

## 7618 PC DEPOT Corporation

### Overhauling the Solution Service System Focused on Premium Members

September 4, 2018

First section of Tokyo Stock Exchange (TSE)

#### Key Points

- During the current term, PC DEPOT began work on a program to evolve its business model. Since the Company will greatly alter employees' work styles, it will take some time before the program's effects start to appear. However, the direction taken became clear during the first quarter. Management will keep intact those services that give full support to members who face problems with a special focus on premium members. Looking to the future however, PC DEPOT will strengthen its relationships with premium members and in this way create future value.
- PC DEPOT considers stores to be production venues for creating value for customers rather than venues for making sales to customers. Personnel will work with each member to devise a personalized digital life plan for the next four years. By getting families to visit stores, the Company will increase the number of customer contact points while shifting to a consultation-based business model in the future. Some portion of the memberships will shift from the existing three-year plan to a four-year plan, thus making a smaller contribution to near-term profits.
- The new initiative will involve employee' work way reform, which is the top priority measure for the current term ending March 2019. The Company seeks to enhance its value as a business enterprise value by raising productivity by increasing customer satisfaction instead of streamlining. Management will achieve awareness reform for individual employees in a collage format (image materials are edited to fit on a sheet), thus developing human resources.
- The Company launched the member-service-inclusive products last September, which clearly entails membership and incorporate premium services on a four-year contract basis. Full operation of the new system in terms of business performance will likely appear in the next quarter.
- The Company appropriately responded to a case that occurred in August 2016 where services for an elderly customer were deemed inappropriate. The credibility of PC DEPOT's social mission is recovering. The Company plans to further promote this goal, nurturing a mutual understanding of future customer needs and fostering interactive consultation based support. The membership cancellation rate is now on the decline and therefore the number of members will increase on a net basis in the near future.
- PC DEPOT's business model will enter the next stage, likely allowing the Company to build a stronger framework than before. Doing so will cause the Company to further capture service demand and increase the number of permanent members, which is likely to improve profitability. Since the Company forecasts posting an ordinary income to sales ratio of 10% and ordinary income of 5 billion yen within the next five years, the Company's market evaluation will presumably change for the better.

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Company rating: B

Stock price (September 4, 2018): 530 yen

Market capitalization: 27.9 billion yen (52.622 million shares)

PBR 1.14

ROE 8.1%

PER 14.0

Dividend yield: 2.5%

(Figures are in millions of yen)

Fiscal yearend	Sales	Operating	Ordinary	Net	EPS	Dividend
Mar. 2011	46872	1308	1447	683	19.0	3.9
Mar. 2012	49631	526	684	238	6.0	3.9
Mar. 2013	51359	867	924	441	11.2	3.9
Mar. 2014	53772	2256	2357	1536	38.0	4.7
Mar. 2015	51261	3045	3162	1914	42.0	6.9
Mar. 2016	51729	4086	4139	2693	56.9	9.6
Mar. 2017	46417	3402	3467	2269	44.1	13.0
Mar. 2018	43590	2981	3079	1958	38.6	13.0
Mar. 2019 (forecast)	43000	2800	2900	1900	37.9	13.0
Mar. 2020 (forecast)	45000	3400	3500	2300	45.8	13.0

(18.6 base)

Total assets: 34,972 million yen

Net assets: 23,394 million yen

Equity ratio: 66.7%

BPS: 466.1 yen

NOTE: ROE, PER and dividend yield are based on the most recent forecast. In October 2013, the Company carried out a share split at a ratio of 1:100, in January 2015, a share split at a ratio of 1:1.5 and in October 2016, a share split at a ratio of 1:1.2. The EPS and dividends for the preceding terms have been revised accordingly.

Analysis by: Yukio Suzuki

(Chief Analyst, Belle Investment Research of Japan)

Definition of Company rating: Qualitative evaluation based on criteria such as 1) management capabilities; 2) abilities to grow/maintain the business; 3) possibilities of downward revisions to earnings forecasts. The Company is expressed as a four-level rating where "A" means good, "B" means some degree of improvement is required, "C" means considerable improvement is required, and "D" means the state of the company is extremely grave.

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## 1. Characteristics: Migration to stores specializing in Internet device services

### Specializing in PC-related technical services, keeping the lead position in the industry

The Company is strong in Japan's Kanto region and covers 90% of the population there. Consumers who want to make use of PC DEPOT support services will find there is a store within reasonable travel distance. Consumers who buy a desktop or notebook can have a Wi-Fi router set up for them at the store, and can start using their new computer as soon as they get home simply by plugging it in. This saves them from having to do the initial setup themselves. Smartphones also can connect to these Wi-Fi routers. If customers have a problem, they can call the Company's call center and get immediate attention. Users can obtain all these services just by paying a monthly fee. The Company leads the industry in PC repairs and maintenance services. Although the Company is a middle-standing company in the industry, in terms of the number of PCs sold, it has unique service characteristics.

Over the last 10 years, PC DEPOT has gradually shifted its business to services. The Company has achieved a unique presence among its competition with mass home electronics retailers. It has survived well against local competition as a computer specialist although it could not compete against major companies in terms of total sales volume.

Under these circumstances, the Company did not overextend itself when opening new stores. It did decide however to become a customer-orientated IT solutions company, by striving to improve its services instead of increasing the sales volume for desktops, notebooks and other hardware. The Company markedly changed its tack to follow this direction in 2005. This was the second turning point for the Company since it was founded.

Trend in constituent ratios of sales accessories

(% , millions of yen)

	2009.3		2011.3	2013.3	2015.3	2017.3	2018.3	
	Sales	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Constituent ratios	Sales
Goods sales	35572	82.4	75.8	69.0	58.8	43.4	40.6	17720
PC and peripherals	24375	58.5	52.0	46.4	33.7	23.5	21.5	9391
Accessories, supplies, and software	6554	14.6	13.9	12.1	8.5	6.7	6.2	2689
Used items and others	4643	9.3	9.9	10.5	16.6	14.2	12.9	5639
Service sales	11340	17.6	24.2	31.0	41.2	56.6	59.3	25870
Sales from solution services	8726	10.3	18.6	27.3	38.3	53.7	56.4	24566
Royalties and other revenue (FC)	522	1.3	1.1	0.3	0.3	0.2	0.1	62
Internet-related businesses	2090	6.0	4.5	3.4	2.6	2.7	2.8	1241
Total	46912	100.0	100.0	100.0	100.0	100.0	100.0	43590

NOTE: Sales from solution services include sales of service inclusive products and technical services/fees.

Providing solutions in combination with various services is the key to success. Moreover, when members subscribe to the Company's premium services, they can get any support they need:

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maintenance, call-center services, anti-virus support, and a "full installation" service when customers replace old PCs. One of the Company's strengths is this lineup of original services it has developed and runs. No other PC shop is capable of delivering technical services especially data recovery, as speedily as PC DEPOT. The Company set its transformation into a store that specializes in services as a part of its policy objectives and has strengthened its commitment to this policy as it entered the Internet era.

### **Unique business model with premium services as its source of income**

The Company's solution services consist of three service categories. The first is the PC Clinic which provides installations along with repair and replacement services. Support for solution services are provided at all stores and is managed by about 1,000 employees.

The second is premium services which solve problems customers are having. The services cover: (1) any type of product; (2) products regardless of how old they are; and (3) products purchased at the stores of other companies. The premium services are grouped into six major service plans. The third is solution services which combine communication or content with devices. By subscribing to these services, customers can read digital magazines on their iPad or connect with the printer wirelessly with a monthly payment. Five premium services with the exception of the Assembled PC plan backed up on the cloud (automatic data storage) provide sufficient capability to cope with defective hardware or security issues.

The Company's business model is quite unique, even when compared to companies outside of Japan. The model consists of product sales, service sales, its operation as an MVNO, and other areas. Members essentially enter into a three-year or four-year premium service contract. The company bears the cost of support up front, and then recovers it from the fees paid by members.

Customers want to use the PCs, tablets or other devices they have bought as soon as they get home. President Nojima remembers what that feels like. If after buying a PC for example, a user takes three hours to do things such as create a recovery disc, set up anti-virus software, configure the initial settings and set a password, and if the customer then hits a dead end, he or she will be stuck without help. PC DEPOT's premium services are solutions that help such users over the Internet.

Suppose a customer brings their old computer and member card to a PC DEPOT store, and buys a new one. The store's service personnel will then carry out all the necessary software installations for the customer onto that customer's new computer. The customer takes the new PC home, and is able to use it immediately in the same way as the old one, via the PC DEPOT-branded wireless router, without having to do anything in particular. This is total convenience.

A patent for the Company's router's systems was registered in March 2012. The packages are also

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cloud-capable. The Company has gradually been expanding and improving these services. PC DEPOT's business model, which generates revenue from service sales, was brought fully into operation in November 2005 and has been steadily expanded ever since. Conventionally, various technical services such as installing additional memory have been provided for a price. Today, however, when a fixed month fee is paid, a wireless router is leased to enable the consumers to use high-speed Internet service with the purchase of just a PC alone.

As mentioned above, PC DEPOT also is an MVNO. An MVNO does not have its own mobile communication network, but provides services under its own brand by renting network space from major carriers. PC DEPOT, however, provides services to customers as a telecommunications carrier. This makes it possible to provide services that customers may want in a single package and makes for a very convenient premium service.

