LAST UPDATE【2015/12/14】

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.
Total Sales	**166,778**	**194,246**	**190,891**	**198,021**	**176,757**	**206,867**	**217,232**	**200,000**
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	17.0%	5.0%	-7.9%
Gross Profit	**19,990**	**22,467**	**22,326**	**25,007**	**22,501**	**24,039**	**26,152**	
YoY	9.2%	12.4%	-0.6%	12.0%	-10.0%	6.8%	8.8%	
GPM	12.0%	11.6%	11.7%	12.6%	12.7%	11.6%	12.0%	
Operating Profit	**2,137**	**2,327**	**2,855**	**4,855**	**2,973**	**3,888**	**5,056**	**4,500**
YoY	47.3%	8.9%	22.7%	70.1%	-38.8%	30.8%	30.0%	-11.0%
OPM	1.3%	1.2%	1.5%	2.5%	1.7%	1.9%	2.3%	2.3%
Recurring Profit	**2,322**	**2,513**	**3,013**	**5,032**	**3,081**	**3,917**	**5,124**	**4,500**
YoY	48.0%	8.2%	19.9%	67.0%	-38.8%	27.1%	30.8%	-12.2%
RPM	1.4%	1.3%	1.6%	2.5%	1.7%	1.9%	2.4%	2.3%
Net Income	**1,135**	**1,179**	**1,376**	**2,458**	**2,011**	**2,466**	**4,049**	**3,000**
YoY	-	3.9%	16.7%	78.6%	-18.2%	22.6%	64.2%	-25.9%
Net Margin	0.7%	0.6%	0.7%	1.2%	1.1%	1.2%	1.9%	1.5%
Per Share Data (JPY)								
Number of Shares (thousands)	12,025	12,025	12,025	24,050	24,050	24,050	24,050	
EPS	48.8	52.3	61.3	109.7	89.8	109.4	178.9	132.5
EPS (Fully Diluted)	-	-	-	109.6	89.6	108.1	176.2	
Dividend Per Share	15.0	15.00	15.00	27.50	22.50	24.75	28.50	30.00
Book Value Per Share	799.5	846.4	883.7	972.1	1,036.2	1,128.3	1,293.0	
Balance Sheet (JPYmn)								
Cash and Equivalents	5,463	6,312	8,220	12,359	10,155	9,996	15,867	
Total Current Assets	**44,864**	**40,140**	**41,039**	**48,269**	**47,930**	**47,025**	**52,449**	
Tangible Fixed Assets, net	1,952	1,668	1,555	1,392	1,110	1,342	688	
Other Fixed Assets	3,355	3,405	2,780	2,946	2,976	5,065	5,900	
Intangible Assets	4,488	3,836	3,132	1,715	985	446	854	
Total Assets	**54,661**	**49,050**	**48,507**	**54,323**	**53,003**	**53,879**	**59,893**	
Notes and Accounts Payable	20,748	19,832	20,204	23,042	22,672	20,099	20,118	
Short-Term Debt	5,520	2,460	-	-	-	-	-	
Total Current Liabilities	**33,171**	**27,436**	**25,837**	**29,617**	**26,883**	**25,036**	**26,957**	
Long-Term Debt	430	30	-	-	-	-	1	
Total Fixed Liabilities	**3,305**	**2,651**	**2,867**	**2,909**	**2,829**	**3,148**	**3,355**	
Total Liabilities	**36,476**	**30,088**	**28,704**	**32,527**	**29,713**	**28,185**	**30,312**	
Net Assets	**18,184**	**18,962**	**19,802**	**21,795**	**23,289**	**25,694**	**29,580**	
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	
Investment Cash Flow	-851	-391	-315	-50	-108	-87	-158	
Financing Cash Flow	-975	-4,481	-2,852	-421	-588	-2,618	-628	
Financial Ratios								
ROA	4.5%	4.8%	6.2%	9.8%	5.7%	7.3%	9.0%	
ROE	6.2%	6.3%	7.1%	11.8%	8.9%	10.1%	14.8%	
Equity Ratio	33.3%	38.7%	40.8%	40.1%	43.9%	47.7%	49.4%	

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.

Recent updates

Highlights

On **December 14, 2015**, Shared Research updated the report following interviews with management.

On **November 20, 2015**, Happinet Corporation 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 goal 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.

