by 11% a year from 79.2mn in 2014 to 79.2mn 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	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total (JPYmn)	4,015	4,051	4,088	3,866	3,406	3,110	2,837	2,820	2,402	2,301	2,297
YoY	-	0.9%	0.9%	-5.4%	-11.9%	-8.7%	-8.8%	-0.6%	-14.8%	-4.2%	-0.2%
Music software sales value (JPYbn) exl. music video	367.2	351.6	333.3	296.1	249.6	225.0	211.7	227.7	198.5	186.4	182.6
YoY	-	-4.2%	-5.2%	-11.2%	-15.7%	-9.9%	-5.9%	7.6%	-12.8%	-6.1%	-2.0%
Paid distribution of music (JPYbn)	34.3	53.5	75.5	90.5	91.0	86.0	72.0	54.3	41.7	43.7	47.1
YoY	-	56.0%	41.2%	20.0%	0.5%	-5.5%	-16.3%	-24.5%	-23.2%	4.8%	7.8%
Total (mn units/plays)	578	666	732	727	682	651	567	490	407	369	348
YoY	-	15.3%	9.9%	-0.7%	-6.2%	-4.5%	-12.9%	-13.6%	-16.9%	-9.3%	-5.7%
Music software sales volume (mn units) exl. music video	310	298	267	248	214	210	200	218	191	172	170
YoY	-	-3.9%	-10.4%	-7.1%	-13.7%	-1.9%	-4.8%	9.0%	-12.4%	-9.9%	-1.2%
Paid distribution of music (mn plays)	268	368	465	479	468	441	367	272	216	197	178
YoY	-	37.4%	26.3%	3.1%	-2.3%	-5.7%	-16.8%	-26.0%	-20.5%	-8.8%	-9.6%

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 (2013), 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

Game console market in the doldrums. Nintendo launched the Family Computer System (later released as the Nintendo Entertainment System (NES) in America) in 1983, and the overall market for home 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. The game market is now impacted by the popularity of smartphones and online (including social media) games in tandem with new consoles. Since 2010 online gaming has mushroomed yet the game console market remains in the doldrums.

Shipments of Home Video Game Consoles

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

Source: Shared Research based on CESA data

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

Japanese capsule toy market

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

Capsule Toy Market Size	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Value (JPYbn)	33.5	30.5	30.5	28.5	24.9	25.9	30.1	27.0	27.8	31.9
YoY	1.5%	-9.0%	0.0%	-6.6%	-12.6%	4.2%	16.0%	-10.3%	3.0%	14.7%

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 diablock block toys being the most famous. For FY05/14 Kawada reported annual sales of JPY22.0bn (per Kawada's website). Happinet sells much more volume than Kawada and their products are different, so they are not competitors.

Strategy

The company's strategy 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 video games 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 August 2009 the company and Nikkatsu Corp, a movie producer, agreed that Happinet will become a comprehensive seller of Nikkatsu's visual package products. Bandai Visual (a Namco Bandai subsidiary) began to shift some of its sales operations to Happinet in July 2010. Shared Research thinks that handling software makers' sales promotion and distribution functions is a potential money spinner.

Videogame: 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.

Given the contracting overall market, Shared Research considers that other distributors may exit at an increasing rate, implying opportunities for Happinet to grab market share. Happinet may have an opportunity to use this acquisition as an opportunity to expand market share and sales (as with the consolidation of Toys Union).

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. Shared Research thinks the company is likely to join hands with publishers and TV broadcasters to produce and broadcast original programs, in tandem with creating and selling character toys.

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

Q3 FY03/16 results

Sales:	JPY150.0bn (-13.9% YoY)
Operating profit:	JPY3.2bn (-37.6% YoY)
Recurring profit	JPY3.3bn (-37.7% YoY)
Net income:	JPY2.1bn (-47.1% YoY)

The entertainment industry that the group deals in is going through a difficult time, such as the declining birth rate, diversifying consumer needs, and increasing prominence of smartphone-based games and download software over packaged items and hard copies. Although sales at its manufacturing businesses saw improvement, sales and profits at its distribution business were both down due to a lack of hit products to support it during the year-end shopping rush.

Toys

In the Toys segment, sales fell 16.6% YoY to JPY62.5bn and segment profit declined 39.4% to JPY2.6bn.

Toys segment sales fell due to a lack of hit products to support it during the year-end shopping rush. According to materials published by Bandai Namco Holdings, sales for goods related to characters such as Kamen Rider, Super Sentai, and Aikatsu! were down year-on-year. For reference, sales of merchandise featuring the Yokai Watch characters—a key component of sales—amounted to JPY28.3bn as of Q3 FY03/16, compared to JPY43.0bn for the same period during FY03/15.