PC Clinic can readily be used as a one-time-only technical service. Making customers into premium service users is a better strategy in order to retain them as members to whom ongoing services can be provided over a long period time. In addition, PC DEPOT's direct running of PC Clinics facilitates the agile management of PC Clinics. That is why the Company changed its policy and began directly managing PC Clinics.

### **Elimination of the digital divide, which the Company has regarded as one of its social missions**

PC DEPOT is prioritizing support for customers struggling to use digital network devices. To this end, the Company is improving its services in a slow and steady manner. These efforts cultivate a service market, enabling the Company to achieve its unique business model. President Nojima says that the Company will take up challenges but will not take excessive risks. The Company will conduct experiments, confirming a new course of action before carefully expanding its business.

The Company has been developing IT solution stores known as Smart Life stores that customers can maintain a relationship with over the long term. Instead of merely enjoying the convenience of a neighborhood PC superstore, users can have the Company solve the problems they experience when using IT equipment and networks.

New devices and services are continuously entering the market, which is a characteristic of the information and communication technology market. Customers need support in order to maintain an IT environment that enables them to fully utilize the products and services they use. Smart Life stores provide services and detailed explanations so that users can make full use of the features of their desktops, notebooks, smartphones, tablets (multi-function mobile terminals), and other devices, as well as meeting any other user requirements as part of a total set.

These services are truly convenient. If consumers use products over a long period of time, in

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addition to the profit generated at the time they make the purchase, it is quite likely they will start to pay fees for services that make using such products more convenient. To make this happen, users must already be satisfied with the convenience provided by the service.

The starting point for traditional retailers is merchandise, but since the Company is both a retailer and service provider, its starting point is also services. It will offer Internet-related services, mainly for devices, thereby building relations with its customers.

The Company generates profits in three ways: firstly, selling products; secondly, through technical fees for product repairs; and thirdly, from monthly fees paid by members who receive ongoing support from the Company. The core of the Company's business in particular is the support fees paid by its premium members, making it unique in the retail industry.

The Company considers that its corporate social responsibility (CSR) is to lower the digital divide in society. To a certain extent, a digital divide arises between people who can use information and communication technologies, and those who cannot. It is not good for society as a whole when people who cannot use these technologies find themselves at a disadvantage. The Company intends to contribute to more convenient and enjoyable daily lives of these people by supporting them in making the most of IT services. This support service is being provided by PC DEPOT, with its stores acting as a base for such services.

### **Business starts with personal computers**

President Nojima (age 59) used to work at Nojima Corporation, a consumer product mass retailer (Code No. 7419, listed on the first section of the TSE). The eldest son of Nojima Corporation's founder is currently president of that company, while Takahisa Nojima his brother, is president of PC DEPOT. He was in charge of supervising stores and merchandise at Nojima Corporation, but once personal computers began to become popular, he decided to set out on his own and established an independent business. While Nojima is still one of the shareholders of Nojima Corporation, there is no business relationship between that company and PC DEPOT.

At age 34, President Nojima founded the Company, which will celebrate its 25th anniversary in 2018. In the early days after the founding of his business, many people wanted to own their own desktop or notebook computer, but such hardware was still beyond their reach. In those days, only a limited number of people went all the way to Akihabara to buy their own personal computers. In contrast, Nojima went into business selling PCs in the same way that retailers in general deal with new merchandise. Company business performance steadily improved and in 1999 some five years after its establishment, it became listed on JASDAQ. Subsequently, the Company was promoted to the first section of the TSE in November 2015.

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As the Internet era emerged in 2000, the Company entered into a new phase. At the time it was listed, it operated about a dozen stores with net sales of 15 billion yen, ordinary income of 800 million yen, and no debt.

At present, desktops, notebooks and related products are commonly sold at consumer electronics superstores. Also, there is a wide variety of specialist computer superstores. When viewed in the broad sense of consumer electronics and computer superstore sectors, the Company ranks in a low position in terms of size, yet is competing on a different playing field to its rivals. The Company is not directly competing with the biggest companies such as Yamada Denki, Edion, and K's Denki, but is differentiating itself from these companies.

Store development conditions

As of August 2018				(Stores)
	PC DEPOT Large suburban-type stores	Smart Life stores Medium and small stores in metropolitan areas	PC Clinics Counters established as concessions inside consumer electronics superstores	Total
Directly-managed	13	42	53	108
Subsidiaries	12	1	5	18
FC	3			3
Total	28	43	58	129

NOTE: Smart Life stores represent PC DEPOT Smart Life Partner (SLP) stores.

Subsidiaries represent PC DEPOT Stores (Kyushu, Chubu, Shikoku, Shinetsu and Tohoku regions).

PC Clinics represent counters established as concessions inside consumer electronics superstores, and FC represents franchise stores.

### Converting franchises to directly-managed stores

When developing its PC DEPOT stores, which are comprehensive specialist computer retailers, the Company allowed K's Denki stores, which are operated by K'S HOLDINGS CORPORATION (Code No. 8282), to become PC DEPOT franchisees. K's Denki was the second PC DEPOT franchisee. It was a beneficial move for both companies in that a consumer electronics superstore began to deal with PCs.

The Company does business in cooperation with K's Denki because, according to President Nojima, the management concepts of the two companies are quite similar and he felt much empathy with Shuichi Kato, former Chairman of K'S HOLDINGS CORPORATION. The Company focuses basically on being a chain store operation that is easy for customers to use for example by offering self-service sales aside from parts and offering discounts for paying cash instead of points cards.

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From the very start, Mr Max Co. and Kitamura Co. also became PC DEPOT franchisees. However, since major operators became dominant in the consumer product mass retailer format, general discount stores found it difficult to sell PCs. The FC stores of Mr Max Co. were bought by the Company and became its subsidiary (currently, PC DEPOT Stores) by 2010.

Aside from PC DEPOT franchises, PC DEPOT PC Clinics which are franchise outlets providing technical services which were established as concessions inside consumer electronics superstores. PC Clinics successfully operated in K's Denki stores, and the franchise was then expanded.

As of the end of August 2018, there are 55 directly-managed PC DEPOT stores (including 42 Smart Life stores), 13 stores outside the Kanto region run by the PC DEPOT Stores Co., Ltd. subsidiary (including 1 Smart Life store), and 3 franchise stores, for a total of 71 stores. In addition, there are 53 directly-managed PC Clinics, 5 stores run by the PC DEPOT Stores Co., Ltd. subsidiary. As such, the Company currently operates 129 stores.

PC Clinic was operated mainly by FC stores until seven years ago, but the Company transformed the FC stores into directly-managed stores. The Company and K's Denki agreed that direct management would be more effective for enhancing service functions of the stores, and so the Company acquired these franchised stores. Currently, the Company operates directly managed PC Clinics inside K's Denki stores.

### **Ongoing Web business**

EJWORKS Co. (ejworks), a PC DEPOT subsidiary is engaged in the IT solution business and has a line of business that includes providing Internet services and Web content creation. The Internet services market started from around 2000. However, this market has since matured, and a process of survival by natural selection has begun among Internet service providers. The Company is acquiring small-to-midsize providers and working to maintain their customer-oriented services. Customers will experience a seamless transition since they would keep their original email addresses.

Moreover, the Company has recently been utilizing this subsidiary as a support team for its content development and has come to attach more importance to it. The idea is to position it as a new support base for development.

### **The Company has made use of part-time workers, and it has hired some of them as regular employees.**

As of the end of June 2018, in addition to 823 regular employees, 1,052 part-timers (on an 8-hour shift basis) were working for the Company. Ten categories of tasks are assigned including operations (cashiers and baggers), attending to customers (customer-service personnel), Smart Life Partner (SLP,

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customer-service personnel), clinic services (preventative and recovery services) and quality improvement; workers are trained to handle the basic tasks involved in one category within one week. They carry walkie-talkies with them in the store in order to help each other by sharing information, which allows them to ensure a high level of customer satisfaction. Many part-time workers have been working for the Company for years, and each year roughly 40 to 50 workers change their status from part time to full time.

### **Complying with corporate governance: Review of outside directors**

As a result of the general meeting of shareholders held in June, there are currently ten directors on the Board (decreased by one), including three outside directors (increased by one). Mr. Mineo Fukuda, an outside director, is an entrepreneur who successively filled the post of managing director at Recruit Holdings Co., Ltd., president of KADOKAWA CORPORATION, and vice-president of Jupiter Telecommunications Co., Ltd. Mr. Hidetaka Fukuda, a newly-appointed outside director, has worked at the Ministry of Economy, Trade and Industry and is acquainted with IT, information and telecommunication. Ms. Yumiko Masuda, also a newly-appointed outside director, is the representative director of Consumer Voice Research Institute, Limited and familiar with consumer-oriented management. With these newly-appointed outside directors, discussions at the Board of Directors have been further stimulated.

In fiscal year 2017, the Company changed the accounting auditor from Ernst & Young ShinNihon LLC to Shinsoh Audit Corporation. Shinsoh Audit Corporation is involved in auditing services at 48 companies, including those listed on the First Section of the TSE.

The reasons for changing the accounting auditor are as follows: (1) An audit corporation was chosen to conclude a new agreement since the term of the current agreement had expired. Shinsoh Audit Corporation was selected considering its size, ability to perform tasks, independence, and internal management, (2) although there were no disagreements with the previous accounting auditor regarding a series of corrections that have been made to financial data in fiscal year 2017, conducting a series of auditing procedures placed a heavy strain on both the Company and the accounting auditor, and (3) based on the above, the Company decided to comprehensively establish a relationship of trust with a new accounting auditor.