On **November 11, 2015**, the company announced earnings results for 1H 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		FY03/16	
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY Est.	1H Est.	% of FY	FY Est.
Sales	40,039	93,437	174,327	217,232	37,300	83,993			96.5%	87,000	42.0%	200,000
YoY	10.7%	6.9%	5.4%	5.0%	-6.8%	-10.1%				-6.9%		-7.9%
Gross Profit	5,559	12,016	20,717	26,152	5,035	10,606						
YoY	10.7%	11.4%	10.2%	8.8%	-9.4%	-11.7%						
GPM	13.9%	12.9%	11.9%	12.0%	13.5%	12.6%						
SG&A	4,728	9,653	15,568	21,095	4,256	8,769						
YoY	7.1%	4.6%	5.3%	4.7%	-10.0%	-9.2%						
SG&A / Sales	11.8%	10.3%	8.9%	9.7%	11.4%	10.4%						
Operating Profit	831	2,362	5,149	5,056	779	1,837			91.9%	2,000	40.8%	4,500
YoY	37.6%	52.3%	28.0%	30.0%	-6.3%	-22.2%				-15.3%		-11.0%
OPM	2.1%	2.5%	3.0%	2.3%	2.1%	2.2%				2.3%		2.3%
Recurring Profit	863	2,413	5,219	5,124	794	1,857			92.9%	2,000	41.3%	4,500
YoY	40.6%	52.8%	28.5%	30.8%	-8.0%	-23.0%				-17.1%		-12.2%
RPM	2.2%	2.6%	3.0%	2.4%	2.1%	2.2%				2.3%		2.3%
Net Income	928	1,814	3,995	4,049	471	1,185			91.2%	1,300	39.5%	3,000
YoY	256.9%	31.9%	52.3%	64.2%	-49.2%	-34.7%				-28.3%		-25.9%
NPM	2.3%	1.9%	2.3%	1.9%	1.3%	1.4%				1.5%		1.5%

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		
YoY	10.7%	4.3%	3.6%	3.6%	-6.8%	-12.6%		
Gross Profit	5,559	6,457	8,701	5,435	5,035	5,571		
YoY	10.7%	12.0%	8.5%	3.9%	-9.4%	-13.7%		
GPM	13.9%	12.1%	10.8%	12.7%	13.5%	11.9%		
SG&A	4,728	4,925	5,915	5,527	4,256	4,513		
YoY	7.1%	2.3%	6.6%	3.0%	-10.0%	-8.4%		
SG&A / Sales	11.8%	9.2%	7.3%	12.9%	11.4%	9.7%		
Operating Profit	831	1,531	2,787	-93	779	1,058		
YoY	37.6%	61.7%	12.7%	-	-6.3%	-30.9%		
OPM	2.1%	2.9%	3.4%	-	2.1%	2.3%		
Recurring Profit	863	1,550	2,806	-95	794	1,063		
YoY	40.6%	60.6%	13.0%	-	-8.0%	-31.4%		
RPM	2.2%	2.9%	3.5%	-	2.1%	2.3%		
Net Income	928	886	2,181	54	471	714		
YoY	256.9%	-20.5%	74.8%	-	-49.2%	-19.4%		
NPM	2.3%	1.7%	2.7%	0.1%	1.3%	1.5%		

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

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		
YoY	10.7%	6.9%	5.4%	5.0%	-6.8%	-10.1%		
Toys	16,411	39,479	74,911	93,270	15,219	34,742		
YoY	13.4%	23.8%	22.9%	21.4%	-7.3%	-12.0%		
Visual and Music	10,454	21,376	32,379	43,372	8,601	17,352		
YoY	4.2%	0.4%	-2.0%	1.0%	-17.7%	-18.8%		
Videogames	7,094	19,939	48,571	56,448	8,018	20,212		
YoY	8.8%	-13.5%	-10.6%	-11.3%	13.0%	1.4%		
Amusement	6,079	12,643	18,464	24,140	5,459	11,686		
YoY	18.1%	13.4%	7.7%	2.8%	-10.2%	-7.6%		
Operating profit	831	2,362	5,149	5,056	779	1,837		
YoY	37.6%	52.3%	28.0%	30.0%	-6.3%	-22.2%		
Toys	584	1,663	4,258	4,279	532	1,256		
YoY	155.0%	195.4%	59.7%	57.9%	-8.9%	-24.5%		
Visual and Music	97	145	27	202	23	144		
YoY	0.0%	-61.5%	-91.4%	-34.2%	-76.3%	-0.9%		
Videogames	-114	-61	427	254	-58	-50		
YoY	-	-	21.7%	221.5%	-	-		
Amusement	551	1,264	1,475	1,796	573	1,154		
YoY	0.7%	6.2%	-10.1%	-12.5%	4.0%	-8.7%		
Adjustment	-287	-648	-1,037	-1,475	-292	-667		
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		
YoY	10.7%	4.3%	3.6%	3.6%	-6.8%	-12.6%		
Toys	16,411	23,068	35,432	18,359	15,219	19,523		
YoY	13.4%	32.5%	21.9%	15.6%	-7.3%	-15.4%		
Visual and Music	10,454	10,922	11,003	10,993	8,601	8,751		
YoY	4.2%	-3.1%	-6.1%	10.7%	-17.7%	-19.9%		
Videogames	7,094	12,845	28,632	7,877	8,018	12,194		
YoY	8.8%	-22.3%	-8.4%	-15.4%	13.0%	-5.1%		
Amusement	6,079	6,564	5,821	5,676	5,459	6,227		
YoY	18.1%	9.4%	-2.8%	-10.5%	-10.2%	-5.1%		
Operating profit	831	1,531	2,787	-93	779	1,058		
YoY	37.6%	61.7%	12.7%	-	-6.3%	-30.9%		
Toys	584	1,079	2,595	21	532	724		
YoY	155.0%	223.1%	23.3%	-51.2%	-8.9%	-32.9%		
Visual and Music	97	48	-118	175	23	121		
YoY	0.0%	-82.9%	-	-	-76.3%	152.1%		
Videogames	-114	53	488	-173	-58	8		
YoY	-	341.7%	53.9%	-	-	-84.9%		
Amusement	551	713	211	321	573	581		
YoY	0.7%	10.9%	-53.2%	-22.1%	4.0%	-18.5%		
Adjustment	-287	-361	-389	-438	-292	-375		

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

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 Toy 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.

