Happinet / 7552

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

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Key financial data

Income statement (JPYmn)	FY03/09 Cons.	FY03/10 Cons.	FY03/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Cons.	FY03/18 Est.
Total sales	**166,778**	**194,246**	**190,891**	**198,021**	**176,757**	**206,867**	**217,232**	**187,274**	**174,059**	**193,000**
YoY	-1.3%	16.5%	-1.7%	3.7%	-10.7%	17.0%	5.0%	-13.8%	-7.1%	10.9%
Gross profit	**19,990**	**22,467**	**22,326**	**25,007**	**22,501**	**24,039**	**26,152**	**21,997**	**21,971**	
YoY	9.2%	12.4%	-0.6%	12.0%	-10.0%	6.8%	8.8%	-15.9%	-0.1%	
GPM	12.0%	11.6%	11.7%	12.6%	12.7%	11.6%	12.0%	11.7%	12.6%	
Operating profit	**2,137**	**2,327**	**2,855**	**4,855**	**2,973**	**3,888**	**5,056**	**3,450**	**3,698**	**4,800**
YoY	47.3%	8.9%	22.7%	70.1%	-38.8%	30.8%	30.0%	-31.8%	7.2%	29.8%
OPM	1.3%	1.2%	1.5%	2.5%	1.7%	1.9%	2.3%	1.8%	2.1%	2.5%
Recurring profit	**2,322**	**2,513**	**3,013**	**5,032**	**3,081**	**3,917**	**5,124**	**3,497**	**3,479**	**4,600**
YoY	48.0%	8.2%	19.9%	67.0%	-38.8%	27.1%	30.8%	-31.8%	-0.5%	14.9%
RPM	1.4%	1.3%	1.6%	2.5%	1.7%	1.9%	2.4%	1.9%	2.0%	2.4%
Net income	**1,135**	**1,179**	**1,376**	**2,458**	**2,011**	**2,466**	**4,049**	**2,359**	**2,040**	**3,800**
YoY	-	3.9%	16.7%	78.6%	-18.2%	22.6%	64.2%	-41.7%	-13.5%	86.3%
Net margin	0.7%	0.6%	0.7%	1.2%	1.1%	1.2%	1.9%	1.3%	1.2%	2.0%
Per share data (JPY)										
Shares issued (year end; '000)	12,025	12,025	12,025	24,050	24,050	24,050	24,050	24,050	24,050	
EPS	48.8	52.3	61.3	109.7	89.8	109.4	178.9	104.1	92.3	172.0
EPS (fully diluted)	-	-	-	109.6	89.6	108.1	176.2	102.2	90.4	
Dividend per share	15.00	15.00	15.00	27.50	22.50	24.75	28.50	30.00	35.00	40.00
Book value per share	799.5	846.4	883.7	972.1	1,036.2	1,128.3	1,293.0	1,364.8	1,464.8	
Balance sheet (JPYmn)										
Cash and cash equivalents	5,463	6,312	8,220	12,359	10,155	9,996	15,867	11,412	11,605	
Total current assets	**44,864**	**40,140**	**41,039**	**48,269**	**47,930**	**47,025**	**52,449**	**44,905**	**48,975**	
Tangible fixed assets	1,952	1,668	1,555	1,392	1,110	1,342	688	753	777	
Intangible fixed assets	4,488	3,836	3,132	1,715	985	446	854	1,086	1,005	
Investments and other assets	3,355	3,405	2,780	2,946	2,976	5,065	5,900	10,047	10,579	
Total fixed assets	**9,797**	**8,910**	**7,468**	**6,054**	**5,072**	**6,854**	**7,443**	**11,887**	**12,361**	
Total assets	**54,661**	**49,050**	**48,507**	**54,323**	**53,003**	**53,879**	**59,893**	**56,793**	**61,337**	
Notes and accounts payable	20,748	19,832	20,204	23,042	22,672	20,099	20,118	18,282	21,550	
Short-term debt	5,520	2,460	-	-	-	-	-	-	-	
Total current liabilities	**33,171**	**27,436**	**25,837**	**29,617**	**26,883**	**25,036**	**26,957**	**21,817**	**25,188**	
Long-term debt	430	30	-	-	-	-	-	-	-	
Total fixed liabilities	**3,305**	**2,651**	**2,867**	**2,909**	**2,829**	**3,148**	**3,355**	**3,621**	**3,837**	
Total liabilities	**36,476**	**30,088**	**28,704**	**32,527**	**29,713**	**28,185**	**30,312**	**25,438**	**29,026**	
Net assets	**18,184**	**18,962**	**19,802**	**21,795**	**23,289**	**25,694**	**29,580**	**31,355**	**32,311**	
Total interest-bearing debt	5,950	2,490	-	-	-	-	-	-	-	
Cash flow statement (JPYmn)										
Cash flows from operating activities	951	6,232	5,083	4,609	-1,505	2,547	6,658	978	3,055	
Cash flows from investing activities	-851	-391	-315	-50	-108	-87	-158	-4,752	-1,107	
Cash flows from financing activities	-975	-4,481	-2,852	-421	-588	-2,618	-628	-677	-1,754	
Financial ratios										
ROA (RP-based)	4.5%	4.8%	6.2%	9.8%	5.7%	7.3%	9.0%	6.0%	5.9%	
ROE	6.2%	6.3%	7.1%	11.8%	8.9%	10.1%	14.8%	7.8%	6.5%	
Equity ratio	33.3%	38.7%	40.8%	40.1%	43.9%	47.7%	49.4%	55.2%	52.7%	

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

Recent updates

Highlights

On **March 12, 2018**, Shared Research updated the report following interviews with Happinet Corporation.

On **February 8, 2018**, the company announced earnings results for Q3 FY03/18; see the results section for details.

On **the same day**, the company announced revisions to its forecast for full-year results and its fiscal year-end dividend payment (payment of a special dividend).

Revised forecast for FY03/18 sales and earnings

- ▷ Sales: JPY193.0bn (versus previous forecast of JPY180.0bn)
- ▷ Operating profit: JPY4.8bn (JPY4.2bn)
- ▷ Recurring profit: JPY4.6bn (JPY4.0bn)
- ▷ Net income*: JPY3.8bn (JPY3.2bn)
- ▷ EPS: JPY171.95 (JPY144.80)

*Net income attributable to parent company shareholders

Reasons for the revision
Explaining the upward revision, the company said sales of the Nintendo Switch game console and related software (under its Videogame segment) during the all-important Christmas and year-end sales season were strong and that, as a result, sales and earnings were expected to finish the year above its previous forecast.

Dividend forecast revision
Taking into consideration the stronger-than-expected earnings outlook for the full year, the company decided to raise its dividend payment at the end of the fiscal year to JPY25 per share, leaving its regular dividend payment unchanged at JPY15 while adding special dividend payment of JPY10.

On **December 19, 2017**, Shared Research updated the report following interviews with the company.

On **December 18, 2017**, the company announced a revision to earnings forecasts.