Most directors who execute business are in their 40s, indicating that management talent has developed. President Nojima established this Company after leaving Nojima Corporation. Regarding the operation of the company, the president is aiming to implement business management suitable to fulfill the need for PC DEPOT to continuously develop in the rapidly-changing IT industry as a public company.

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## 2. Strength: Shifting to a profit structure focused on service revenue

### **A mechanism that is impossible for others to copy**

The business model at PC DEPOT is unique, and competitors have opened stores similar to Smart Life stores. However, these competitors have not yet established a system or trained employees to provide premium services at the same level as the Company. The Company is a retail service company for personal devices that provides solution services under a membership system. With no other companies pursuing a solution-service-based business model in the same manner as the Company does, the Company is building up to become the one and only business of its type.

Even if another company tried to provide such services, it would be extremely difficult to (1) train the personnel required for technical services, (2) tolerate a decline in profits in the early stages due to the shift to a service income type business, and (3) provide an extensive service menu from now onwards. We can therefore say that the Company's superiority over its rivals is significant.

Service income has been increasing as the number of use of PCs, smartphones and tablets increases. Most individual own not only one device but rather multiple devices. Also, families own multiple devices. Needs for dependable services rise according to the number of devices owned which makes it easier for the Company to have such users become regular customers. Moreover, service income has been increasing thanks to an increase in the number of users of service-inclusive products where products and services are provided together.

The Company provides services by assigning experts in each service category and having them work as a single team. It has spent more than 10 years developing this system, which has become a business model that constitutes part of its corporate culture.

### **Convenient services—"Just Show up and Buy a New PC"**

Up until now, people have visited PC DEPOT only when they need something related to PCs; however they now visit PC DEPOT for almost any type of Internet device, including smartphones, tablets, and printers.

Under such conditions, the cloud is the key element. The Company has launched full-fledged "Comprehensive Cloud Services." Now that stable server operation has been secured, the Company will currently be able to provide new services from here onwards.

One of the typical new services is "Just Show up and Buy a New PC." The Company provides its premium members with an automatic data backup service for Internet devices such as PCs and backup data reproduction services at store counters using a patented, proprietary, comprehensive cloud system.

Since data on PCs are backed up, when you buy a new PC, you don't need to bring your own PC to

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the store to take data from it. Customers can have their new PCs ready for use with no hassles since the general mirroring service (backup of the same data on the cloud) provided by the Company allows them to save the data from their PCs onto the cloud. Their smartphone data is also saved on the cloud via PCs. Investments in such services are not big investments compared to those involved in the creation of a new store so the Company can gradually keep expanding this service.

It will prove difficult for other companies to offer the same service. The Company has enhanced the PC Clinic functions at its stores. It has trained and developed engineers with expertise in PCs, smartphones and the Internet. The Company has already thus created a mechanism through which it can make profits. Even if mass home electronics retailers try to imitate our business model, it will prove difficult for them to develop the same functions by using such staff at their stores.

### **Specialist services are needed even with the reinvention of Internet devices**

The position of leading player in personal communications has shifted from personal computers to smartphones. Cloud systems will become the main infrastructure. Computers used to be at the core of the Internet, but these are now giving way to network devices embedded in appliances, cars and homes, making them useable anywhere. Software is required to control such functions, and services are also required to make full use of this software. The Company is committed to providing these services, and has set as its objective the adopting of a strategy to expand its business to cover Internet devices and not to limit its services merely to computer-oriented goals.

### **Smart Life stores are fashionable and convenient: Specialization in services**

Smart Life stores display less merchandise than conventional stores. Smartphones and tablets now occupy more of the display shelves. Space available for service needs has greatly increased via store renovation that provides all services the customer wants rather than focusing on selling products.

The variety of professional accessories in a store may not satisfy the needs of PC aficionados, but this poses no problems since customers can ask for an item at the store counter and the store will obtain it for them soon after. The name of the counter for responding to customers' needs (such as computer repairs) changed from PC Clinic to Dr. Smart, and staff members now wear a new uniform.

People want to use the IT services they need immediately without having to deal with anything inconvenient. Tablets and other devices are provided with content services pre-installed and with all necessary configuration tasks completed. This convenience allows customers to use their tablets with these services without having to do any cumbersome preparation. The customers neither need to configure the initial settings while staring at user guides nor do they have to call several call centers and ask for help.

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The Company also advises customers on Internet connections and fees for each PC, smartphone and tablet that they are now using, thereby allowing them to lower the fees for all of their devices or to switch to more convenient service packages.

The "Smart Pack" billing plan is also coming into wide use, which includes a hardware device, software, and Internet connection in a single package. This package allows customers to use hardware, software and an Internet connection by simply paying a monthly fee instead of having to buy a hardware device and paying a monthly fee for the necessary software and Internet connection. Although this is a type of three to four year loan for an amount determined by subtracting the product's estimated residual value at the end of the loan term from the product's sticker price, since customers are already familiar with the billing plans of Japanese cell phone carriers, which require a two-year subscription, they will find this system acceptable.

The Company has embarked on full-scale store innovation. The PC DEPOT logo includes the terms "Low Price" and "The Computer Superstore," and its image is that of a PC supermarket, but in some areas this image no longer reflects the reality. Therefore, these two terms were removed from the logo of the new stores.

Smart Life stores will not just sell products; they will create packages and provide customers with the solutions that they want. Their customers will become members who will use the services they offer over long periods of time. PC DEPOT's president, Takahisa Nojima, stressed that the approach for Smart Life stores will not be to simply display products and ask customers to choose the ones they like. Instead they will be offered a one-stop service to provide them with the Internet communications that they want. Consequently, the atmosphere at these stores will be different from that of conventional stores and customer counters will be centrally placed within them.

Inventories decrease in Smart Life stores. By helping free customers from the burden of choosing products and services themselves, the role of these stores will be to provide the services needed by customers, as a result reducing inventories. However, a certain amount of accounts receivables will increase on the balance sheet because the merchandise will be in the form of packages made up of hardware, software, and content with payment being collected in the form of monthly charges.

### **Opening a large number of Smart Life stores by renovating existing ones**

The Company continues to open new Smart Life stores by renovating and reopening existing stores. The Company will also open new stores, with a greater focus on central Tokyo than in the case for current stores.

Smart Life stores transformed from existing PC DEPOT stores already have achieved a certain level of recognition and regular customers. The key to their success is how many new service-oriented

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customers they can acquire. Smart Life stores can be set up even if the location is less than favorable. As the service grows, and the percentage of total sales that it represents increases, profitability will further improve as a result.

Costs for renovation are lower than those for opening new stores. Moreover, a marked impact can be noted. Comparing the situations before and after renovation, the profitability of renovated stores is about 20% higher than that of existing ones. The same expenditure required to open a new store with an area of 400 to 500 *tsubo* could instead be used for renovating four stores each with an area of 300 *tsubo*. Furthermore, the probability of recouping investments is higher, and the returns are also higher. Therefore, such moves are given first priority.

On the other hand, there still remains considerable room for new Smart Life store openings. As a store focusing on providing services, we estimate there are approximately 200 locations where these stores could be opened. The Company will first open stores primarily in the Kanto region to enhance its brand power through providing community-based services. The Company reckons that it requires 100 to 200 *tsubo* of land in Tokyo's 23 wards and 200 to 300 *tsubo* of land in the greater Tokyo area if it plans to effectively open a Smart Life store in a vacant space.

	(Stores)											
Number of stores at the end of each term	1995.3	2000.3	2005.3	2010.3	2011.3	2012.3	2013.3	2014.3	2015.3	2016.3	2017.3	2018.3
PC DEPOT												
Directly managed Smart Life store	1	10	28	43	44	48	50	46	36	28	23	16
Subsidiaries Smart Life store				4	4	12	11	11	13	13	13	12
FC		8	32	17	17	5	5	5	3	3	3	3
PC DEPOT PC Clinics												
Directly managed					30	46	49	49	52	52	53	53
Subsidiaries						1	1	1	0	5	5	5
FC				24	6	7	7	7	6	1	0	0
<b>Total</b>	<b>1</b>	<b>18</b>	<b>60</b>	<b>88</b>	<b>101</b>	<b>119</b>	<b>123</b>	<b>123</b>	<b>125</b>	<b>127</b>	<b>128</b>	<b>129</b>

NOTE: Smart Life stores include renovated stores and new openings. Decline in number of directly-managed stores due to conversion to Smart Life stores.

### Opening Smart Life stores in central Tokyo

The Setagaya-Kinuta Store was the first new Smart Life store. Customers are now steadily increasing there. Many customers are bringing in hardware purchased from other companies for repairs, thus increasing the store's customer base. This store was launched on a full-fledged basis in March 2016 and the Company invested around 400 million yen in this store opening due to its wide floor space of 300 *tsubo*. However, this is an exceptional case. The Company usually invests roughly 200 million yen in stores with a floor space of 100 to 150 *tsubo*, and roughly 40 million yen in stores

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that have all their own fixtures and furnishings.

Since this is the first new Smart Life store, the store does not have any already existing customers. It did not attempt to attract customers with product sales as traditional PC DEPOT stores do. Instead, first the store encourages customers to visit and then it attempts to gain their acceptance by providing them with services for which they can readily seek advice if they encounter any problems. It takes some time for the store to build up its popularity; however, customers will start relying on the store when they have difficulties with their smartphones, PCs, and tablets. Local residents will also appreciate having such a store located in Setagaya.