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

Full-year outlook

Full-year Forecast (JPYmn)	FY03/15 1H Act.	FY03/15 2H Est.	FY03/15 FY Est.	FY03/16 1H Act.	FY03/16 2H Est.	FY03/16 FY Est.
Sales	**93,437**	**123,795**	**217,232**	**83,993**	**116,007**	**200,000**
CoGS	81,421	109,659	191,080	73,386		
Gross Profit	12,016	14,136	**26,152**	**10,606**		
GPM	12.9%	-0.8%	12.0%	12.6%		
SG&A	9,653	11,442	21,095	8,769		
SG&A / Sales	10.3%	-0.6%	9.7%	10.4%		
Operating Profit	**2,362**	**2,694**	**5,056**	**1,837**	**2,663**	**4,500**
OPM	2.5%	-0.2%	2.3%	2.2%	2.3%	2.3%
Recurring Profit	**2,413**	**2,711**	**5,124**	**1,857**	**2,643**	**4,500**
RPM	2.6%	-0.2%	2.4%	2.2%	2.3%	2.3%
Net Income	**1,814**	**2,235**	**4,049**	**1,185**	**1,815**	**3,000**
Net Margin	1.9%	-0.1%	1.9%	1.4%	1.6%	1.5%

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

(JPYmn)	FY03/15 1H Act.	FY03/15 2H Act.	FY03/15 FY Act.	FY03/16 FY Est.
Sales	93,437	123,795	217,232	200,000
YoY	6.9%	3.6%	5.0%	-7.9%
Toys	39,479	53,791	93,270	84,000
YoY	23.8%	19.7%	21.4%	-9.9%
Visual and Music	21,376	21,996	43,372	40,000
YoY	0.4%	1.6%	1.0%	-7.8%
Videogames	19,939	36,509	56,448	52,000
YoY	-13.5%	-10.0%	-11.3%	-7.9%
Amusement	12,643	11,497	24,140	24,000
YoY	13.4%	-6.8%	2.8%	-0.6%
Operating Profit	2,362	2,694	5,056	4,500
YoY	52.3%	15.3%	30.0%	-11.0%
Toys	1,663	2,616	4,279	3,800
YoY	195.2%	21.8%	57.9%	-11.2%
OPM	4.2%	4.9%	4.6%	4.5%
Visual and Music	145	57	202	200
YoY	-61.4%	-	-34.3%	-1.0%
OPM	0.7%	0.3%	0.5%	0.5%
Videogames	-61	315	254	200
YoY	-	600.0%	217.9%	-21.3%
OPM	-0.3%	0.9%	0.4%	0.4%
Amusement	1,264	532	1,796	1,600
YoY	6.2%	-38.4%	-12.5%	-10.9%
OPM	10.0%	4.6%	7.4%	6.7%
Adjustments	-648	-827	-1475	-1300

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

FY03/16 forecasts

- Sales: JPY200.0bn (-7.9% YoY)
- Operating profit: JPY4.5bn (-11.0%)
- Recurring profit: JPY4.5bn (-12.2%)
- Net income: JPY3.0bn (-25.9%).

Company forecasts and efforts underway by segment are as follows:

Toy Business

The company anticipates JPY84.0bn (-9.9% YoY) in sales and JPY3.8bn (-11.2 YoY) in operating profit.

While Bandai products comprise approximately half of its sales in this segment, Bandai Namco Holdings, Inc. expects a 4.7% YoY decline in sales in its Toy And Hobby segment in FY03/16 with sales forecasts for Yokai Watch related products at JPY30.0bn (-45.7% YoY) in its sales plan in a breakdown by character (domestic toys and hobbies).

In 2H, Bandai Namco Holdings, Inc. plans to release a range of products related to its new TV animation character "Himitsu no Cocotama". The company is working to secure retail space and improve sales.

The company plans to expand the formats of products that it has developed so they can be used for various characters.

Visual and Music Business

The company forecasts JPY40.0bn in sales (-7.8% YoY) and JPY200mn (-1.0% YoY) in operating profit.

Declines are expected in sales and profits due to expectations of a sluggish market for product packages on the effects of software distribution and while hits such as “Frozen” had contributed to sales, similar hits are not anticipated in FY03/16.

As set out in the medium-term business plan, the company is concentrating assets in its best markets. It is shifting away from a product package sales focus towards a strategy of maximizing use of its own production and sales networks to drive the creation and release of the company's own titles. Happinet also produced its own animation, developed jointly with external partners, entitled “Ore ga Ojo-sama Gakko ni ‘Shomin Sample’ toshite Get sareta Ken”, which was released on television from October 2015 (with DVD sales to start from January 2016.) Another production led by the company, mystery movie "Zan-e: Sunde wa ikenai heya" (Zan-e: The room that must not be lived in), is also scheduled for release in January 2016.