FY03/18 earnings forecasts

- ▷ Sales: JPY180.0bn (previous forecast was JPY180.0bn)
- ▷ Operating profit: JPY4.2bn (JPY4.2bn)
- ▷ Recurring profit: JPY4.0bn (JPY4.0bn)
- ▷ Net income*: JPY3.2bn (JPY2.5bn)

*Net income attributable to parent company shareholders

Reasons for the revisions
In line with the verdict regarding the lawsuit between the company and Software Research Associates, Inc. (SRA), during cumulative Q3 the company booked an extraordinary gain. It now expects net income to come in above previous forecasts.

On **December 13, 2017**, the company announced a verdict from a lawsuit.

Happinet announced that on the same day, it received a verdict from the Tokyo High Court in regard to the lawsuit between the company and Software Research Associates, Inc. (SRA; a subsidiary of SRA Holdings, Inc.). The details of the verdict were largely in line with the Tokyo District Court's judgement of first instance (dated October 31, 2016), in which the company's position had been upheld. The company is currently evaluating the impact of this verdict on its consolidated and parent company earnings for FY03/18.

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

Trends and outlook

Quarterly results

Cumulative	FY03/17				FY03/18				FY03/18	
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY	FY Est.
Sales	32,757	72,448	133,902	174,059	35,150	84,827	153,682		79.6%	193,000
YoY	-12.2%	-13.7%	-10.7%	-7.1%	7.3%	17.1%	14.8%			10.9%
Gross profit	4,312	9,537	17,139	21,971	4,582	10,266	17,954			
YoY	-14.4%	-10.1%	0.0%	-0.1%	6.3%	7.6%	4.8%			
GPM	13.2%	13.2%	12.8%	12.6%	13.0%	12.1%	11.7%			
SG&A expenses	4,160	8,693	13,869	18,273	4,133	8,504	13,260			
YoY	-2.3%	-0.9%	-0.4%	-1.5%	-0.6%	-2.2%	-4.4%			
SG&A ratio	12.7%	12.0%	10.4%	10.5%	11.8%	10.0%	8.6%			
Operating profit	152	844	3,270	3,698	449	1,761	4,694		97.8%	4,800
YoY	-80.5%	-54.1%	1.8%	7.2%	195.4%	108.6%	43.5%			29.8%
OPM	0.5%	1.2%	2.4%	2.1%	1.3%	2.1%	3.1%			2.5%
Recurring profit	95	741	3,090	3,479	392	1,640	4,540		98.7%	4,600
YoY	-88.0%	-60.1%	-5.0%	-0.5%	312.6%	121.1%	46.9%			14.9%
RPM	0.3%	1.0%	2.3%	2.0%	1.1%	1.9%	3.0%			2.4%
Net income	-26	329	1,793	2,040	177	1,044	3,793		99.8%	3,800
YoY	-	-72.2%	-15.1%	-13.5%	-	217.0%	111.5%			86.3%
Net margin	-	0.5%	1.3%	1.2%	0.5%	1.2%	2.5%			2.0%

Quarterly	FY03/17				FY03/18			
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	32,757	39,691	61,454	40,157	35,150	49,677	68,855	
YoY	-12.2%	-15.0%	-6.9%	7.8%	7.3%	25.2%	12.0%	
Gross profit	4,312	5,225	7,602	4,832	4,582	5,684	7,688	
YoY	-14.4%	-6.2%	16.3%	-0.4%	6.3%	8.8%	1.1%	
GPM	13.2%	13.2%	12.4%	12.0%	13.0%	11.4%	11.2%	
SG&A expenses	4,160	4,533	5,176	4,404	4,133	4,371	4,756	
YoY	-2.3%	0.4%	0.3%	-4.6%	-0.6%	-3.6%	-8.1%	
SG&A ratio	12.7%	11.4%	8.4%	11.0%	11.8%	8.8%	6.9%	
Operating profit	152	692	2,426	428	449	1,312	2,933	
YoY	-80.5%	-34.6%	76.3%	80.6%	195.4%	89.6%	20.9%	
OPM	0.5%	1.7%	3.9%	1.1%	1.3%	2.6%	4.3%	
Recurring profit	95	646	2,349	389	392	1,248	2,900	
YoY	-88.0%	-39.2%	68.5%	58.1%	312.6%	93.2%	23.5%	
RPM	0.3%	1.6%	3.8%	1.0%	1.1%	2.5%	4.2%	
Net income	-26	355	1,464	247	177	867	2,749	
YoY	-	-50.3%	58.1%	-0.4%	-	144.2%	87.8%	
Net margin	-	0.9%	2.4%	0.6%	0.5%	1.7%	4.0%	

Source: Shared Research based on company data
Note: Figures may differ from company materials due to differences in rounding methods.
Note: Three-month quarterly figures are calculated as the cumulative figures minus the previous quarter's cumulative figures.
Note: Net income refers to net income attributable to parent company shareholders.

Seasonality: The Toys business typically accounts for 40% of annual sales and 60% of operating profit. Retail toy sales peak in the weeks leading up to Christmas, thus the company's sales and operating profit are highest in Q3 which includes December.