Many people want the solution services provided by PC DEPOT. The Company launched the Aoyama Store in December 2015 and the Azabu-Juban Store in March 2016 as city-center stores in Tokyo. These stores target new customers living in central Tokyo. Customers visiting the Aoyama Store live in the neighborhood. More female customers than expected are visiting the store. The number of customers is increasing and a generation of people somewhat younger than seniors is visiting the store.

The Aoyama Store is located on the first floor of the new Aoyama Quartz Tower (a comprehensive medical facility). The store will occupy two floors with an area of 70 *tsubo*. This will be a new small-sized SLP store and the first store within the circle of the Yamanote Line. The Company has been building up a base of members by targeting people living within a two-kilometer radius of the store. The Aoyama Store is located in a premium location along a main street. President Nojima believes that the Aoyama Store will be a symbol of the Smart Life store, and other stores to be opened in central Tokyo will not need to be situated along a main street if people living within one to two kilometers can locate it easily.

### **Unique service program members**

In-store arrangements like those of Smart Life stores are found in Europe, but the Company's business model, which allows it to retain customers mainly through providing services does not exist either in the West or in Asia.

The inspiration for this business model dated back more than 10 years. At first, the Company started by giving preference to customers who were not familiar with PCs. In those days, there was a perception that PC users were somehow a different "tribe" or subculture of people. President Nojima, however, aimed to make customers of people who were not skilled at using PCs. He tried to provide free help to people who were unable to use PCs easily and those who wanted to reset their frozen PCs.

Next, he gave priority to serving "people who have difficulties." He dug deep into the technical support business and made it a tool for differentiating his company from others. Thinking that it would

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be more convenient to receive service continually by paying monthly fees than paying fees every time a technical problem occurred, he launched a monthly fee system in 2006. Today, the service has been refined into a scheme that can provide services when users face any type of technical trouble. The convenience of the premium service has been enhanced as more women and families use PCs.

Premium members have been increasing at a very high rate. However, this does not make money in the short term. The Company needs to make an up-front investment for each router which takes a year to recoup from the monthly premium service fees. However, once the initial outlay has been covered, profit is generated at a fixed rate from the second year onward.

The sales of services are growing steadily. What this means in practice may be somewhat difficult to understand for people not directly involved, however, the Company's policy is clear. Sales incentives like those given by manufacturers for product sales are included in product sales. Sales from premium services, repair, maintenance, and one-off service plans are classified as service sales.

### **3. Medium term business plan: Pursuit of business model evolution and bolstering of relationships with members**

#### **Declaration by President Nojima: From sales to producing value**

In May 2018, President Nojima released a four-page document entitled "To Stakeholders" that outlined his thoughts which was a highly significant step.

First, he deemed business operations to be productive for creating long-term value. While AI and robots were attracting attention, he wrote about "expansion of human production domains."

Second, President Nojima cited the following corporate values: i) Social (sociability and social contribution); ii) Environment (the environment); iii) Education (work styles and learning methods); iv) Entertainment (creation of new value, such as enjoyment, based on human efforts); v) Governance (corporate governance and operational control). These were referred to as EEESG ("Triple ESG") by adding two Es to ESG.

Third, for education, President Nojima proposed shifting to new work styles in consideration of stability and productivity and humanity enhancement and productivity with respect to living. Stressing the importance of future design, he cited a consultant designer, engineer-artisan, and member benefit designer.

Fourth, President Nojima attached importance to entertainment, seeking to provide venues to deliver satisfaction to customers where: i) customers find satisfaction when they visit stores; ii) PC DEPOT staff can share and deliver satisfaction and create a future by providing the customer a

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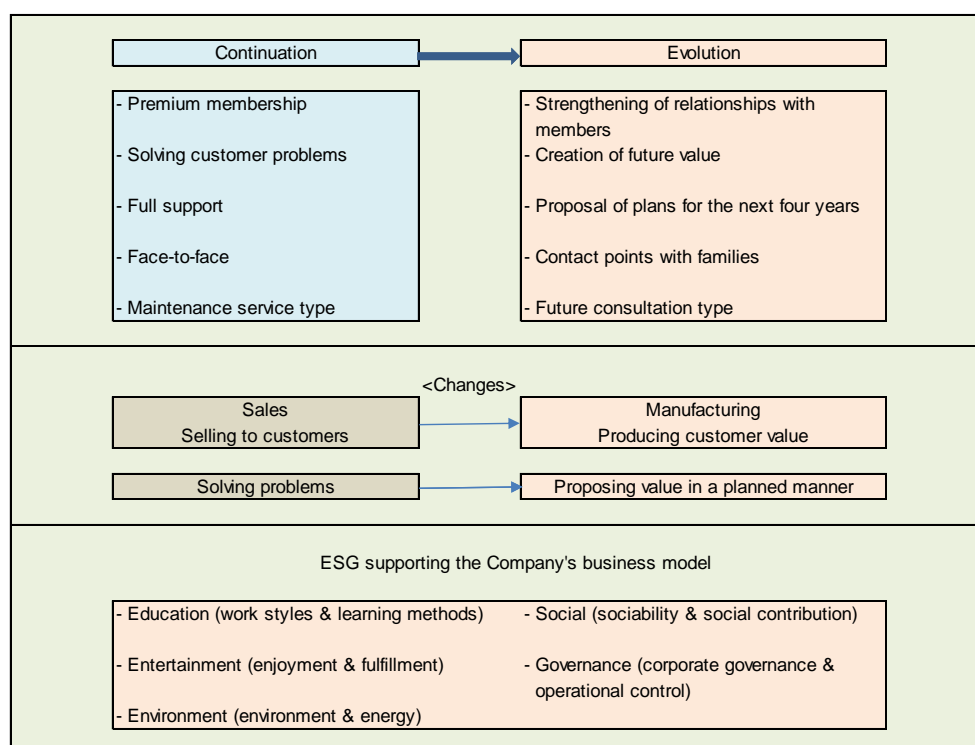
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feeling of being cared for; iii) customers find gaming enjoyable; iv) customers enjoy learning about new ways of using devices; v) customers feel secure when seeing their IT devices being inspected; and vi) customers find it fun to come to stores along with family members and make future digital plans together.

Fifth, to deepen communication with stakeholders through mutual exchange of information, President Nojima installed officers dedicated to v) AR (associate relations), vi) PTR (partner relations), vii) MR (member relations), and viii) ICR (intercompany relations) in addition to the existing officers in charge of i) CCC (customer communication centers), ii) CR (call centers), iii) IRSR (investor shareholder relations), and iv) PR (public relations). AR will serve as the contact point with employees and their families, PTR as the contact point with business partners, MR as the contact point with members, and ICR as an internal public relations contact point.

The aforementioned message from the President expressed the Company's integrated thinking. The fact that the President composed the message himself deserves high praise.

Evolution of PC DEPOT's business model



### Business model evolution

Starting in the fiscal year ending March 2019, the Company made significant changes to its business

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model philosophy. Although the Company will continue to essentially support customers' continual use of devices, it has changed how the support service will be provided.

Looking forward, PCs, smartphones, and tablets will become still more diverse. Customers want to use such devices in a way suited to themselves. Therefore, the Company will provide solutions suited to each customer. It will also create and propose plans after learning of the customer's needs—in other words, the Company will implement the concept of becoming customers' digital life planner.

In promoting the transformation, there are two factors that cause PC DEPOT's business results to temporarily cease growing. The first factor is the fact that shifting to a new business style means that it will be some time before the Company can provide adequate solutions to customers. The second factor is that the Company will lengthen the term of its membership system from three years to four, which will result in a smaller contribution from initial year sales and profits.

In 2017, PC DEPOT launched a four-year contract scheme to follow its three-year contract scheme, and currently the four-year contract scheme is the main scheme. Seeing hardware and service as integral elements, the Company provides service even for hardware bought from other companies if the customer becomes a PC DEPOT service member. Examining the four-year period, the customer incurs an initial cost at the start with maintenance, security, and renewal procedures occurring upfront. This cost is supposed to be recovered over the four-year period. In the interim, the Company must also respond to various inquiries and provide repair service.

PCs and smartphones have matured as products, and product rollouts by manufacturers generate weaker effects in terms of stimulating new replacement purchasing. Users consider and buy replacements in light of their usage conditions. Consulting properly with customers during this process enables the Company to capture replacement demand during the four-year period.

For this to happen, it is important for Smart Life stores to communicate and interact with customers in person and to learn about their lifestyles. To this end, the Company will foster digital life planners who can provide such consulting services.

Customers include young people and seniors. PC DEPOT will obtain user feedback and provide solutions, delivering consulting services over the four-year contract period.

The Company will also widen the scope of store features. In addition to sales and repair services, it will offer consultation and entertainment services, enabling families composed of children, parents, and grandparents who visit a store to enjoy the experience.

Today they may be grandparents, but years ago, they enjoyed NES games. Programming will become important for elementary and junior high school students. President Nojima wants customers to enjoy playing the nostalgic Space Invaders game while discussing computers and programming.

PC DEPOT will enable customers who interact with the Company to have such an experience

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remotely as well. The Company is now in the process of preparing to provide such services.

Thus, PC DEPOT will bolster its entertainment staff while investing in its consultation workforce. Meanwhile, the Company will reduce its existing types of sales promotion and advertising activities. As part of work way reform, it will increase the number of days that the stores are closed.

PC DEPOT will also alter its business concept, shifting from the phase of solving problems that customers experience to the concept of providing members with planned consultation services as part of a move to offer higher quality.

The Company decided to shift from quantity and efficiency to high-quality value creation. Personnel will devise four-year plan sheets for customers through a consultation sales service. By sending invitation letters to users, personnel will attempt to reach new customers.