Video Game Business

The company forecasts JPY52.0bn in sales (-7.9% YoY) and JPY200mn (-21.3% YoY).

It expects declines in sales and profits on the effects of a sluggish market for packaged products due to the impact of software distribution and games for smartphones.

The company plans to launch game software following “Junisai: Honto no Kimochi” released during the preceding period, developed for girls under the brand “Puchi Koi (petit koi).” It launched “Kobayashi ga Kawai sugite Tsurai!!” in August 2015, and plans to launch three new titles "Zosaku Arisu to Oji-sama!" (Creative Alice and Prince!), "Chao Irasuto Kurabu" (Ciao Illustrations Club) and "Niko☆Puchi Gaaruzu Ranuei" (Nico Petit Girls Runway) in 2H. These are all targeting elementary school-aged girls, and due to the limited target range, contribution to profits may not be significant.

Amusement Business

The company forecasts JPY24.0bn in sales (-0.6% YoY) and JPY1.6bn (-10.9% YoY).

Although the company aims to further expand business and introduce its unit management system using its market share, compared to the robust results of the previous year, it expects sales and profits to decline year-on-year.

The company also hopes to boost sales from toy vending machines by setting up the machines at different locations, such as venues for live events and at train stations. The company is planning a number of events in various locations in 2H that it expects will attract customers.

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.

Toy Business

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 Business

The company plans to leverage its strength of having information on both manufacturers and distributors 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 Business

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 Business

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.

Midterm measures for the Manufacturing Business

As for its manufacturing business, the company will, through selection and focus, create markets in which it is at an advantage and attempt to improve profitability in the respective categories for toys, videos, and games.

The company manufactured and sold original toys related to a television animation show for boys during FY03/15 but had not achieved expected results. It says that in the three-year midterm period it hopes to change this to a business with high rates of stability by expanding its market share in categories for original toys which bring in high levels of profitability.

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 (Age 12: 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.

Business

Description

Leading intermediary distributor for toys, DVDs, CDs and videogames. The company buys goods from makers and distributes to retailers, managing inventories and handling orders/shipments. Segments comprise toys (42.9% of FY03/15 sales), visual and music (20.0%), videogames (26.0%), and amusement (11.1%).

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.

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

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

Distribution channels are specialty stores, including consumer electronics and camera stores (29.6% of FY03/14 sales), general merchandise stores (21.7%), e-commerce (17.9%), convenience stores (10.6%), large suburban specialty stores (10.2%), and others (3.9%).

E-commerce's share of sales increased in FY03/14 when Toys Union—with a high proportion of sales going to major online retailers—became a subsidiary. Sales to Amazon.com International Sales Inc. amounted to JPY32.0bn, or 15.5% of the total.

Sales by Channel (JPYmn)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.
Total	166,700	193,900	190,500	198,000	176,700	206,800
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	17.0%
Specialty Stores	55,200	63,900	65,300	62,500	60,400	61,100
YoY	8.4%	15.8%	2.2%	-4.3%	-3.4%	1.2%
% of Total	33.1%	33.0%	34.3%	31.6%	34.2%	29.6%
General Merchandise Stores	27,000	35,600	36,700	40,300	36,900	44,900
YoY	-9.4%	31.9%	3.1%	9.8%	-8.4%	21.8%
% of Total	16.2%	18.4%	19.3%	20.4%	20.9%	21.7%
E-Commerce	28,800	22,200	24,100	25,000	19,200	36,900
YoY	-17.7%	-22.9%	8.6%	3.7%	-23.2%	92.6%
% of Total	17.3%	11.4%	12.7%	12.6%	10.9%	17.9%
Convenience Stores	14,100	21,500	21,300	26,300	22,800	21,800
YoY	11.9%	52.5%	-0.9%	23.5%	-13.3%	-4.2%
% of Total	8.5%	11.1%	11.2%	13.3%	12.9%	10.6%
Large-format Suburban Specialty Stores	9,000	19,300	18,500	19,300	17,200	21,100
YoY	-33.3%	114.4%	-4.1%	4.3%	-10.9%	22.6%
% of Total	5.4%	10.0%	9.7%	9.7%	9.7%	10.2%
Wholesalers	17,000	21,500	15,400	15,200	11,500	12,500
YoY	14.1%	26.5%	-28.4%	-1.3%	-24.3%	8.2%
% of Total	10.2%	11.1%	8.1%	7.7%	6.5%	6.1%
Others	15,300	9,900	9,200	9,100	8,500	8,100
YoY	27.5%	-35.3%	-7.1%	-1.1%	-6.6%	-4.4%
% of Total	9.2%	5.1%	4.8%	4.6%	4.8%	3.9%

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

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

Toys (42.9% FY03/15 consolidated sales; 65.5% operating profit)

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

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

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

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

The company buys goods from big toy makers like Bandai and Tomy and sells them to toy retailers such as

Toys"R"Us-Japan Ltd (unlisted), large consumer electronics stores and retail chains, and major online retailers.