Performance by segment

Segments (cumulative)	FY03/17				FY03/18			
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	32,757	72,448	133,902	174,059	35,150	84,827	153,682	
YoY	-12.2%	-13.7%	-10.7%	-7.1%	7.3%	17.1%	14.8%	
Toys	14,300	31,585	59,433	73,725	13,450	31,206	58,145	
YoY	-6.0%	-9.1%	-4.8%	-4.1%	-5.9%	-1.2%	-2.2%	
Visual and Music	8,138	16,516	25,801	34,890	7,944	18,930	28,148	
YoY	-5.4%	-4.8%	-10.0%	-9.1%	-2.4%	14.6%	9.1%	
Videogames	5,832	14,302	33,476	44,793	9,263	24,856	52,424	
YoY	-27.3%	-29.2%	-20.5%	-10.4%	58.8%	73.8%	56.6%	
Amusement	4,487	10,045	15,190	20,649	4,492	9,833	14,963	
YoY	-17.8%	-14.0%	-9.5%	-6.2%	0.1%	-2.1%	-1.5%	
Segment profit	152	844	3,270	3,698	449	1,761	4,694	
YoY	-80.5%	-54.1%	1.8%	7.2%	195.4%	108.6%	43.5%	
Toys	284	768	2,827	3,044	300	891	2,765	
YoY	-46.6%	-38.9%	9.6%	6.9%	5.6%	16.0%	-2.2%	
Visual and Music	-54	146	358	418	89	311	482	
YoY	-	1.4%	14.7%	-10.3%	-	112.5%	34.6%	
Videogames	-129	-36	249	384	61	402	1,194	
YoY	-	-	982.6%	-	-	-	379.5%	
Amusement	345	642	889	1,281	305	761	1,232	
YoY	-39.8%	-44.4%	-32.1%	-22.5%	-11.6%	18.5%	38.6%	
Adjustments	-292	-675	-1,054	-1,430	-306	-604	-981	
Segments (quarterly)	**FY03/17**				**FY03/18**			
(JPYmn)	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Sales	32,757	39,691	61,454	40,157	35,150	49,677	68,855	
YoY	-12.2%	-15.0%	-6.9%	7.8%	7.3%	25.2%	12.0%	
Toys	14,300	17,285	27,848	14,292	13,450	17,756	26,939	
YoY	-6.0%	-11.5%	0.5%	-0.9%	-5.9%	2.7%	-3.3%	
Visual and Music	8,138	8,378	9,285	9,089	7,944	10,986	9,218	
YoY	-5.4%	-4.3%	-17.9%	-6.4%	-2.4%	31.1%	-0.7%	
Videogames	5,832	8,470	19,174	11,317	9,263	15,593	27,568	
YoY	-27.3%	-30.5%	-12.5%	43.4%	58.8%	84.1%	43.8%	
Amusement	4,487	5,558	5,145	5,459	4,492	5,341	5,130	
YoY	-17.8%	-10.7%	0.8%	4.4%	0.1%	-3.9%	-0.3%	
Segment profit	152	692	2,426	428	449	1,312	2,933	
YoY	-80.5%	-34.6%	76.3%	80.6%	195.4%	89.6%	20.9%	
Toys	284	484	2,059	217	300	591	1,874	
YoY	-46.6%	-33.1%	55.6%	-19.3%	5.6%	22.1%	-9.0%	
Visual and Music	-54	200	212	60	89	222	171	
YoY	-	65.3%	26.2%	-61.0%	-	11.0%	-19.3%	
Videogames	-129	93	285	135	61	341	792	
YoY	-	-	290.4%	-	-	266.7%	177.9%	
Amusement	345	297	247	392	305	456	471	
YoY	-39.8%	-48.9%	59.4%	14.3%	-11.6%	53.5%	90.7%	
Adjustments	-292	-383	-379	-376	-306	-298	-377	

Source: Shared Research based on company data
Note: Figures may differ from company materials due to differences in rounding methods.
Note: Three-month quarterly figures are calculated as the cumulative figures minus the previous quarter's cumulative figures.
Note: Figures larger than 1,000% are represented as a dash (-)

Toys segment

	FY03/17			FY03/18		
(JPYmn)	Q1	Q2	Q3	Q1	Q2	Q3
Sales	14,300	31,585	59,433	13,450	31,206	58,145
YoY	-6.0%	-9.1%	-4.8%	-5.9%	-1.2%	-2.2%
Bandai	6,400	15,400	29,700	6,000	15,100	29,100
YoY	-	-18.9%	-12.8%	-6.1%	-2.1%	-2.3%
% of total	45.2%	48.9%	50.1%	45.1%	48.5%	50.1%
TAKARA TOMY	1,400	3,000	5,700	1,500	3,200	5,800
YoY	-	61.2%	43.7%	7.8%	7.5%	2.7%
% of total	9.9%	9.7%	9.7%	11.4%	10.5%	10.1%
Happinet original	400	800	1,400	200	700	1,300
YoY	-	59.0%	-6.8%	-45.2%	-11.1%	-9.1%
% of total	3.2%	2.8%	2.5%	1.9%	2.5%	2.3%
Other	5,900	12,200	22,400	5,500	12,000	21,700
YoY	-	-7.8%	-1.2%	-6.1%	-1.5%	-2.8%
% of total	41.7%	38.6%	37.7%	41.6%	38.5%	37.5%
Segment profit	284	768	2,827	300	891	2,765
YoY	-46.6%	-38.9%	9.6%	5.6%	16.0%	-2.2%
Segment profit margin	2.0%	2.4%	4.8%	2.2%	2.9%	4.8%

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

Visual and Music segment

	FY03/17			FY03/18		
(JPYmn)	Q1	Q2	Q3	Q1	Q2	Q3
Sales	8,138	16,516	25,801	7,944	18,930	28,148
YoY	-5.4%	-4.8%	-10.0%	-2.4%	14.6%	9.1%
Visual	6,200	12,600	19,700	6,500	15,200	22,600
YoY	-	-2.6%	-10.4%	4.5%	20.6%	14.4%
% of total	77.0%	76.6%	76.6%	82.4%	80.6%	80.4%
Wholsale	5,200	10,700	16,300	5,300	12,900	19,300
YoY	-	-3.9%	-10.6%	1.9%	20.5%	18.3%
% of total	63.9%	65.0%	63.4%	66.7%	68.3%	68.7%
Manufacturers	1,000	1,900	3,400	1,200	2,300	3,200
YoY	-	5.4%	-9.7%	17.2%	21.1%	-4.0%
% of total	13.1%	11.6%	13.3%	15.7%	12.3%	11.7%
Music	1,800	3,800	6,000	1,300	3,600	5,500
YoY	-	-11.5%	-8.5%	-25.4%	-5.0%	-8.4%
% of total	23.0%	23.4%	23.4%	17.6%	19.4%	19.6%
Segment profit	-54	146	358	89	311	482
YoY	-	1.4%	14.7%	-	112.5%	34.6%
Segment profit margin	-	0.9%	1.4%	1.1%	1.6%	1.7%

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

Videogames segment

	FY03/17			FY03/18		
(JPYmn)	Q1	Q2	Q3	Q1	Q2	Q3
Sales	5,832	14,302	33,476	9,263	24,856	52,424
YoY	-27.3%	-29.2%	-20.5%	58.8%	73.8%	56.6%
Nintendo products	4,300	10,100	24,800	7,600	21,200	46,100
YoY	-	-35.2%	-29.8%	76.7%	108.9%	85.7%
% of total	73.9%	71.2%	74.3%	82.2%	85.5%	88.1%
SIE products	1,200	3,700	7,900	1,500	3,300	5,700
YoY	-	11.8%	43.0%	19.8%	-10.2%	-27.5%
% of total	22.2%	26.0%	23.8%	16.8%	13.4%	11.0%
Others	200	400	600	0	200	400
YoY	-	-65.9%	-43.3%	-56.9%	-35.5%	-25.8%
% of total	3.9%	2.8%	1.9%	1.0%	1.1%	0.9%
Segment profit	-129	-36	249	61	402	1,194
YoY	-	-	982.6%	-	-	379.5%
Segment profit margin	-	-	0.7%	0.7%	1.6%	2.3%

Source: Shared Research based on company data
Note: Figures may differ from company materials due to differences in rounding methods.
Note: SIE is Sony Interactive Entertainment Inc.