President Nojima has deemed the current term to be a year for staff re-education as well as quality and governance development with regard to the aforementioned steps.

Although the Company will continue its membership-type business model, personnel will contact individual customers to provide planned consultation services instead of regarding customers as a mass quantity while examining average numbers.

President Nojima has said with confidence that, although the business results for the current term were forecast to be more or less flat compared to the previous term, the Company is seeing encouraging signs toward building the new business model, and employees view the developments positively.

### **From problem solving to future value creation**

Although PC DEPOT's existing business model gradually came into existence over the past 10 years, it faced complaints from some members in 2016 regarding the membership structure. Although the structure was not illegal, the Company concluded that the membership needs to be operated in a manner suited to customers. So, the Company spent a year creating a new system.

The internal quality control system is nearly complete. Although PC DEPOT appeared to take this opportunity to begin taking aggressive steps at once, President Nojima instead started action on the next reform.

President Nojima redefined stores as venues for producing long-term value for utilizing IT rather than as sales venues for providing products and services. Personnel are to put this concept into practice, which will be burdensome in the beginning and take a long time to take hold among employees. Although efforts will gain momentum after six months or so, business results for the current term are expected to remain at the same level as the previous term.

PC DEPOT aims to evolve its business model. The Company will continue to provide the premium services of helping solve customers' problems and giving them full support. Personnel will not only

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bring smiles to customers in trouble but also get involved in creating future value for them.

In the future, users will continue to use IT devices, including use as a family. Moreover, during a given period of time, users will have various needs, such as using IT devices in a certain manner or buying new ones and buying replacements. Personnel will prepare schedules as plans and provide planned proposals, thus facilitating continuous use and support services.

Employees will become digital life planners who provide premium services. In the financial services sector, there is a job called financial planner. Employees will provide consultation services not only to solve the problems that customers experience now in their digital lives but also to help them enjoy their future digital lives with peace of mind.

PC DEPOT launched its membership system in 2006, and the Company began to migrate to the Smart Life store format in 2013. Starting from 2018, the Company has been shifting from a problem-solving-type business model to a future value creation-type business model.

### **Progress toward internal reform**

Looking back on this year, President Nojima emphasizes the following two points: (1) Internal reform has been developed and established. Engineers in charge of repairs fully understand the stores, devices and services, and can also read customer behavior. On the other hand, due to productivity varying among stores, it took time to raise the level of service to customers while increasing added value; and (2) The responses of member customers have already calmed down, and there are cases where users who had cancelled their memberships returned. In other words, the Company feels more confident that the number of customers will substantially increase if the Company can provide them with accurate advice on the services they really need.

### **Promoting workers' work way reform**

PC DEPOT has set a regular closed store day. As a general rule, all stores are closed on the third Wednesday of each month. Exceptions are PC Clinics inside K's Denki stores and Smart Life stores inside the Kinokuniya bookstore at Lalaport in Toyosu.

The Company will focus on three points in future management. The first point is the work way reform, by which the Company has shortened business hours. The Company has shifted the closing time of the stores which used to stay open until 8 or 9 p.m. to around 7:30 p.m. While the customers come to our stores with problems, if we can quickly understand and respond to those problems, this will result in greater customer satisfaction and shortened waiting time. This will also prove effective in fostering a workforce. The training of new employees has been making progress and it is likely that they will soon become a substantial part of the workforce.

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Secondly, the Company will focus on the importance of PCs in the educational market and make an effort to restore the role played by the PC. The Company will emphasize not only smartphones but also the smooth connection to smartphones with the PC as a base. On the other hand, low-priced smartphones are not the Company's main products and focusing on IoT is regarded as a little bit premature even if the use of IoT will eventually spread to homes.

Thirdly, the Company will make work creative and highly value-added through the development of new customers. While people seeking cheap products go to other shops, the Company will aim to attract customers to our stores for excellent services. Consultation on membership is increasing. General customers who are not the members of our services also visit our stores with their smartphones or PCs purchased at other shops when problems occur.

Store operating hours have been shortened and also one regular closed store day per month has been set. It is therefore essential to improve productivity. This does not mean quickly selling merchandise and services in a throw-away style. Our employees must have a good understanding of customer needs and are required to improve their consulting skills to satisfy the store needs.

The pursuit of merchandise selling, sales promotion through price reductions, and increasing efficiency only brings about negative impact on enhancing productivity stresses President Nojima. The Company will, on the contrary, dedicate its focus towards: 1) elevating consulting proficiency, 2) fostering technical expertise, and 3) expansion of member-service-inclusive product line-up.

The consultant shall foresee the client's needs, four years into the future, and present a proposal following a consultation hearing. The consultant shall take into consideration future purchasing needs of families and potential replacement with newer models.

The Company goal for its employees is to deliver information and proposals aligned with the customers' future needs, extending 48 months into the future rather than to be constrained to that day's sales. The employee shall present a clear picture of when and what kind of merchandise and service the customer is likely to require, and propose products and services that match the customer's image.

In terms of training of employees, the Company will proactively rotate employee assignments. Training and practice will be conducted with employees sent to stores other than their own place of work. The Company has no personal quotas so on-site-training should be carried out without any effect on individual wages. Therefore, cooperation among the employees will function well.

Response from call centers shall focus not on the efficiency in handling inquiries from customers, but rather on increasing customer satisfaction (CS), which in turn will lead to enhanced added value.

The Company will not boost its promotion of smart speakers at its stores just for the sake of increasing product sales. The Company will not hastily promote high growth merchandise. The product will be given a place on the Company's store shelves, but the Company believes that it is still

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not too late to achieve a full understanding customer needs and will act only after a genuine need is confirmed.

The Company policy is to foster consulting proficiency that matches customer needs, and use that as the source for its competitiveness. In line with this policy, the Company places importance on personal computers. There is a tendency to believe that with the advent of smartphones, personal computers are no longer necessary. But in reality, this is far from the truth.

Personal computers are indispensable for the education of children, supporting the activities of youngsters and for convenience in the everyday lives of older generations. The Company believes that consumer needs for personal computers as tools to gather necessary data and information will only increase in the future.

### **Practice of proactive awareness change through use of collages**

Under the President's leadership, personnel will create collages of new value creation (a bird's-eye view summarizing ideas currently in mind) and devise written plans suited to individual customers.

This will not be a matter of simply providing new smartphones and having customers buy them as replacements. Each officer and each customer should work together to consider the customer's digital life over the next four years, based on which the former will provide a planned proposal and create value in a planned manner.

The Company requires employees to set goals and act on proposals using collages. Smartphones are two dimensional, but PCs are able to express things in three dimensions. As one way to visualize images and thoughts, the capability to edit gained through the experience of developing a single sheet of A4 sized paper (one PowerPoint slide) with various collage sizes is effective.

The Company will design a framework that will promote employee satisfaction (ES). Incentives to achieve that goal will be introduced into the compensation system. Even persons over 50 can be hired as employees and work up to age 70. In other words, by introducing diversified ways of working at the Company, the Customer will foster trust and confidence through connection with its stakeholders and in that way motivate the employees.

Once this takes effect, the marketing capacity of the Company as a whole will expand, escalating the value of the Company through an increase in added value. So the Company will carry out these strategies.

As one example of the collage exercises at PC DEPOT, employees are asked to put together a single page (an original message assembled using various materials) and express their own thoughts on themes such as: 1) Robots, AI and my work, 2) Image of my expertise as it relates to the customer, and 3) Human qualities required in the future workplace. Such activities are currently arranged and

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provided under the leadership of the President.

### **Devising of planned proposals is the key**

For premium services, PC DEPOT is now in the process of shifting from its existing three-year format to a four-year format. The Company will create value on a four-year basis based on four-year proposals.

Providing planned proposals will enable the Company to enjoy growth in PC sales even if PC sales continue to decline on a global basis. While coming to understand news ways to use devices, customers are encouraged to buy new products for replacement. Regarding smartphones, new product launches do not motivate replacement purchasing. Smartphone product penetration in the market has more or less run its course. Going forward, customers want to buy replacement products that meet their needs when appropriate. What happens at that time? If a consulting service has been properly provided, the customer will want an item that has high quality and functionality. It will certainly be convenient to know how to use it. This is the fundamental reason the Company attaches importance to face-to-face customer interactions.

Each officer will write customers' needs down to devise proposals, making it easy for customers to imagine their digital lives over the next four years. Although devising written plans is burdensome, doing so will make it easier to provide proposals for the future. As such customers are premium members, they can be contacted properly. By giving proposals for planning and spending, officers can reliably retain customers.

### **Making greater efforts toward organization building**

While making organizational changes from time to time, the Company has begun to replace the term "Sales" with the term "Manufacturing." The Sales Supervisory Headquarters was renamed the Operations and Manufacturing Headquarters in March 2018. Although the unit will continue to operate stores, as a concept it is important to engage in production activities designed to generate joy and value for customers, rather than sales for the sake of selling.

The name Quality Control/Manufacturing Headquarters contains the term "Manufacturing." In a shift from the previous quality, general affairs, and human resources, quality will now be provided by employees. The general affairs and human resource units will develop professionals and transform their internal structures. The term manufacturing was used to indicate creation of new things.

PC DEPOT is earnestly striving to shift from sales to production and from selling to value creation, moves which make use of President Nojima's prime drive.