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

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

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

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 animated cartoons. Bandai has leveraged these character goods to increase its domestic toy sales.

Bandai's character goods portfolio

Leading toy characters with the highest sales rankings at Bandai are those from the Super Sentai, Kamen Rider, and Precure series. Toei or Toei Animation makes these series; TV Asahi broadcasts them on Sundays. Program sponsor Bandai merchandises related toys. This system has a long history; the Super Sentai series, the longest-running of the trio, started with *Himitsu Sentai Gorenger* in 1975. Its 39th series, *Shuriken Sentai Ninninjer*, aired in 2015. In the 30-minute *Super Sentai* program, a team of three to five people use special items to become superheroes wearing helmets and color-coded jumpsuits, and fight bad guys or monsters. In each episode the enemy, once defeated, is reborn as a giant monster and the heroes ride a giant robot to destroy it. Each year a TV series starts in February and a movie version is launched in August. With new characters and items added during the year, Bandai merchandises all the transforming items, weapons and robots. All super hero toys are ready for Christmas when sales peak.

Bandai Sales by Character (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 Est.
Youkai Watch	-	-	-	-	-	1.4	55.2
Mobile Suit Gundam	16.0	14.4	13.4	15.6	16.5	18.4	22.9
Kamen Rider	8.7	17.5	23.0	28.3	27.1	22.3	20.6
Super Sentai	12.0	10.5	9.2	13.0	9.6	14.4	11.3
Anpanman	9.1	8.4	8.6	9.6	10.0	10.3	8.1
Precure Series	10.5	11.9	12.5	10.7	10.6	9.8	6.5
Dragon Ball	3.7	3.3	2.7	4.4	4.8	6.4	5.8
Aikatsu!	-	-	-	-	1.5	13.0	8.6
Ultraman	4.3	3.1	2.8	1.8	2.0	3.2	2.6

Source: Shared Research based on company data

Visual and music (20.0% FY03/15 consolidated sales; 3.1% operating profit)

This segment comprises the visual wholesale section (60.2% of segment sales in FY03/15), the visual manufacturing section (15.9%), and the music section (23.9%).

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.
Total	36,570	67,838	57,759	55,719	44,810	42,955	43,372
YoY	-5.1%	85.5%	-14.9%	-3.5%	-19.6%	-4.1%	1.0%
Visual	36,500	42,500	40,300	39,600	31,500	31,600	33,000
YoY	-5.2%	16.4%	-5.2%	-1.7%	-20.3%	0.1%	4.4%
% of Total	99.8%	62.6%	69.8%	71.1%	70.5%	73.6%	76.1%
Wholsale	29,100	36,800	34,400	33,600	25,900	25,200	26,000
YoY	-2.3%	26.5%	-6.5%	-2.3%	-22.8%	-2.7%	3.3%
% of Total	79.6%	54.2%	59.6%	60.3%	58.0%	58.8%	60.2%
Maker	7,400	5,700	5,800	5,900	5,600	6,300	6,900
YoY	-14.0%	-23.0%	1.8%	1.7%	-5.1%	13.3%	8.7%
% of Total	20.2%	8.4%	10.0%	10.6%	12.5%	14.8%	15.9%
Music	0	25,200	17,400	16,100	13,200	11,300	10,300
YoY	-	-	-31.0%	-7.5%	-18.0%	-14.3%	-8.5%
% of Total	0.0%	37.1%	30.1%	28.9%	29.5%	26.4%	23.9%

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

Visual wholesale section

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

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

Visual manufacturing section

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

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

The movie industry and movie production partnerships handle production, distribution, exhibition, and secondary use (renting/selling movie content to consumers). 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 it as a DVD to obtain sales and profits.

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

Music wholesale section

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

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

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

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

Music CDs: resale price maintenance

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

Videogames (26.0% FY03/15 consolidated sales; 3.9% operating profit)

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

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

Following the consolidation of Toys Union—a distributor of Nintendo products—in FY03/14, Nintendo products account for over 80% of sales, with Sony products next at about 15%. 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 Computer Entertainment toys, and has an exclusive distribution agreement in Japan with Microsoft.

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.
Total	50,474	44,372	46,447	42,704	36,839	63,609	56,448
YoY	-7.4%	-12.1%	4.7%	-8.1%	-13.7%	72.7%	-11.3%
Nintendo (stand-alone)	4,200	6,400	4,700	3,200	4,400	10,700	9,100
YoY	-53.3%	52.4%	-26.6%	-31.9%	37.5%	142.4%	-15.3%
% of Total	8.3%	14.4%	10.1%	7.5%	11.9%	16.9%	16.2%
Nintendo (portable)	9,600	10,300	9,900	10,400	14,200	40,300	36,900
YoY	-24.4%	7.3%	-3.9%	5.1%	36.7%	182.8%	-8.3%
% of Total	19.0%	23.2%	21.3%	24.4%	38.7%	63.4%	65.5%
PlayStation (stand-alone)	6,700	6,900	6,000	6,800	5,300	4,800	3,100
YoY	-23.9%	3.0%	-13.0%	13.3%	-22.1%	-9.1%	-34.8%
% of Total	13.3%	15.6%	12.9%	15.9%	14.4%	7.6%	5.6%
PlayStation (portable)	10,300	8,000	11,600	12,200	7,100	4,700	4,300
YoY	10.8%	-22.3%	45.0%	5.2%	-41.8%	-33.1%	-9.4%
% of Total	20.4%	18.0%	25.0%	28.6%	19.3%	7.5%	7.7%
Others	19,400	12,500	14,000	9,800	5,600	2,900	2,800
YoY	35.7%	-35.6%	12.0%	-30.0%	-42.2%	-48.8%	-1.9%
% of Total	38.4%	28.2%	30.1%	22.9%	15.4%	4.6%	5.0%