Segment profit was also down due to a booking of excess inventory write-downs, in addition to lower gross profit stemming from a decrease in sales.

Visual and Music

In the Visual and Music segment, sales fell 11.5% YoY to JPY28.7bn and segment profit rose 1054.2% to JPY312mn.

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. Additionally, while the Frozen movie was popular during Q3 FY03/15, there were no standout hits during Q3 FY03/16.

However, an improvement in sales at its manufacturing businesses and fewer unprofitable titles resulted in a significant boost in segment profit.

Videogames

In the Videogame segment, sales fell 13.3% YoY to JPY42.1bn, with segment profit declining 94.4% to JPY23mn.

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 even during the year-end shopping rush.

Profits were also down due to a booking of write-downs of the company's original products. In manufacturing, the company appears to be focusing on expanding its lineup of products targeting young girls in an effort to concentrate on promising target markets.

Amusement

In the Amusement segment, sales declined 9.1% YoY to JPY16.8bn, while segment profit declined 11.3% to JPY1.3bn.

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 were down.

According to materials from Bandai Namco Holdings, the number of digital cards sold during Q3 FY03/16 was 174mn units (216mn units during Q3 FY03/15).

1H FY03/16 results

Sales:	JPY84.0bn (-10.1% YoY)
Operating profit:	JPY1.8bn (-22.2% YoY)
Recurring profit	JPY1.9bn (-23.0% YoY)
Net income:	JPY1.2bn (-34.7% YoY)

The entertainment industry that the group deals in is going through a difficult time, such as the declining birth rate, the diversifying consumer needs, and the increasing prominence of smartphone-based games and download software over packaged items and hard copies. Although it worked to improve group sales and profits by concentrating resources into favorable markets at the manufacturing businesses, earnings were down YoY in comparison with strong performance of its distribution business the previous year.

Toys

In the Toys segment, sales fell 12.0% YoY to JPY34.7bn and segment profit declined 24.5% to JPY1.3bn.
Sales of the company's standard products were firm, but overall sales still fell short of its strong performance the previous year, particularly for character goods.

Sales of Bandai products were down 14.7% YoY to JPY19.0bn, with the contribution from Bandai products to sales in this segment falling 1.7% YoY to 54.9%.
According to documents from Bandai Namco Holdings, Inc., sales shrank YoY for its character products such as Kamen Rider, Super Sentai, and Aikatsu!. Yokai Watch products, the mainstay of sales the preceding year, contributed JPY23.3bn to sales for Bandai Namco Holdings, Inc. (JPY22.5bn the preceding year).

Disposal costs were JPY520mn (JPY630mn the preceding year).

Inventory was priced at JPY4.6bn (JPY3.4bn the preceding year). The main reason for this increase was a calculated increase in Yokai Watch products to avoid shortages and to help make Yokai Watch products standard stock.

Visual and Music

In the Visual and Music segment, sales fell 18.8% YoY to JPY17.4bn and segment profit declined 0.9% to JPY144mn.

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. There have been no hit products in 1H FY03/16 comparable to “Frozen” and other hit titles of the preceding year.

However, whereas revenue from the company’s original titles was low the preceding year due to the cost of acquiring rights for a number of these titles, this did not apply in 1H FY03/16, so earnings from the company’s original titles showed improvement.

Videogames

In the Videogame segment, sales rose 1.4% YoY to JPY20.2bn, with a segment loss of JPY50mn versus a loss of JPY61mn a year earlier.

Although the increasing prominence of smartphone games and download software continued to negatively impact the market for packaged products, sales and earnings improved thanks to firm sales of titles such as Splatoon for the Nintendo Wii U, leading to an improvement in segment earnings.

In self-developed products, the company released a Nintendo 3DS software “Kobayashi ga Kawai sugite Tsurai!!” (Kobayashi is So Cute It's Painful!!) but its contribution to earnings appears to have been limited.

The disposal price was JPY140mn (JPY90mn in 1H FY03/15). Disposal costs increased due to miscalculated procurement estimates.

Amusement

In the Amusement segment, sales declined 7.6% YoY to JPY11.7bn, while segment profit declined 8.7% to JPY1.2bn.

As there were no products to boost sales in comparison to the previous year, earnings from children’s card game machines were slow. Earnings from toy vending machines were bolstered by the planning and holding of events.