Amusement segment

	FY03/17			FY03/18		
(JPYmn)	Q1	Q2	Q3	Q1	Q2	Q3
Sales	4,487	10,045	15,190	4,492	9,833	14,963
YoY	-17.8%	-14.0%	-9.5%	0.1%	-2.1%	-1.5%
Capsule toys	2,200	4,800	7,000	2,400	5,300	8,000
YoY	-	-11.8%	-5.8%	7.6%	10.1%	14.2%
% of total	49.5%	48.4%	46.2%	53.5%	54.4%	53.5%
Card games	1,800	4,200	6,600	1,600	3,700	5,700
YoY	-	-12.5%	-7.5%	-10.8%	-11.6%	-13.1%
% of total	40.1%	42.3%	43.5%	37.2%	38.2%	38.4%
Other	400	900	1,500	400	700	1,200
YoY	-	-29.1%	-28.7%	3.4%	-22.1%	-22.8%
% of total	10.4%	7.4%	10.3%	9.3%	7.4%	8.1%
Segment profit	345	642	889	305	761	1,232
YoY	-39.8%	-44.4%	-32.1%	-11.6%	18.5%	38.6%
Segment profit margin	7.7%	6.4%	5.9%	6.8%	7.7%	8.2%

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

Q3 FY03/18 results

- Sales: JPY153.7bn (+14.8% YoY)
- Operating profit: JPY4.7bn (+43.5%)
- Recurring profit: JPY4.5bn (+46.9%)
- Net income*: JPY3.8bn (+111.5%)

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

Sales and operating profit increased as sales were robust for the Nintendo Switch game console and related software in the Videogames segment, and select products were hits in the Visual and Music segment.

While the videogame industry has been continuing to recover, other industries in which the company operates continue to go through a difficult time, due to such factors as the declining birth rate and diversifying consumer needs in the toy industry and diversifying viewing methods owing to the popularity of distribution services in the visual and music industries.

Toys

In the Toys segment, sales fell 2.2% YoY to JPY58.1bn while segment profit slipped 2.2% to JPY2.8bn.

Segment sales came in below year-ago levels as strong videogames market siphoned off demand for toys during the year-end shopping season. There were a few success stories, though, including Bandai products related to the shows *Kamen Rider Build* and *Ultraman Geed* as well as part of goods featuring characters from TV animation series for school-aged girls.

Sales of Bandai's products related to the TV shows *Kamen Rider Build* and *Ultraman Geed*, which began airing in September and July 2017, respectively, as well as hobby products targeting girls, were robust, but not enough to boost the market and sales were down YoY as a result.

Broken down by manufacturer, sales of Bandai products totaled JPY29.1bn (-2.3% YoY) for a share of 50.1% of the total (versus 50.1% in Q3 FY03/17). Sales of Takara Tomy products were JPY5.8bn (+2.7% YoY) for a share of 10.1% (+9.7%) and sales of its own products were JPY1.3bn (-9.1%) for a share of 2.3% (2.5%).

Sales of the toy and hobby segment of Bandai Namco Holdings Inc. came to JPY164.4bn (-0.8% YoY) in Q3 FY03/18. According to Bandai Namco materials, merchandise sales were brisk for mainstay IP such as the Kamen Rider, Super Sentai, and Precure series. Domestic sales of Yokai Watch-related products totaled JPY3.1bn versus JPY8.5bn in Q3 FY03/17.

Sales of the Japan segment of Tomy came to JPY116.8bn (+11.7% YoY) in Q3 FY03/18. Sales of Licca-chan products, which marked its 50th anniversary, grew and mainstay IP such as the TV animation series, Tomica Hyper Rescue Drive Head, continued to be strong.

In addition to a decrease in sales, increased losses resulting from the clearing out inventory led to lower profit.

Visual and Music

In the Visual and Music segment, sales rose 9.1% YoY to JPY28.1bn and segment profit was JPY482mn (+34.6%).

Sales rose YoY due to the strong performance of the packaged version of *Kiseki: Ano Hi no Sobito* and an internally managed movie, the film *Kimi no Na wa*. In the Visual subsegment, sales of the wholesale business were JPY19.3bn (+18.3% YoY) and sales of the manufacturing business were JPY3.2bn (-4.0%), while sales of the Music subsegment came to JPY5.5bn (-8.4%).

Segment profit benefited from higher sales, a reactionary gain after booking an investment loss on a movie the company produced in Q1 FY03/17, and the earnings contribution of exhibition revenue and sales of the packaged version released in July 2017 of *Kiseki: Ano Hi no Sobito* (released in January 2017 at theaters).

Videogames

In the Videogames segment, sales rose 56.6% YoY to JPY52.4bn, with segment profit of JPY1.2bn (+379.5%).

By manufacturer, sales of Nintendo products were JPY46.1bn (+85.7% YoY) and sales of Sony Interactive Entertainment products were JPY5.7bn (-27.5%).

The increase in sales and earnings was driven by sales of the Nintendo Switch game console and related software (such as *Super Mario Odyssey*), and Nintendo 3DS software *Pokemon Ultrasun-Ultramoon* and also the new *Nintendo Classic Mini-Super FamiCon* game console. Sales of the Nintendo Switch game console were JPY20.3bn (JPY1.4bn in Q3 FY03/17) and software sales were JPY7.7bn (+441.7% YoY).

Profit increased mainly due to sales of the Nintendo Switch related software.

Amusement
In the Amusement segment, sales declined 1.5% YoY to JPY15.0bn, while segment profit increased 38.6% to JPY1.2bn.

Sales of capsule toys totaled JPY8.0bn (+14.2% YoY) and sales of card games were JPY5.7bn (-13.1%). Capsule toys performed well, aided by strong sales of *Kamen Rider*-related goods and favorable locations for vending machines in large-scale shopping malls. However, card game machines performed poorly, leading to lower sales.

As stated above, it strived to secure favorable locations and withdrew from unprofitable locations. This led to higher sales of capsule toys. In addition, narrowing down locations reduced outsourcing costs for replenishing capsule toys, resulting in higher profit.

Other: **Special dividend**
A JPY10 per share special dividend has been added to the JPY15 ordinary year-end dividend, for a total of JPY25. This is on top of a JPY15 per share dividend paid at the end of 1H, for a total of JPY40 for FY03/17 (JPY30 in ordinary dividends and JPY10 special dividend): the company has now raised dividend payments for five consecutive periods.