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### City-center small type stores and acquiring regular customers

Types of stores launched can be categorized as Version 0 (V0), Version 1 (V1), and Version 2 (V2). An example of V0 is the Azabu-Juban Store which is a very small store. This store focuses on services, and product lineups are limited. Even so, the store will be moderately successful due to a location handy for daily needs. An example of V1 is the Himonya Store which is a little larger and has more product lineups. The Company will start more aggressive operations in the city center with these V0 and V1 type stores. Large stores are categorized into V2, and the Inagi-Wakabadai Store is now operating on a test basis. Once the Company is confident of business prospects for large stores shifting to Smart Life stores, demand for services will further increase. The Company will open new stores in central Tokyo, focusing on five urban districts: Shinjuku-ku, Shibuya-ku, Chuo-ku, Chiyoda-ku, and Shinagawa-ku.

The Company launched the new Smart Life Roppongi Store in July 2017. This is the fourth store following the Aoyama, Azabu-Juban, and Lalaport Toyosu Stores in Tokyo's 23 wards. The store is a city-center super-small type Version 0 (V0) store, the same type as the Azabu-Juban store.

Since new Smart Life stores do not have already existing customers, gaining store recognition is of utmost importance. Moreover, unlike regular mass home appliance retailers, these stores do not display low-priced merchandise. The leaflets distributed in Roppongi introduced some of the store's features to customers, such as (1) a new-style comprehensive specialty store, (2) a store that provides sales, repair, and Internet services, and (3) a store that assists local customers in using their PCs and smartphones with enjoyment. President Nojima uses the words "Please drop by" and "We will assist your smart IT life." The launch went as expected and will gradually continue to attract customers.

New store openings and shift to Smart Life stores

	2014.3	2015.3	2016.3	2017.3	2018.3	2019.3 (forecast)	2020.3 (forecast)
PC DEPOT stores							
Directly managed·subsidiaries		3					
Smart Life store (new)		1	3	2	1	0	0
Smart Life store (renovated)	4	10	7	5	8	5-10	5-10
PC Clinics							
Directly managed		2		1			
<b>Total</b>	<b>4</b>	<b>16</b>	<b>10</b>	<b>8</b>	<b>9</b>	<b>5-10</b>	<b>5-10</b>

NOTE: Forecasts by an analyst are marked (forecast).

### The ongoing shift to Smart Life stores has been extended to large-scale stores

The Tama New Town Store was renovated in June 2016. It was renewed from a large-scale store with a floor space of 600 *tsubo* into a Smart Life store with a floor space of 300 *tsubo*, with the

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remaining space being subleased to other company. The company also commenced to transform the stores run by the PC DEPOT Stores Co., Ltd. subsidiary into Smart Life stores. The Nagano Store was renewed in September 2016.

Large PC DEPOT stores with services provided at Smart Life stores are Smart by Solutions. This type of store was first opened in September 2014 and has been implemented at traditional directly-managed stores by the end of September 2017.

The Company introduced Smart by Solutions (S×S) at the Tomisato-Interchange Store in Chiba. The company also started transforming those stores with the orange signboard that is used by the PC DEPOT Stores Co., Ltd. into Smart Life stores. This store has been installed with counters similar to that in Smart Life stores which have the blue signboard of large conventional stores and not that of Smart Life stores. Large PC DEPOT stores are renovated with a Smart Counter installed inside just as done in Smart Life stores.

Service menus of PC Clinics (examples)

		(yen)	
		Member	General
Service	12 tickets for quick lectures	5000	30000
Setting-up	Windows Updates	0	6000
	Creating recovery media for customer PCs	6000	10000
	Solving printer problems	500	3000
	Installing additional memory/replacing memory	1000	3000
Security measures	Deleting spyware	0	5000

NOTE: "Member" refers to a service member of PC DEPOT; "General" refers to others. Consumption tax is not included.

### Future store development

Because Smart Life stores will introduce entertainment services, they may face a store seating shortage, so the Company will likely further renovate existing stores.

Although experts predict the PC market will continue to shrink in general, there are strong needs to have both a PC and a smartphone since the former is used separately from the latter. PC DEPOT provides users with a full range of services, including those for PC software that motivates even seniors to actively buy new PCs for replacement. This means that the number of the Company's heavy PC

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users is highly likely to increase rather than decrease. The evolution of this business model should be watched closely.

The Company plans to remodel 5 to 10 stores into Smart Life stores. Among its existing stores, Smart Life stores totaled 43 as of August 2018, which includes stores that need small-scale renovations (such as increased seating counts) given their floor layout. Management will address this issue.

Conventional PC DEPOT stores total 25 (including directly-managed stores and subsidiaries), and these will be converted into Smart Life stores in due course. All will probably be converted within the next three to four years.

### **Responding to service demand: Renewing the menu for premium services to make it easier to understand**

The Company changed all menus for membership services to make the selection process easier. The menu for premium services was renewed in February 2017, where the plans are offered according to the usage situation rather than the number of devices owned, which was how the previous service plans were based.

The plans include: 1) PC plan with a monthly fee of 2,500 yen (Internet connection to be setup by the member), 2) Home network plan with a monthly fee of 3,500 yen (home Wi-Fi), 3) Multi-network plan with a monthly fee of 4,500 yen (at home and outside), and 4) Smartphone plan with a monthly fee of 1,000 yen.

Customers receive various services. Therefore, it is not appropriate to consider the Company's service fee income by looking at the number of members multiplied by the average membership fee. Some customers visit stores for repairs, others for specific services. Some customers subscribe to premium services and once they have received the Company's services, they come to realize that being maintenance-free is advantageous and that additional services will also be useful. More customers will use the cloud service. What is going to happen next? As the quality of services is improved, customers will be upgraded.

The Company plans to steadily expand service lineups and shift to prices corresponding to service expansion. The focus is shifting to improved software with increased security and improved usability with increased router speed.

In March 2015, the Company launched a member support system, called JIMAS, which comprehensively increases the efficiency of services. (JIMAS stands for Jitaku (home) Internet device Multi-Assistant System). Customers are invited to join the service with a device management system. Under this service, the condition of certain devices is constantly monitored with a dedicated application installed on the device. If a device is lost, it can be locked remotely. These services allow

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the Company to manage digital information and store it as customer records. Using these records, customer service can be further enhanced.

Premium service

Plan (From February 2017)	(yen/month)			Usage environment
	3 year plan Monthly fee	2 year plan Monthly fee	1 year plan Monthly fee	
PC plan	2500	–	3300	Internet connection to be setup by the member
Home network plan	3500	–	4800	Home Wi-Fi Support for up to 5 devices
Multi-network plan	4500	–	5800	At home and outside With smartphone support Support for up to 5 devices
Assembled PC plan	3000	–	4300	Support for assembled PC
Smartphone plan	–	1000	–	Data support
Mobile Internet plan	7000	–	–	Mobile wireless support Includes mobile Support for up to 5 devices

NOTE: Initial administration fee is 5,000 yen (3,000 yen for smartphones). The monthly fees are subtracted on pro-rata basis in the event of cancellation during the contract period.

### Release of "Member-service-inclusive products" in September 2017

Service-inclusive products are now referred to as "Member-service-inclusive products" to clarify the concept. In other words, this means that a customer can purchase service-inclusive products only after becoming a member of the Company's program.

Of course, it is possible for a customer to purchase just products only. The customer may also select an appropriate service from various service menus. However, the Company will strive to improve the mechanism that attracts members for a long time, by further meeting customers' needs and increasing customer satisfaction through services and products combined together.

The Company launched member-service-inclusive products in September 2017. The Company will increase the line of products from now on, and sales from solution services have been exceeding those of the same period last year, starting from the second half of the prior term.

However, these service-inclusive products will start contributing to earnings with a slight time lag. These products have a mechanism similar to four-year installment sales, where the Company puts much effort at the time of selling and offers various services. Since the cost will be collected as part of the monthly service fees, these products will start contributing to earnings after six months to one year.

(1) Value Pack provides a multi-network plan of premium services (4,500 yen per month) with the Apple's MacBook Air (13 inch, 128 GB) for a monthly fee of 5,500 yen. On the iPhone, it is possible

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to share images and data via MacBook. MacBook's data allows a smooth transition from iPhone 7 to iPhone X.

(2) The Company has launched the "Membership Solution Hardware Plan" available for both existing members and new customers. This Plan allows users to use devices such as iPhone 8 in addition to a series of premium services. For example, by combining the multi-network plan with iPhone 8, the user can use network services for a monthly fee of 2,500 yen (under a four-year plan) after paying 20,000 yen for the phone at the time of purchase. Since usability will be improved by connecting the iPhone and MacBook, the Company will promote the sale in such combination.

(3) When members subscribe to the Company's premium services, they can use an iPad 2017 (9.7 inch, 32 GB) for a monthly fee of 1,200 yen, after paying a one-time fee of 10,000 yen for the device itself. Similar services are currently available.

Member-service-inclusive products as mentioned in (1) above will collect the cost over a four-year contract period. Since the need for replacement by new products arises after two or three years, there is a high possibility of entering into a new contract within four years.

Service-inclusive products are selling well. Performance has hit bottom in the first half of the current term, and is expected to improve from the second half, initially at a slightly slow rate and then accelerate from the second half of the next term. Service-inclusive products at one point increased to account for 15% of sales from solution services. The proportion of sales from solution services is expected to gradually increase to 5% and 10% of the total.