Q1 FY03/16 results

Sales:	JPY37.3bn (-6.8% YoY)
Operating profit:	JPY779mn (-6.3% YoY)
Recurring profit	JPY794mn (-8.0% YoY)
Net income:	JPY471mn (-49.2% YoY)

Sales and earnings finished the quarter down, hurt by a lack of original hit products that carry high margins and move the market.

Toys

In the Toys segment, sales fell 7.3% YoY to JPY15.2bn and segment profit declined 8.8% to JPY532mn.
Sales of the company's standard products were firm, but overall sales still fell short of Q1 the previous year when Bandai characters saw brisk sales. Bandai Namco Holdings, Inc. (TSE: 7832) materials showed lower year-on-year sales for characters such as Kamen Rider and Aikatsu!.

Visual and Music

In the Visual and Music segment, sales fell 17.7% YoY to JPY8.6bn and segment profit declined 75.9% to JPY23mn.

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. Further, while certain visual products were a hit in Q1 FY03/15, there were no major hit products this Q1. The drop in earnings was further aggravated by the lack of any big hits among the company's original titles, which carry high profit margins.

Videogames

At the Videogame segment, sales rose 13.0% YoY to JPY8.0bn, with a segment loss of JPY58mn versus a loss of JPY114mn a year earlier.

The gains in sales and earnings were attributable to firm sales of titles such as Splatoon for the Nintendo Wii.

Amusement

At the Amusement segment, sales declined 10.2% YoY to JPY5.5bn while segment profit rose 3.9% to JPY573mn.

Sales of toy vending machines and digital card games both declined, falling short of Q1 the previous year when Bandai characters saw brisk sales. The decline in sales reflects difficult comparisons with a year earlier, when sales were exceptionally strong. Bandai Namco Holdings's materials showed digital cards sales at 58mn cards, 21mn less than in Q1 the previous year.

Operating profit still rose, however, as earnings were no longer weighed down by the investment spending on new children's card game machines acquired at this time last year.

FY03/15 full-year 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.

FY03/14 results

The acquisition of Toys Union, distributor of Nintendo products, resulted in a JPY27.2bn increase in sales.

Higher sales and profits in the toys and amusement businesses contributed to the increase in operating profit.

Toys

Sales were JPY76.8bn (+2.9% YoY) and segment profit was JPY2.7bn (+31.8%).

Sales and profits increased due to hit products such as Kamen Rider Gaim character products by Bandai, along with Zyuden Sentai Kyoryuger and Yokai Watch. High-margin Bandai products accounted for a larger share of total sales, meaning overall margins were up YoY.

Visual and music

Sales were JPY43.0bn (-4.1% YoY) and segment profit was JPY307mn (-0.7%).

Profits and sales fell YoY. Some products were successful hits, such as part-funded Nobou no Shiro and 100% in-house animation Zoids. However, the packaged-product market was weak due to the spread of online distribution. Revenue from some DVD titles fell below the minimum guarantee, resulting in a loss.

Videogames

Sales were JPY63.6bn (+72.7% YoY) and segment profit was JPY79mn (-88.2%).

The packaged-product market stalled, but the company achieved YoY growth in sales as Toys Union Co. Ltd. became a subsidiary. Profits fell owing to valuation losses booked on excess inventory of some videogame titles and accessories (about JPY800mn).

Amusement

Sales were JPY23.5bn (+14.8% YoY) and segment profit was JPY2.1bn (+62.4%).

Sales were robust for Aikatsu!, Yokai Watch, and Dragon Ball Heroes products for children's card game machines. Sales of Kamen Rider Gaim and Yokai Watch products for toy vending machines were also strong.

Recurring profit was up 27.1%. The increase in net income was 22.6%. The company booked an extraordinary profit of JPY409mn on gains on negative goodwill from the acquisition of Toys Union, but also an extraordinary loss of JPY166mn on withdrawal from the employee pension fund.

Other information

History

1969 Incorporated as Tosho Ltd (Tosho becomes a stock company in 1972).

1972 Starts full-scale transactions with Popy (now Bandai).

1991 Company name changes to Happinet Corp with absorption of Dairin Corp and Seiko Corp (integration of Bandai-affiliated toy distributors).

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

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

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

1994 Bandai buys more Happinet shares; Happinet joins the Bandai group. Happinet begins distributing PlayStation game consoles and starts distributing 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.

News and topics

March2016

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 (capital: JPY10mn) with a founding date of February 12, 2016. The new LLC will be a joint venture with Naoyuki Matsunaga—the President of Yokocho 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 though 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 & 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	FY03/13	FY03/14	FY03/15
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.

February 2015

On **February 10, 2015**, the company announced a revision to its FY03/15 year-end dividend.