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

Full-year company forecasts

	FY03/17			FY03/18		
(JPYmn)	1H Act.	2H Act.	FY Act.	1H Act.	2H Est.	FY Est.
Sales	**72,448**	**101,611**	**174,059**	**84,827**	**108,173**	**193,000**
Cost of sales	62,911	89,177	152,088	74,561		
Gross profit	**9,537**	**12,434**	**21,971**	**10,266**		
GPM	13.2%	12.2%	12.6%	12.1%		
SG&A expenses	8,693	9,580	18,273	8,504		
SG&A ratio	12.0%	9.4%	10.5%	10.0%		
Operating profit	**844**	**2,854**	**3,698**	**1,761**	**3,039**	**4,800**
OPM	1.2%	2.8%	2.1%	2.1%	2.8%	2.5%
Recurring profit	**741**	**2,738**	**3,479**	**1,640**	**2,960**	**4,600**
RPM	1.0%	2.7%	2.0%	1.9%	2.7%	2.4%
Net income	**329**	**1,711**	**2,040**	**1,044**	**2,756**	**3,800**
Net margin	0.5%	1.7%	1.2%	1.2%	2.5%	2.0%

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

Forecast by segment

	FY03/17			FY03/18		
(JPYmn)	1H Act.	2H Act.	FY Act.	1H Act.	2H Est.	FY Est.
Sales	72,448	101,611	174,059	84,827	108,173	193,000
YoY	-13.7%	-1.6%	-7.1%	17.1%	6.5%	10.9%
Toys	31,585	42,140	73,725	31,206	41,794	73,000
YoY	-9.1%	0.0%	-4.1%	-1.2%	-0.8%	-1.0%
Visual and Music	16,516	18,374	34,890	18,930	21,070	40,000
YoY	-4.8%	-12.6%	-9.1%	14.6%	14.7%	14.6%
Videogames	14,302	30,491	44,793	24,856	35,144	60,000
YoY	-29.2%	2.3%	-10.4%	73.8%	15.3%	33.9%
Amusement	10,045	10,604	20,649	9,833	10,167	20,000
YoY	-14.0%	2.6%	-6.2%	-2.1%	-4.1%	-3.1%
Segment profit	844	2,854	3,698	1,761	3,039	4,800
YoY	-54.1%	76.9%	7.2%	108.6%	6.5%	29.8%
Toys	768	2,276	3,044	891	2,109	3,000
YoY	-38.9%	43.0%	6.9%	16.0%	-7.3%	-1.5%
OPM	2.4%	5.4%	4.1%	2.9%	5.0%	4.1%
Visual and Music	146	272	418	311	239	550
YoY	1.4%	-15.5%	-10.3%	113.0%	-12.1%	31.4%
OPM	0.9%	1.5%	1.2%	1.6%	1.1%	1.4%
Videogames	-36	420	384	402	798	1,200
YoY	-	-	-	-	90.0%	212.0%
OPM	-0.3%	1.4%	0.9%	1.6%	2.3%	2.0%
Amusement	642	639	1,281	761	789	1,550
YoY	-44.4%	28.3%	-22.5%	18.5%	23.5%	21.0%
OPM	6.4%	6.0%	6.2%	7.7%	7.8%	7.8%
Adjustments	-675	-755	-1,430	-604	-896	-1,500

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

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

Sales in FY03/18 are expected to reach JPY193.0bn (+10.9% YoY), operating profit JPY4.8bn (+29.8% YoY), recurring profit JPY4.6bn (+32.2% YoY), and net income attributable to parent company shareholders JPY3.8bn (+86.2% YoY).

Along with the release of Q3 results in February 2018, the company revised its sales and earnings forecast for the full year. Under its revised forecast for FY03/18, the company revised up sales, operating profit, recurring profit, and net income attributable to parent company shareholders by JPY13.0bn (+7.2% versus the previous forecast), JPY600mn (+14.3% versus the previous forecast), JPY600mn (+15.0% versus the previous forecast), and JPY600mn (+18.8% versus the previous forecast), respectively. Explaining the upward revision, the company said sales of the Nintendo Switch game console and related software during the all-important Christmas and year-end sales season were strong.

Initiatives for each segment and earnings assumptions:

Toys segment

Sales are expected to reach JPY73.0bn (-1.0% YoY), and operating profit JPY3.0bn (-1.5% YoY)

This segment generates about half of its sales from Bandai products (Bandai products comprised 51.0% of sales in FY03/17). Bandai Namco Holdings (TSE1:7832) expects that sales of its Toys and Hobby segment will see a 1.4% YoY decrease in FY03/18. By character (Domestic Toy and Hobby), Kamen Rider products are expected bring in JPY24.0bn (+16.5% YoY) and sales related to Super Sentai are expected to increase. In contrast, sales of Yokai Watch-related products are expected to decline to JPY3.7bn (-63.0% YoY).

For this segment, Happinet will strengthen sales of hobby items, such as plastic models, and those of products that the company exclusively distributes. The company is in talks with manufacturers and potential clients over hobby products, believing that its market share for these items has room for further growth. It released a wireless power supply system X-BASE, an original product in the hobby business, in December 2017. In addition, the company plans to handle more items such as character apparel and costumes to offer a variety of products to its existing customers. These will be available at stores alongside toys.

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

The company will further strengthen its inventory control and review operations and personnel allocations.

Visual and Music segment

Sales are expected to be JPY40.0bn (+14.6% YoY), and operating profit JPY550mn (+31.4% YoY)

In the visual wholesale section, the company released the packaged version of the animated movie *Kimi No Na Wa*, which was a hit in FY03/17, and contributed to sales and profits.

In the visual manufacturing section, *Kiseki: Ano Hi no Sobito*, an internally managed movie released in theaters in FY03/17, generated revenue of JPY1.5bn. The movie contributed to earnings in FY03/18 thanks to its box-office distribution and the packaged version released in July 2017. Happinet owns the distribution rights to this movie as well. The company invested in the movie *Namiya Zakkaten no Kiseki*, which was released at theaters in September 2017, and generated box-office sales of JPY1.0bn. The company expects the movie to contribute to earnings in Q4 FY03/18 thanks to exclusive sales of the packaged version.

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

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

In March 2018, Happinet plans to take over the wholesale division for Seikodo Co., Ltd.'s music and video merchandise. In FY06/17, Seikodo booked sales of JPY53.3bn (-3.1% YoY) and an operating loss of JPY123mn (JPY55mn loss in the previous period). Happinet stated that it will enhance efficiency by sharing logistics functions and systems. Shared Research estimates that the integration of the wholesale division will not have a large impact on profit because FY03/18 sales will be roughly JPY3.0bn and the company will also amortize goodwill.

Videogame segment

Sales are expected to be JPY60.0bn (+33.9% YoY), and operating profit JPY1.2bn (+212.0% YoY)

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

With respect to profits, the company expects contribution to earnings by sales growth, as well as continued strong sales of Nintendo Switch, a console that was put on the market in Q4 FY03/16, and the release of new software titles, which are more profitable than hardware. The company further plans to improve profitability by expanding sales of exclusively distributed products and game peripherals. In contrast, expenses related to original games are likely to emerge in Q4 FY03/18.

Amusement segment

Sales are expected to be JPY20.0bn (-3.1% YoY), and operating profit JPY1.6bn (+21.0% YoY)

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

Medium-term outlook

Medium-term plan

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

Midterm measures for intermediate distribution

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

Toys segment

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

Visual and Music segment

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

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

Videogame segment

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

Amusement segment

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

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

Medium-term plan for the manufacturing industry

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

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

As to the production of visual products, the company will produce work, mainly animations, which it will manage. It said that even as the market for video software packages contracts, it expects core users to support animations and that a stable market will be secured. In order to create a structure that will enable it to cope with changes in the market environment, the company said it would focus its investments on products that it manages, chiefly animations, through joint development with external partners.