Service-inclusive products for premium members

MacBook	PC	Education&Hobby PC
iMac	Tablet	VAIO Mobile
iPad	Smartphone	FMV Mobile
iPhone	Router	Mobile router
Apple Watch	Camera	iPad + Magazine
Apple TV	Printer	Wireless printer system
MiDi keyboard	Audio	Pen tablet
Sound Bar	Speaker	Access point
MacBook Pro	Keyboard	4K wide display
Wireless speaker system	Display	Digital camera
Multi-audio component	Magazine	
Stereo record player		

(Note) Premium members may select services in which any of the above products are combined

### Various support is available for IoT and AI

Smart speakers are regarded as premature so far. Although this is currently a hot topic, the Company

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intends to observe the enhancement of functions and sales pace for a while before adding them to its service menu.

In the medium-term, the 5G network services will start in 2020. There will be various new movements such as the programming education to be required at elementary schools and digital textbooks to be implemented. While smartphones are becoming the mainstream, there is still demand for PCs and plenty of reasons to use the PC at home.

The new devices and services stemming from IoT and AI will rapidly spread to homes. President Nojima believes that the base of the technology is in PCs. To put it more plainly, he believes that the area where the Company's engineers and support teams play an active role will expand rapidly.

If IoT devices start to be used in various areas including watches, healthcare, and residential gateways, their related services will be needed. For instance, when a customer buys a smartwatch, that person can choose from several options such as buying the unit alone for 50,000 yen, or paying a monthly fee that includes all settings to connect with a smartphone and after-sales maintenance.

The Company is developing services, one after another including a device lock in case of loss of the device, smartphone data automatic storage in the cloud, and backup systems that connect smartphones, PCs and the cloud in a system. Patent applications have also been submitted.

To make full use of IoT, there will be a variety of service-inclusive products with a monthly-fee membership, like Premium Service Solution & Things. Use of devices expands new connectivity in areas including healthcare, wearable computing and networks, security, entertainment and content, and leads to development of new uses. Contract details including liability exemptions are expected to change.

The Company will pursue IoT for personal use while maintaining PCs as a platform. Companies such as Google Inc., Apple Inc., and Amazon.com, Inc. will begin providing new services. Robots will be used in homes. Regardless of the circumstances, the introduction of a new network will require new support. This is the Company's main reason operating in specialized areas.

### **In new solution services, accounts receivable from sales including service fees are on the increase.**

In Smart Life-based businesses, it takes three to four years to collect the full amount of revenue from products and services. Product sales are recorded under accounts receivable.

The accounts receivables increase as Smart Life-based sales rise. For example, iPad Air + magazine sales are growing. These are recorded first as product sales and then as service sales. The monthly fee charging service for tablets and printers is designed to sell hardware first and then collect its price through monthly fees. In other words, this means that accounts receivables grow on the balance sheet.

Accounts receivables increased by 600 million yen in the term ended March 2013, by 1.9 billion

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yen in the term ended March 2014, by 4 billion yen in the term ended March 2015, and by 3.8 billion yen in the term ended March 2016. Using different words, the Company needed more working capital as such accounts grew. If the Company makes progress in collecting monthly fees, however, the amount of working capital needed will not increase as it is currently doing, because a balance between outstanding accounts receivable and required working capital will gradually be achieved.

An increase in accounts receivable will also require enhanced credit management. In sales at conventional merchandise stores, the individual credit risks arising from customers paying by credit card are assumed by the credit card companies, but such risks accompanying sales at Smart Life stores must be shouldered by the Company. In the event that a customer becomes unable to make monthly payments for any reason, the Company will have to assume that customer's debt.

In principle, as the Company sells products and services to individual customers who use IT products, it performs identification and usage checks very carefully before the sale. Volume sales to corporate customers are outside the scope of its business. In many cases, the Company may turn down a bulk purchase even from an individual customer because it is unsure whether such products and services are actually for private use. As is obvious from the above, credit risks are well controlled by stores and therefore there is no need to worry about such risks.

Changes in gross profit of products and services (provisional)

	2013.3		2014.3		2015.3		2016.3		2017.3	
	(millions of yen, %)									
Overall sales (consolidated)	51359	100.0	53772	100.0	51261	100.0	51729	100.0	46417	100.0
Service sales (consolidated)	12622	24.6	16194	30.1	19696	38.4	24631	47.6	24984	53.8
Goods sales (consolidated)	38737	75.4	37578	69.9	31565	61.5	27098	52.4	21433	46.2
Cost of services	3176	25.2	4676	28.9	5520	28.0	7443	30.2	6710	26.9
Overall gross profit (consolidated)	16114	31.4	18273	34.0	19472	38.0	21715	42.0	21249	45.8
Service gross profit (provisional)	9446	74.8	11518	71.1	14176	72.0	17188	69.8	18274	73.1
Goods gross profit (provisional)	6668	17.2	6755	18.0	5296	16.8	4527	16.7	2975	13.9

NOTE: Goods sales includes other services (royalties, Internet-related).

Figures in the column next to sales amount are a ratio of each segment sales to overall sales.

Provisional values are not necessarily accurate; these are approximations as reference data.

### The quality of services is its source of competitiveness

The Company does not merely sell hardware such as PCs and tablets, but offers services. The Company aims not only to solve customer's particular problem but also understand what the customer is hoping to accomplish and present solutions that will enhance customer satisfaction (CS) through the use of IT to enrich their everyday life.

This is a system under which convenient solutions are provided on a continual basis for a monthly fee. Some 60% of visitors to PC Clinics are those who bought products at other stores. That means they are interested in something other than low prices. PC Clinics support PCs owned by our

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customers, which brings about efficiency.

When considering the profits generated by products sales and from service sales from a perspective of operating profit levels, a clear-cut breakdown of levels classified into products and services is nearly impossible to achieve. The reason why this cannot be done is that the Company's management does not differentiate between products sales and service sales. Even though each staff member at stores has their own role, everyone provides both products and services. These sales are not differentiated when assessing employee performance. One pattern used involves a customer buying a product and subscribing to a service, thus becoming a regular customer of PC DEPOT, who naturally comes back again to buy some other product.

However, even when profits derived from product sales and from service sales are viewed from the perspective of operating income under certain prerequisites, the structure in which service sales are highly profitable remains unchanged. In the competition to capture this demand for services, the Company has an advantage that is furthered by its track record over the years and its personnel. Originally, the Company core policy that differentiates it from competitors is providing services requiring time and effort for those customers who are having difficulties using their purchases, but not for customers who do not require any follow-up services after purchase. Such customers are the main target of other companies.

### **Response to the rise of Internet shopping**

There is some concern that Internet shopping might be a threat to over-the-counter sales. In fact, some people browse products at stores but actually buy them online, because of the lower prices.

This scenario is fine for those users who are able to make full use of their newly purchased hardware. However, others are in great need of convenient services in case they do not understand how to use their new hardware fully or are faced with some problem. That is where the Company has a chance to show what it can do. Basic sales of products such as iPhones or iPads do not make much profit. But if customers subscribe to premium services, the relationship with them can be maintained for a long period time, and service sales will contribute to earnings. In that sense, the Company is continuing to handle new products in a proactive way.

### **Pursuit of lifetime value**

PC DEPOT has been evolving to achieve a brand new type of format by completing a total makeover of PC mass retailers. After transformation to Smart Life stores, stores experience changes in comparison from their previous formats, in that (1) customers stay in the stores longer, (2) more female customers visit, (3) customers revisit more frequently, and (4) customers consult with employees about

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various matters. The extent of sales in terms of customer hardware purchases changes little after renovation. However, sales from providing services are certain to increase. In other words, the stores gain long-term customers.

A short interval between visits means that visitors revisit the store again sooner once they have bought a product or service. Increasing numbers of female visitors represent the fact that needs for digital devices in households have risen and people wish to have a better command of those devices.

"Lifetime value" is a concept in which the time span during which a customer uses a product is considered to be that product's "lifetime." The value of the customer to the business in a general sense during the lifetime of that product is raised, allowing the Company to generate sales accordingly during that time. The Company's service sales do grow but in the normal growth pattern for services they become profitable only in the second or third year of a three or four-year contract. Service quality should be improved so that members are encouraged to buy more products from the same store. Of course, member numbers are bigger at existing stores than at new stores. New stores should initially compete in terms of products sales and then gradually increase the number of customer members from then onwards.

The number of service subscription members is increasing, so the "lifetime value" of a particular level can be ensured depending on the terms of the members' subscriptions. PC DEPOT is meeting the challenge of expanding a business model that is dependent on a customer base formed from members who subscribe to its services. The Company operates while carrying out analysis of its service sales.

### **Aiming to achieve an ordinary income to sales ratio of 10% and ROE of 15%**

President Nojima has set management goals of an ordinary income to sales ratio of 10% and ROE of 15% as the key performance indicators (KPI). If the proportion of income from services increases under the current business model, a profitability ratio of 10% can definitely be achieved. Assuming the monthly fee for membership services is five thousand yen, if the number of members grows to one million, the income from services could reach 60 billion yen. How will the Company capture customer demand for those services? The market will be paying attention to its strategy for the deployment of stores and the development of a new service menu.

The shift to Smart Life stores has sped up the transformation from a flow-based business model to an asset-based one. Connections between customers and the Company have become stronger. Connections between customers and the Company have certainly become stronger. Moreover, giving consultations to customers also serves to increase contact with them. Members of the service system exhibit several usage patterns which cannot be explained only by the number of members and average values such as the average unit price. The conventional pattern has been service on a per-household

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basis. However, in the age of cloud services, the personal management of data has become important, and accounts for individual users are therefore important. The nature of services will also be further diversified.