The company plans to raise its year-end dividend amount by JPY13.5, to JPY15 per share. As a result, annual dividends for FY03/15 will total JPY28.5 per share, a year-on-year increase of JPY3.75 per share. This will be subject to shareholder approval at the shareholder meeting to be held in late June 2015.

November 2014

On **November 7, 2014**, the company announced revisions to its 1H FY03/15 and full-year FY03/15 earnings forecasts.

Revised 1H FY03/15 earnings forecast (previous forecast in parentheses)

- Sales: JPY93.0bn (JPY90.0bn)
- Operating profit: JPY2.4bn (JPY1.6bn)
- Recurring profit: JPY2.4bn (JPY1.6bn)

- Net income: JPY1.8bn (JPY1.1bn)

Revised full-year FY03/15 earnings forecast (previous forecast in parentheses)

- Sales: JPY215.0bn (JPY210.0bn)
- Operating profit: JPY5.0bn (JPY4.0bn)
- Recurring profit: JPY5.0bn (JPY4.0bn)
- Net income: JPY3.5bn (JPY2.6bn)

Revision details

Although the company booked one-time fees associated with the merger of subsidiaries in the videogame business, sales in the toys and amusement businesses were robust. Major contributors were products featuring Bandai properties Yokai Watch and Kamen Rider Gaim. Sales and profits are now forecast to exceed initial company estimates for 1H FY03/15 and the full year.

Major shareholders

Top Shareholders	Amount Held
Namco Bandai Holdings Inc.	25.90%
Japan Trustee Services Bank, Ltd. (Trust account)	3.30%
Japan Trustee Services Bank, Ltd. Sumitomo Mitsui Trust Bank, Limited Retrust Portion/SMBC Employee Pension Trust	3.00%
Yasuhiko Idaira	2.50%
Hiroshi Kawai	1.30%
Happinet Employees' Stockholding	1.30%
Takashi Nishimura	1.30%
CBNY-Government of Norway	1.30%
The Master Trust Bank of Japan, Ltd. (Trust account)	1.06%
ICHIGO TRUST PTE.LTD,	1.10%

Source: Shared Research based on company data
As of March 31, 2016
*Excluding 1,367,800 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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Apamanshop Holdings Co., Ltd.	Harmonic Drive Systems Inc.	Resorttrust, Inc.
ArtSpark Holdings Inc.	Hearts United Group Co., Ltd.	Round One Corp.
AS ONE Corporation	Heiwa Real Estate Co., Ltd.	Ryohin Keikaku Co., Ltd.
Axell Corporation	IID, Inc.	SanBio Company Limited
Azbil Corporation	Infomart Corp.	Sanix Incorporated
Bell-Park Co., Ltd.	Intelligent Wave Inc.	Sanrio Co., Ltd.
Benefit One Inc.	istyle Inc.	SATO Holdings Corp.
Canon Marketing Japan Inc.	Itochu Enex Co., Ltd.	SBS Holdings, Inc.
Carna Biosciences, Inc.	ITO EN, Ltd.	Ship Healthcare Holdings Inc.
Chiyoda Co., Ltd.	J Trust Co., Ltd	SMS Co., Ltd.
Chugoku Marine Paints, Ltd.	Japan Best Rescue System Co., Ltd.	SOURCENEXT Corporation
Cocokara Fine, Inc.	JIN Co., Ltd.	Star Mica Co., Ltd.
Comsys Holdings Corporation	Kameda Seika Co., Ltd.	SymBio Pharmaceuticals Limited
CRE, Inc.	Kenedix, Inc.	Takashimaya Co., Ltd.
Creek & River Co., Ltd.	LAC Co., Ltd.	Takihyo Co., Ltd.
Daiseki Corp.	Lasertec Corp.	Tamagawa Holdings Co., Ltd
DIC Corporation	MAC-HOUSE Co.	TEAR Corporation
Digital Garage Inc.	Matsui Securities Co., Ltd.	3-D Matrix, Ltd.
Don Qijote Holdings Co., Ltd.	Medinet Co., Ltd.	TOKAI Holdings Corp.
Dream Incubator Inc.	MEGANESUPER CO., LTD.	WirelessGate, Inc.
Elecom Co.	Milbon. Co., Ltd.	Yellow Hat Ltd.
EMERGENCY ASSISTANCE JAPAN Co.	MIRAIT Holdings Corp.	Yumeshin Holdings
en-Japan Inc.	MONEY SQUARE HOLDINGS, INC.	VOYAGE GROUP, Inc.
FerroTec Corp.	NAGASE & CO., LTD	ZAPPALLAS, INC.
Fields Corp.	NAIGAI TRANS LINE LTD.	

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