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

Other

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

Business alliance with Broccoli

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

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

Alliance particulars

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

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

Business

Description

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

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

Segment sales and profit

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

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

Toys

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

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

It buys goods from big toy makers like Bandai and Tomy and sells them to toy retailers such as Toys"R"Us-Japan Ltd. (unlisted), large consumer electronics stores and retail chains, and major online retailers. Major toy manufacturers are shown in the following table. Happinet handles about 90% of Bandai's toy distribution in Japan, Japan's largest toy manufacturer.

Toys: main manufacturers

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

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

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

Also, toy manufacturers often make use of overseas factories, particularly in China. These toys are different in nature from automobiles or consumer electronics, which usually remain in production for an extended period of time. Toymakers must adjust their production based on demand forecasts and produce items within a limited time frame. It takes about three months from when toys are manufactured till they are ready to be sold by retailers, due to strict procedures for managing and checking quality—after all, these are products that will be used by children.

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

Toy distribution:

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

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

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

Toy earnings

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

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

According to Happinet, it is a major intermediary distributor of toys, holding a 30% market share. The company's rise to prominence as the largest intermediary distributor of toys began in the 1990s with the relaxation of the Large Scale Retail Store Law. Distributors began to need advanced information and logistics systems in order to keep up with the growing size of retailers, and Happinet rose to meet the needs of the changing business environment. Additionally, Shared Research notes that growth in toy sales by Bandai Co., Ltd., a subsidiary of Bandai Namco Holdings (TSE1: 7832) that holds 24.5% of Happinet stock has led Happinet to become the largest company in the industry.

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

Bandai's character goods portfolio: Leading toy characters with the highest sales rankings at Bandai are those from the Super Sentai, Kamen Rider, and Precure series. Toei or Toei Animation makes these series; TV Asahi broadcasts them on Sundays. Program sponsor Bandai merchandises related toys. This system has a long history; the Super Sentai series, the longest-running of the trio, started with *Himitsu Sentai Gorenger* in 1975. The 41th series, *Uchu Sentai Kyu Ranger,* aired in 2017.

In the 30-minute *Super Sentai* program, a team of three to nine people use special items to become superheroes wearing helmets and color-coded jumpsuits, and fight bad guys or monsters. In each episode the enemy, once defeated, is reborn as a giant monster and the heroes ride a giant robot to destroy it.

Each year a TV series starts in February and a movie version is launched in August. New characters and items are added during the year based on interest in the TV program, and Bandai merchandises all the transforming items, weapons, and robots. All super hero toys are ready for Christmas when sales peak.

Bandai Sales by Character (Domestic Toy and Hobby)

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

Source: Shared Research based on company data

Visual and Music

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

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

Visual and Music earnings

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

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

Visual wholesale section

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

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

Visual manufacturing section

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

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

The movie industry and movie production partnerships handle production, distribution, exhibition, and secondary use (renting/selling/distributing movie content to consumers). DVD content makers obtain videogram rights to movies by investing in production partnerships or by purchasing the rights from their holders. Rights to receive box-office proceeds are distributed in proportion to the amount invested in the production partnership. Box-office profits are defined as proceeds—i.e., number of viewers multiplied by ticket prices—less expenses (cinema operators and distributors, production, and advertising). According to the company, it is difficult to predict the profitability of investing in production partnerships, because production costs, investment stake, and box-office proceeds differ from movie to movie. In addition to profits related to box office revenue by stake, based on the conditions for investing in a production partnership, the company obtains videogram rights to the movie, and will therefore sell that videogram as DVD content to obtain sales and profits corresponding to sales volumes.

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

Music wholesale section

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

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

Japan's resale price maintenance system (recommended retail price)—as established by Japanese copyright law—means the manufacturers are able to force retailers to observe a certain retail price for music software. As product discounting does not occur, the distribution of music media differs from that of visual media. Although in both cases companies are effectively purchasing stock, for music media a limit is set for a proportion of the sales that may be returned, and the seller sometimes ends up accepting these returns.

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

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

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

Videogames

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

Happinet generates profits by buying videogame consoles and game software from manufacturers and distributing these to shops. This segment has the lowest GPM of all the company's businesses, which stems from the company bearing little inventory risk due to short order placement/delivery times.

Happinet buys products from Nintendo Co Ltd (TSE1: 7974), Sony Interactive Entertainment Inc. (a subsidiary of Sony [TSE1: 6758]), and Microsoft Corp. It is the only wholesaler handling all consumer game consoles available in Japan. Following the consolidation of Toys Union—a distributor of Nintendo products—in FY03/14, Nintendo products accounted for approximately 70% of sales in FY03/17, with Sony Interactive Entertainment Inc. products next, at about 20%. The company distributes products to major online retailers and consumer electronics chains.

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

Videogame sales breakdown

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

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

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

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

Amusement

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

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

Amusement sales breakdown

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

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

Toy vending machine section

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

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

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

Capsule-toy vending machines

Source: Shared Research based on company data

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

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

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

Digital card game section

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

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

The company buys and leases digital card game machines from Bandai, which also supplies the cards. As of May 2017, the company operates card games including Dragon Ball, Kamen Rider, Yokai Watch, and Mobile Suit Gundam. The company in November 2016 began to install machines that combine the features of card game machines for Disney characters and machines for capsule toys. These two features operate in conjunction with each other in the same machine.

Card game machine

Card game/capsule machine

Source: Company data

Group companies

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

Consolidated subsidiaries

Happinet Marketing Corp. (100% owned)

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

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

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

MAXGAMES Corporation (100% owned)

Sells videogame consoles and videogames.

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

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

Happinet Vending Service Corporation (100% owned)

Operates toy vending machines.

Happinet Logistics Service Corporation (100% owned)

Handles logistics business for group companies.

Equity-method affiliates

Broccoli Co., Ltd. (25.15% ownership)

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

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

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

Strengths and weaknesses

Strengths

- **Business diversification leading to stable earnings.** Shared Research understands that faddish toy demand makes for big fluctuations in sales. If a distributor is dependent on a particular manufacturer its earnings will be greatly affected by the sales of that manufacturer's products. But Happinet trades with many domestic toy manufacturers, and does not depend solely on Bandai as a supplier. Furthermore, the company has diversified into other fields like videogames, movies, and music. Thus its profits may be described as stable.
- **Solid relationship with Bandai.** Shared Research thinks that Bandai will continue to have a stable domestic toy business. This belief is based on the broad, intergenerational popularity of its products—mainly its character toys portfolio—and its capabilities in developing new character toys. Bandai Namco Holdings Inc., Bandai's parent company, is Happinet's largest shareholder with a 25% stake, and Happinet distributes about 90% of Bandai toys sold in Japan (company estimate). We assume the company will continue to enjoy the benefits of doing business with Bandai.