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 (November 2014).

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

Amusement (11.1% FY03/15 consolidated sales; 27.5% operating profit)

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

Toy vending machine section

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

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

In December 2013, the company had machines at 4,800 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 unprofitable. When operating toy vending machines, staff members still need to visit machine sites to monitor sales, refill capsules, and collect takings. The company must therefore allocate labor according to the number of machines at sites and the frequency of visits. There were many unprofitable areas where sales did not cover fixed costs.

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

Digital card game section

The company operates card game machines based on popular animation characters, in major retail and electronics stores.

As in the toy vending machine section, gross profits are high for the digital card game section because it is close to retail.

To play on a digital card game machine, a customer inserts JPY100 (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 2015, 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.
Sales	32,436	31,350	31,531	32,236	31,527	32,395	38,383
YoY	-	-3.3%	0.6%	2.2%	-2.2%	2.8%	18.5%
Recurring Profit	299	597	818	950	773	980	1,917
YoY	-	99.7%	37.0%	16.1%	-18.6%	26.8%	95.6%
Net Income	179	349	473	517	465	586	1,164
YoY	-	95.0%	35.5%	9.3%	-10.1%	26.0%	98.6%

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.
Sales	-	-	-	-	35,357	31,868	43,622
YoY	-	-	-	-	-	-9.9%	36.9%
Recurring Profit	-	-	-	-	393	-158	309
YoY	-	-	-	-	-	-	-
Net Income	-	-	-	-	194	-296	164
YoY	-	-	-	-	-	-	-

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)	FY03/09 Act.	FY03/10 Act.	FY03/11 Act.	FY03/12 Act.	FY03/13 Act.	FY03/14 Act.	FY03/15 Act.
Sales	-	-	-	-	4,372	6,786	6,256
YoY	-	-	-	-	-	55.2%	-7.8%
Recurring Profit	-	-	-	-	833	2,150	1,484
YoY	-	-	-	-	-	158.1%	-31.0%
Net Income	-	-	-	-	877	1,908	904
YoY	-	-	-	-	-	117.6%	-52.6%

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 totalling 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 the company's 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. As a debutant therefore 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 pummelled by online distribution. The company's large market shares in these types of product mean that it is unlikely to be able to escape the impact of these changes on its sales.

Market and value chain

Overview

Japan's toy market

Market likely to remain stable. According to the National Institute of Population and Social Security Research (IPSS), the number of people in Japan aged 0-14 decreased from 17.9mn in 2003 to 16.4mn in 2012 (meaning an annual decline of 0.9%). The market for baskets of eight types of toys contracted from JPY323.2bn in 2003 to JPY315.9bn in 2013, maintaining an average decline of 0.2%.

Dividing market size by the number of people aged 0–14, spending per head increased from JPY18,050 in 2003 to JPY19,270 in 2013 (up 0.7% 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 profit.

Domestic Toy Market and Population	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Market of 8 toy items (JPYbn)	323.2	316.2	317.1	312.9	319.1	320.5	319.0	326.2	325.1	316.1	315.9
Population at ages of 0-14 (thousand)	17,905	17,734	17,521	17,434	17,292	17,176	17,010	16,803	16,705	16,548	16,390
Average Purchase price of 8 toy items (JPY)	18,050	17,830	18,100	17,950	18,450	18,660	18,750	19,410	19,460	19,100	19,270

"* 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 2003 and 2013.

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 is purchasing visual media, resulting in a shrinking market.

Video Software Market (JPYbn)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total	670.2	669.5	664.2	630.1	574.1	530.7	502.1	480.2	461.5	439.0
YoY	-	-0.1%	-0.8%	-5.1%	-8.9%	-7.6%	-5.4%	-4.4%	-3.9%	-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
YoY	-	4.5%	-6.9%	-6.8%	-5.6%	-1.5%	-5.9%	-2.7%	0.7%	-5.9%
Software for Rental	357.8	343.1	360.4	346.9	306.7	267.2	254.2	238.9	218.4	210.3
YoY	-	-4.1%	5.0%	-3.7%	-11.6%	-12.9%	-4.9%	-6.0%	-8.6%	-3.7%

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

Video Software Purchasing Survey	2005年	2006年	2007年	2008年	2009	2010	2011	2012	2013	2014
Purchase Rate (%)					31.4	21.2	21.6	19.3	16.3	18.2
Average Total Purchases (titles)					4.6	5.5	3.9	3.8	5.0	4.2
Average Total Spend (JPY)					17,923	23,370	15,706	14,720	18,004	17,745

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.