Weaknesses

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

Market and value chain

Overview

Japan's toy market

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

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

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

Domestic toy market and population

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

Note: The eight toy items are electronic toys, models, toys for boys, toys for girls, analog games, seasonal and miscellaneous toys, educational toys, and stuffed toys. Videogames are not included.
Source: Shared Research based on data from Yano Research Institute Ltd., National Institute of Population and Social Security Research (IPSS), and the Statistics Bureau's Population Census

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

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

Japan's visual media market

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

Video software market

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

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

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

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

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

Source: Shared Research based on Japan Video Association
Note; Purchase Rate: the percentage of total respondents that had purchased video software. The total number of respondents differs per year.

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

Video on Demand (VOD) market

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

Source: Shared Research based on Digital Content Association of Japan

Shared Research forecasts that the visual media market will continue to decline in the face of free online video, the spread of pay-video distribution and the expected fall in the number of people aged 15-64 (the main buyers). Importantly, the National Institute of Population and Social Security Research estimates that the number of people aged 15 to 64 will decrease by 0.6% a year from 76.0mn in 2016 to 71.7mn in 2025.

Music content

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

Record production and paid distribution music

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

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

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

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

Japan's game market

Nintendo launched the Family Computer System (later released as the Nintendo Entertainment System (NES) in America) in 1983, and the overall market for home videogame consoles peaked at JPY760bn in 1997. The market, spearheaded by Nintendo and Sony Computer Entertainment, remained on a downtrend through 2005, dancing to the beat of new consoles and major game releases. Between 2005 and 2007 the market recovered given new portable game consoles including Nintendo's Wii and Sony's PlayStation 3. The market thereafter has been anemic.

Shipments of Domestic Home Videogame Consoles

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

Source: Shared Research based on CESA data

The game market is now impacted by the popularity of smartphones and online (including social media) games in tandem with new consoles. Since 2010 online gaming has mushroomed yet the game console market remains in the doldrums.
The package game software market is likely to contract due to migration to smartphones and online gaming. Yes, game consoles may be a sunset sector but some sunsets last a long time. Bedrock demand should stay firm given key advantages: low price next to smartphones and PCs, internet access is not needed, software borrowing/lending is possible, and software once bought is free to use (online gaming requires ongoing payments).

Japanese capsule toy market

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

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

Source: Shared Research based on Japan Toy Association

Competition

Limited competition. Happinet said that it and Kawada are among the major distributors operating nationwide with a variety of toy manufacturers, and that it is the only company handling a range of products from toys to visual and music products. Kawada distributes original products like block toys and educational toys, with diablock block toys being the most famous. For FY05/16 Kawada reported annual sales of JPY26bn (per Kawada's website), compared with JPY23.6bn in FY05/15. Happinet sells much more volume than Kawada and their products are different, so they are not competitors.

Strategy

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

Market share expansion

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

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

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

Visual and Music: scope for expansion

Happinet said that direct transactions between visual/music content makers and retailers topped 50% of overall distribution of visual media and music in the year to end March 2015. Shared Research thinks that the curtailment of content sold at bricks and mortar stores may cause visual and music software makers to shift part of their sales promotion and distribution operations to intermediary distributors like Happinet in the future. In December 2009 the company and Nikkatsu Corp, a movie producer, agreed that Happinet will become a comprehensive seller of Nikkatsu's visual package products. Bandai Visual (a Namco Bandai subsidiary) began to shift some of its sales operations to Happinet in July 2010. Shared Research thinks that handling software makers' sales promotion and distribution functions is a potential money spinner.

Videogames: also scope for expansion

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

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

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

Originally developed products: increased sales

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

In its seventh medium-term plan starting in FY03/16, the company plans to make fresh considerations from the ground up for products which it develops and hopes to improve profitability by focusing on markets where it has an advantage. Specifically, this includes increases in the variety of formats of its toys so they can be used for various characters; products related to television shows which have been on the air for long periods of time; the development of game software for school-aged girls; and visuals and music, chiefly animations which it has managed.

Historical performance

Historical financial statements

1H FY03/18 results

- ▷ Sales: JPY84.8bn (+17.1% YoY)
- ▷ Operating profit: JPY1.8bn (+108.6%)
- ▷ Recurring profit: JPY1.6bn (+121.1%)
- ▷ Net income*: JPY1.0bn (+217.0%)

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

Sales and operating profit increased as sales were robust for the Nintendo Switch and related software in the Videogames segment, and select products were hits in the Visual and Music segment.

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

Toys

In the Toys segment, sales fell 1.2% YoY to JPY31.2bn and segment profit increased 16.0% to JPY891mn.

Sales of Bandai's products related to the TV shows *Kamen Rider Build* and *Ultraman Geed*, which began airing in September and July 2017, respectively, as well as hobby products targeting girls, were robust, but not enough to boost the market and sales were down YoY as a result.

Broken down by manufacturer, sales of Bandai products totaled JPY15.1bn (-2.1% YoY) for a share of 48.5% of the total (versus 48.9% in 1H FY03/17). Sales of Takara Tomy products were JPY3.2bn (+7.5% YoY) for a share of 10.5% (+9.7%) and sales of its own products were JPY700mn (-11.1%) for a share of 2.5% (2.8%).

Sales of the toy and hobby segment of Bandai Namco Holdings Inc. came to JPY98.1bn (-5.5% YoY) in Q2 FY03/18. According to Bandai Namco materials, merchandise sales were brisk for mainstay IP such as the Kamen Rider, Super Sentai, and Precure series. Domestic sales of Yokai Watch-related products totaled JPY2.0bn versus JPY5.6bn in Q2 FY03/17.

Sales of the Japan segment of Tomy came to JPY73.8bn (+20.9% YoY) in Q2 FY03/18. Sales of Licca-chan products, which marked the 50^{th} anniversary, grew and Beyblade Burst and novel egg-and-hatchling pet toy *Umarete Woomo* ("Hatchimals" in English) continued to be strong.

Profits were up thanks to lower SG&A expenses. Specifically, repair expenses that occurred in FY03/17 decreased this year. Losses on inventory disposal increased to JPY390mn from JPY340mn in Q2 FY03/17.

As one of the initiatives in the medium-term plan, the company is expanding market share of hobby products such as plastic models.

Visual and Music

In the Visual and Music segment, sales rose 14.6% YoY to JPY18.9bn and segment profit was JPY311mn (+112.5%).

Sales rose due to the strong performance of the packaged version of *Kiseki: Ano Hi no Sobito*, an internally managed movie (released in January 2017 at theaters), and the film *Kimi no Na wa*. In the Visual subsegment, sales of the wholesale business were

JPY12.9bn (+20.5% YoY) and sales of the manufacturing business were JPY2.3bn (+21.1%), while sales of the Music subsegment came to JPY3.6bn (-5.0%).

Segment profit benefited from higher sales, a reactionary gain after booking an investment loss on a movie the company produced a year earlier, and the earnings contribution of exhibition revenue and sales of the packaged version released in July 2017 of *Kiseki: Ano Hi no Sobito* (released in January 2017 at theaters).

Videogames

In the Videogames segment, sales rose 73.8% YoY to JPY24.9bn, with segment profit of JPY402mn (segment loss of JPY36mn in 1H FY03/17).