Reasons for falling purchase amount (per 2013 Japan Video Software Association survey): fewer good titles, slimmer household budgets, and the popularity of free online video and file-sharing software.

The spread of pay-video distribution hurt sales of visual media. According to the Digital Content Association of Japan, the domestic market of pay-video distribution expanded from JPY76.2bn in 2010 to JPY82.6bn in 2011, JPY101.6bn in 2012, and JPY123.0bn in 2013, and JPY125.5bn in 2014. Reasons for the expansion include increasing membership of mobile carriers' smartphone services, new users for existing services as they adapt to smartphones, and higher sales of services that allow users to catch up on missed television programs.

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 10% a year from 78,996,000 in 2013 to 70,845,000 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
Total (JPYmn)	4,015	4,051	4,088	3,866	3,406	3,110	2,837	2,820	2,402	2,301
YoY	-	0.9%	0.9%	-5.4%	-11.9%	-8.7%	-8.8%	-0.6%	-14.8%	-4.2%
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
YoY	-	-4.2%	-5.2%	-11.2%	-15.7%	-9.9%	-5.9%	7.6%	-12.8%	-6.1%
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
YoY	-	56.0%	41.2%	20.0%	0.5%	-5.5%	-16.3%	-24.5%	-23.2%	4.8%
Total (mn units/plays)	578	666	732	727	682	651	567	490	490	492
YoY	-	15.3%	9.9%	-0.7%	-6.2%	-4.5%	-12.9%	-13.6%	-16.9%	-9.3%
Music Software Sales Volume (mn units) exl. Music Video	310	298	267	248	214	210	200	218	218	219
YoY	-	-3.9%	-10.4%	-7.1%	-13.7%	-1.9%	-4.8%	9.0%	-12.4%	-9.9%
Paid Distribution of Music (mn plays)	268	368	465	479	468	441	367	272	272	273
YoY	-	37.4%	26.3%	3.1%	-2.3%	-5.7%	-16.8%	-26.0%	-20.5%	-8.8%

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. And 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.

Given this dynamic since the mid-1990s Happinet has expanded through M&A. Shared Research sees this strategy continuing to bear fruit.

Visual and music: scope for expansion

Happinet said that direct transactions between visual/music content makers and retailers topped 50% of overall distribution of visual media and music in the year to end March 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, its share of the Nintendo-related market is 25%. This places Happinet at a level equivalent to the second largest distributor of Nintendo-related products. Given the contracting overall market, other distributors may leave the market at an increasing rate, implying opportunities for Happinet to grab market share.

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 midterm period from 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

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 Toy segment, sales fell 7.3% YoY to JPY15.2bn and operating 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 operating 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 an operating 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 operating 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 operating 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 operating 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 operating 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 operating 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.

Q3 FY03/15 results

- Sales: JPY174.3bn (+5.4% YoY)
- Operating profit: JPY5.1bn (+28.0%)
- Recurring profit: JPY5.2bn (+28.5%)
- Net income: JPY4.0bn (+52.3%)

Hit products in the Toys and Amusement businesses contributed to robust sales and profits.

Toys

Sales were JPY74.9bn (+22.8% YoY) and operating profit was JPY4.3bn (+59.6%).

Products featuring Bandai properties such as Yokai Watch and Kamen Rider Gaim showed strong sales, contributing to higher sales and profits. According to Bandai, sales of Bandai Watch products were around JPY43bn in Q3, up from zero in Q3 FY03/14. Happinet says it handles around half of Bandai Watch product sales.

Visual and Music

Sales were JPY32.4bn (-2.0% YoY) and operating profit was JPY27mn (-91.4%).

The packaged product market was weak due to the proliferation of online distribution. The company's visual wholesale section saw some hit titles, but in the high-margin visual manufacturing section, which typically makes a major contribution to revenues, a lack of hit titles led to subdued year-on-year operating profit.

The part-funded *Nobou no Shiro* and in-house animation *Zoids* boosted profits year-on-year.

Videogames

Sales were JPY48.6bn (-10.6% YoY) and operating profit was JPY427mn (+21.5%).

Sales of packaged products continue to be weak due to the proliferation of mobile and online games. Sales were lower year-on-year due to a lack of hit titles, although the company reported strong sales of products for the Nintendo 3DS console, such as *Pokemon Omega Ruby*, P*okemon Alpha Saphire*, and *Yokai Watch 2: Shinuchi*. Even so, profits rose due to the consolidation of subsidiaries and reduced inventory eliminations.

Sales were in line with the company's expectations on its releases of Nintendo 3DS games based on the *Dolly Kanon* and

12-Sai: Honto no Kimochi series from the Ciao magazine for elementary school girls. These games made a modest contribution to profits.

Amusement

Sales were JPY18.5bn (+7.7% YoY) and operating profit was JPY1.5bn (-10.2%).

Segment sales increased due to contributions from products featuring popular characters.

Sales of card games were down year-on-year, due to sluggish sales of games based on *Aikatsu!* and *Dragon Ball Heroes*, although a game based on *Yokai Watch* performed well.

Profits were down as the sales composition of high-margin digital card games declined, coupled with losses related to inventory write-offs.

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 operating 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 operating 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 operating 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 operating 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)

News and topics

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 Giam. Sales and profits are now forecast to exceed initial company estimates for 1H FY03/15 and the full year.

April 2014

On **April 14, 2014**, the company announced a revision to its FY03/14 full-year earnings forecast.

FY03/14 full-year earnings forecast

- Sales: JPY207.0bn(previous forecast: JPY205.0bn)
- Operating profit: JPY3.8bn (JPY3.4bn)
- Recurring profit: JPY3.9bn (JPY3.5bn)
- Net income: JPY2.4bn (JPY2.0bn)
- Earnings per share: JPY106.53 (JPY88.88)

Revision details

According to the company, although it recorded write-downs on excess inventory of products such as videogame merchandise, the toy and amusement businesses outperformed expectations. Particularly strong sales of products from Bandai franchises Kamen Rider Giam, Aikatsu!, and Yokai Watch paved the way for higher sales, operating profit, recurring profit, and net income compared to previous forecasts.

March 2014

On **March 11, 2014**, the company announced the merger of Toys Union Co., Ltd. and Mori Games Co., Ltd., both wholly-owned subsidiaries of the company.

Toys Union is a wholesaler of videogame products. According to the company, it trades a much greater amount of Nintendo Co., Ltd. videogame consoles and software products since acquiring Toys Union as a subsidiary in July 2013. The company aims to further strengthen its relationship with Nintendo by merging Toys Union and Mori Games, which are both involved in wholesaling videogames. It also hopes that streamlining its organization in this way will lead to earnings growth. The company plans to merge the two companies on July 1, 2014. Toys Union will be the absorbing firm.

Major shareholders

Top Shareholders	Amount Held
Namco Bandai Holdings Inc.	24.46%
Japan Trustee Services Bank, Ltd. (Trust account)	3.10%
Japan Trustee Services Bank, Ltd. Sumitomo Mitsui Trust Bank, Limited Retrust Portion/SMBC Employee Pension Trust	2.81%
Yasuhiko Idaira	2.34%
Chase Manhattan Bank GTS Clients Account Escrow	1.51%
Hiroshi Kawai	1.24%
Happinet Employees' Stockholding	1.22%
Takashi Nishimura	1.19%
CBNY-Government of Norway	1.06%
ICHIGO TRUST PTE.LTD,	1.00%

Source: Shared Research based on company data
As of September 31, 2015
*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	

About Shared Research Inc.

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Anritsu Corporation	Harmonic Drive Systems Inc.	Resorttrust, Inc.
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AS ONE Corporation	IID, Inc.	Sanix Incorporated
Axell Corporation	Infomart Corp.	Sanrio Co., Ltd.
Azbil Corporation	Intelligent Wave Inc.	SATO Holdings Corp.
Bell-Park Co., Ltd.	istyle Inc.	SBS Holdings, Inc.
Benefit One Inc.	Itochu Enex Co., Ltd.	Ship Healthcare Holdings Inc.
Canon Marketing Japan Inc.	ITO EN, Ltd.	SMS Co., Ltd.
Carna Biosciences, Inc.	J Trust Co., Ltd	SOURCENEXT Corporation
Chiyoda Co., Ltd.	Japan Best Rescue System Co., Ltd.	Star Mica Co., Ltd.
Cocokara Fine, Inc.	JIN Co., Ltd.	SymBio Pharmaceuticals Limited
Comsys Holdings Corporation	Kameda Seika Co., Ltd.	Takashimaya Co., Ltd.
CRE, Inc.	Kenedix, Inc.	Takihyo Co., Ltd.
Creek & River Co., Ltd.	KLab Inc.	Tamagawa Holdings Co., Ltd
Daiseki Corp.	LAC Co., Ltd.	TEAR Corporation
DIC Corporation	Lasertec Corp.	3-D Matrix, Ltd.
Digital Garage Inc.	MAC-HOUSE Co.	TOKAI Holdings Corp.
Don Qijote Holdings Co., Ltd.	Matsui Securities Co., Ltd.	Verite Co., Ltd.
Dream Incubator Inc.	Medinet Co., Ltd.	WirelessGate, Inc.
Elecom Co.	MIRAIT Holdings Corp.	Yellow Hat Ltd.
EMERGENCY ASSISTANCE JAPAN Co.	MONEY SQUARE HOLDINGS, INC.	Yumeshin Holdings
en-Japan Inc.	NAGASE & CO., LTD	VOYAGE GROUP, Inc.
FerroTec Corp.	NAIGAI TRANS LINE LTD.	ZAPPALLAS, INC.
Fields Corp.	NanoCarrier Ltd.	ZIGExN Co., Ltd.
FreeBit Co., Ltd.	Nippon Parking Development Co., Ltd.	

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