By manufacturer, sales of Nintendo products were JPY21.2bn (+108.9% YoY) and sales of Sony Interactive Entertainment products were JPY3.3bn (-10.2%).

Sales were robust for Nintendo Switch, *Splatoon 2*, and related software, as well as the hit game *DragonQuest XI: Echoes of an Elusive Age* for the Nintendo 3DS and Playstation 4, resulting in higher sales and segment profit.

Amusement

In the Amusement segment, sales declined 2.1% YoY to JPY9.8bn, while segment profit increased 18.5% to JPY761mn.

Capsule toys performed well as the company secured favorable locations by increasing machines in large-scale shopping malls and selling limited-time only products in stations and highway service areas. However, card game machines performed poorly, leading to lower sales. Sales of capsule toys totaled JPY5.3bn (+10.1% YoY) and sales of card games were JPY3.7bn (-11.6%).

The company was able to increase profits by reviewing its product locations. As stated, it strived to secure favorable locations and withdrew from unprofitable locations. This led to higher sales of capsule toys. In addition, narrowing down locations reduced outsourcing costs for replenishing capsule toys

Q1 FY03/18 results

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

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

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

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

Toys

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

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

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

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

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

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

Visual and Music

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

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

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

Videogames

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

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

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

Amusement

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

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

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

Full-year FY03/17 results

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

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

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

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

Toys

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

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

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

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

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

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

Visual and Music

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

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

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

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

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

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

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

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

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

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

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

FY03/16 results

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

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

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

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

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

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

Visual and Music segment

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

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

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

Videogames segment

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

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

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

Amusement segment

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

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

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

FY03/15 results

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

Toys

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

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

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

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

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

Visual and Music

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

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

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

Videogames

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

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

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

Amusement

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

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

Other information

History

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

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

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

1969 Incorporated as Tosho Ltd (Tosho becomes a stock company in 1972).
1972 Starts full-scale transactions with Popy (now Bandai).
1991 Company name changes to Happinet Corp with absorption of Dairin Corp and Seiko Corp (integration of Bandai-affiliated toy distributors).
1994 Bandai buys more Happinet shares; Happinet joins the Bandai group. Happinet begins distributing PlayStation game consoles and starts distributing videogames.
1994 Acquires Taiyo Gangu Shokai, Aichi Prefecture.
1995 Acquires Hiranaka, Hokkaido.
1999 Buys shares in Beam Entertainment Corp, advancing into DVD distribution business.
2001 Buys shares in Toyokuni Corp, Shizuoka Prefecture.
2002 Happinet JP Corp takes over the operations of Matsui Sakae Toys, a toy wholesaler in Osaka.
2006 Buys shares in Mori Toys, a wholesaler of Nintendo products in Osaka.
2007 Buys shares in Sunlink and The Apple Corporation.
2009 Buys shares in Wint Corp, the second largest intermediary distributor of visual media and music, advancing into CD wholesaling.
2013 Buys shares in Toys Union Co Ltd, a Nintendo distributor.
2014 Merges Happinet PM
2014 Toys Union Co., Ltd. and Mori Games Co., Ltd. merged; renamed Maxgames Corporation (presently a consolidated subsidiary)
2015 Creates capital business alliance with Broccoli Co., Ltd. (now an equity-method affiliate)
2016 Joint establishment of Happinet Live Entertainment LLC (now Happinet Live Emotion LLC).

News and topics

December 2017

On **December 11, 2017,** the company announced that it will take over the music and video wholesale business of Seikodo Co., Ltd. via an absorption-type company split, making it into a subsidiary.

At a board of director's meeting held on December 11, 2017, the company agreed to take over the music and video wholesale business of Seikodo, and to make it into a wholly owned subsidiary through a company split (company name: Seikodo Marketing). The absorption-type split will be effective March 1, 2018.

Reasons and goals of the business transfer

The packaged music and video market is sluggish, given the spread of music and video software distribution, and wholesale market for packaged software is seeing a decline in orders. As such, by acquiring the music and video wholesale business of Seikodo, one of the leading industry players, the company aims to enhance the shared use of logistics functions and systems, and provide market-oriented services. The aim is to use the strengths of both companies to enhance the nation-wide logistics network and solidify customer relationships, as well as expand the market by strengthening partnerships with multiple manufacturers.

Earnings and financial condition of Seikodo (JPYmn)

Fiscal year	FY06/15	FY06/16	FY06/17
Sales	58,520	55,061	53,327
Operating profit	-103	-55	-123
Recurring profit	-219	-190	-257
Net income	-252	-216	-1,471
Net assets	2,126	1,903	432
Total assets	19,343	18,158	17,803

The earnings of the business transferred in the company split are roughly equivalent to the earnings and financial conditions of Seikodo.

September 2017

On **September 25, 2017**, the company announced a revision to its earnings forecasts.

Revisions to 1H FY03/18 earnings forecasts

- Sales: JPY83.0bn (previous forecast was JPY77.0bn)
- Operating profit: JPY1.6bn (JPY1.2bn)
- Recurring profit: JPY1.5bn (JPY1.1bn)
- Net income*: JPY900mn (JPY700mn)

*Net income attributable to parent company shareholders

Reasons for the revisions

The strong performance of the Videogames segment in 1H FY03/18 backed by robust sales of Nintendo Switch units and related software resulted in an upward revision of sales, operating profit, recurring profit, and net income attributable to parent company shareholders versus previous forecasts.

The company has not changed the full-year forecasts for FY03/18, since the situation surrounding the prime year-end shopping rush still remains unclear.

February 2017

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

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

- Sales: JPY172.0bn (JPY190.0bn)
- Operating profit: JPY3.7bn (JPY4.0bn)
- Recurring profit: JPY3.5bn (JPY4.0bn)
- Net income*: JPY2.2bn (JPY2.6bn)

*Net income attributable to parent company shareholders

Reasons for revision

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

Revision of FY03/17 year-end dividend

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

November 2016

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

October 2016

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

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

Verdict details

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

Appeals filed by SRA and Happinet

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

September 2016

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

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

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

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

August 2016

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

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

- Sales: JPY71.0bn (JPY80.0bn)
- Operating income: JPY800mn (JPY1.5bn)
- Recurring income: JPY650mn (JPY1.5bn)
- Net income: JPY300mn (JPY1.0bn)

Reasons for the revisions

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

Acquisition of treasury stock

Outline of acquisition

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

Major shareholders

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

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

Profile

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

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Fujita Kanko Inc.
FURYU CORPORATION
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IGNIS LTD.
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Infocom Corporation
Infomart Corporation
Intelligent Wave, Inc.
istyle Inc.
Itochu Enex Co., Ltd.
J Trust Co., Ltd
Japan Best Rescue System Co., Ltd.
JINS Inc.
KAMEDA SEIKA CO., LTD.
Kenedix, Inc.
KFC Holdings Japan, Ltd.
LAC Co., Ltd.
Lasertec Corporation
MATSUI SECURITIES CO., LTD.
MEDINET Co., Ltd.
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