There are four challenges. The first challenge is to secure locations for opening new stores. The second challenge is the manner of attracting customers. Since opening new stores in the form of Smart Life stores is intended in particular to obtain customers who need services, more ingenuity is required in attracting customers for this purpose than for mainly selling products that the Company used to focus on. Because sales that originate from rendering services to members become the core, the time period for recouping investment tends to be longer than in the past. On the other hand, as more and more customers become members, profitability can be easily maintained.

The third challenge is employee training. While the Company has been achieving success in technical training, which is its area of expertise, it is important for it to nurture employees at the level immediately below the store manager. For example, to what extent are staff members responsible for quality management, store operations, and technical services able to pay careful attention to what is happening throughout an entire store? In this regard, the Company has been hiring retired and talented office workers as part-time working seniors to raise the level of courtesy and service to customers in stores.

The fourth challenge is governance in its daily operations. Rather than selling products, the stores provide services and then recruit customers as members by providing solution services. On the other hand, products are sold in the form of installment sales accompanied by services. The Company emphasizes a stock-type business, not a flow-type business. In this situation, the governance at stores in its broad sense includes the management of customer information and the full-time and part-time employees, and this management needs to be appropriately implemented.

### **Response to working capital is also important**

The balance sheet for the term ended March 2018 shows the collection of accounts receivable progressed as the Company refrained from providing new service-inclusive products, which resulted in cash growing commensurately. If Value Pack products increase in the future, accounts receivable will likely grow again. Cash flows exhibited a similar trend, with free cash flow increasing markedly. The Company strove to buy treasury stock while monitoring the stock price. On the financial front, the Company had no issues.

As sales from member-service-inclusive products rise, accounts receivables increase and so the Company requires more working capital. But this poses no problems since the Company is able to sufficiently cover its needs even if there should be a 10 billion yen increase in the future.

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Balance sheets

(millions of yen, %)

	2013.3	2014.3	2015.3	2016.3	2017.3	2018.3
Current assets	13888	18368	19771	25381	26123	26251
Cash and deposits	2982	4679	2370	4754	7726	10597
Accounts receivable-trade	3969	6731	9609	13249	11202	8514
Inventories	5986	5775	6548	6128	6103	6125
Fixed assets	8942	8644	9336	9622	9506	8801
Tangible fixed assets	5073	4836	5013	5041	4857	4440
Guarantee deposits	1387	1349	1639	1810	1750	1703
Lease deposits	1268	1248	1275	1323	1403	1332
Total assets	22831	27012	29108	35004	35629	35053
Current liabilities	9009	9758	11647	12271	6786	6279
Accounts payable-trade	2087	3506	1691	1245	1230	964
Short-term loans payable	2550	900	4520	5200	0	0
Long-term loans payable (w/within one year)	1849	1727	1447	1044	2125	2243
Fixed liabilities	4149	3915	2428	1347	5830	5523
Long-term loans payable	3479	3244	1796	751	5265	4952
Net assets	9671	13342	15032	21334	23011	23250
Interest-bearing liabilities	7879	5871	7764	7197	7391	7195
Interest-bearing liabilities ratio	34.5	21.7	26.7	20.6	20.7	20.5

On the balance sheet as of the end of March 2017 and the end of March 2018, accounts receivable posted a decrease due to an intentional reduction in sales of service-inclusive products. In connection with this the free cash flow increased.

Even though the accounts receivable increases, the Company will not remove this from the balance sheet. Since the Company is fully aware of its customer attributes, there is virtually no risk of irrecoverable debt. The Company can manage with funds on hand and handle loans without any problem.

Cash flow trends

(millions of yen)

	2013.3	2014.3	2015.3	2016.3	2017.3	2018.3	2019.3 (forecast)
Cash flow from operating activities	1597	2010	-2512	516	4292	5045	550
Net profit after tax	537	1848	1790	2742	1325	2282	1650
Depreciation	728	685	781	897	943	919	900
Accounts receivable	-476	-2783	-2903	-3640	2034	2687	-1500
Inventories	1299	210	-772	420	24	-21	-100
Accounts payable	-1421	1417	-1816	-449	-16	-282	-400
Cash flow from investing activities	-994	-441	-1436	-970	-1090	-297	-1000
Tangible fixed assets	-844	-332	-797	-604	-830	-450	-800
Intangible fixed assets	-135	-374	-260	-291	-178	-68	-200
Free cash flow	603	1569	-3948	-454	3202	4748	-450
Cash flow from financing activities	295	127	1637	2837	-229	-1876	-660
Long-short term borrowings	451	-2007	1892	-767	394	-195	0
Common stock issuance	0	2289	0	3983	0	0	0
Common stock repurchases	0	0	-1	0	-5	-1006	0
Cash dividends paid	-155	-153	-253	-380	-612	-660	-660
Cash and cash equivalents at end-term	2984	4679	2370	4754	7726	10597	9487

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There are no major financial concerns. So how should the Company make efficient use of its free cash flow from now on? Well, the Company will be able to put more effort into investing in human resources and start to consider R&D-type open innovations. As a financial strategy, the Company considers a sound financial position to be an equity ratio of at least 50% and a degree of indebtedness within 25%.

#### **4. Near-term operating results: Shifting to a new structure that bears fruit on a full-scale basis from the next term**

##### **Earnings for the term ended March 2017 fell due to the review of membership services since the second half**

For the term ended March 2017, the Company reported net sales of 46,417 million yen (down 10.3% YoY), operating income of 3,402 million yen (down 16.7% YoY), ordinary income of 3,467 million yen (down 16.2% YoY), and net income of 2,269 million yen (down 15.7% YoY).

The results above were due to the substantial decline in performance in the second half, caused by the review of the Company's business structure triggered by the case in August 2016. Operating income in the first half was 2,133 million yen and 1,269 million yen in the second half.

The Company reported higher sales and profits in the first quarter, lower sales and higher profits in the second quarter and lower sales and profits in the third and fourth quarters. The impact of and responses to the problem regarding services to an elderly customer, which occurred in August 2016 had a significant effect on earnings. Sales and profits declined considerably, due to factors such as assignment of in-house personnel to the Quality Management Department, narrowing of product offerings, disposal of product inventories and voluntary restraint on advertising and promotional activities.

The Company made steady progress in confirming current member service situations through direct mail and phone calls. Since the Company assigned 300 in-house personnel to the newly established Quality Management Department, there was currently a shortage of sales staff in the stores.

Regarding product sales, the gross profit from product sales decreased due to disposal of long-term inventories. Sales of service-inclusive products decreased because not enough attention was paid to that area due to the sales staff shortage.

Sales from solution services (on a year-over-year basis) in the third and fourth quarters were heavily affected by the case that occurred in August. A decline in sales was caused by the reduction in the number of premium service members and the lower sales of service-inclusive products.

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On the balance sheet, the decline in sales of service-inclusive products led to a reduction in accounts receivable. Decline of service-inclusive product sales and restraint on new store openings have resulted in dramatic improvement of cash flow. The increase in cash flow was appropriated to reducing short-term debt.

Quarterly results

	(millions of yen)				Operating income
	Net sales				
	Products	Solution services	Internet-related	Total	
2016.1Q	5465	6807	314	12606	1344
2016.2Q	4278	6657	322	11277	789
2016.3Q	4955	5792	316	11100	577
2016.4Q	5400	5728	306	11433	692
2017.1Q	4639	5755	302	10713	585
2017.2Q	4284	5693	315	10305	595
2017.3Q	4519	6598	305	11440	683
2017.4Q	4278	6519	319	11132	1118 (788)
2018.1Q	3512	6499	300	10329	666

(Note) Figure shown in parentheses is the original operating income excluding reversal of allowances (bad debt / warranty)

### Results for the term ended March 2018 are confirmed to have bottomed out, and improvements were seen since the third quarter

For the term ended March 2018, the Company reported net sales of 43,590 million yen (down 6.1% YoY), operating income of 2,981 million yen (down 12.4% YoY), ordinary income of 3,079 million yen (down 11.2% YoY), and net income of 1,958 million yen (down 13.7% YoY).

Actual operating income exceeded the company's plan of 2,420 million yen by approximately 560 million yen, for which revisions made in the fourth quarter to provision for merchandise warranties and allowance for doubtful accounts had the effect of raising operating income by 360 million yen. Provision for warranties, which was previously set at a relatively high level, began to level off because the recording of allowance for doubtful accounts for service-inclusive products ran its course.

Net sales declined by approximately 2,800 million yen, with product sales falling by a marked 2,400 million yen and solution service sales by 400 million yen. By product; PCs, peripherals, and used devices declined in sales.

Seen on a quarterly basis, the Company's performance was sluggish for the third and fourth quarters of the term ended March 2017 as well as the first and second quarters of the term ended March 2018. However, gradual improvements were made in the subsequent third and fourth quarters. The Company

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revised its internal structure. In September 2017, it released new member-service-inclusive products (Value Pack), which have been performing strongly.

A Value Pack product is a combination of hardware with membership service. With the growth in sales of Value Pack products, service sales began to post positive growth rates in October 2017. Service sales, after falling approximately 15% YoY (year-on-year) for the first and second quarters, grew approximately 14% YoY for both the third and fourth quarters.

New Smart Life store openings were one store, and renovations were underway for eight Smart Life stores, bringing total investment to 580 million yen.

PC DEPOT steadily pays dividends with a payout ratio of 30% as a guide. For the term ended March 2018, dividends totaled 652 million yen, and buying of the Company's own shares amounted to 660 million yen; the payout ratio stood at 39.5% and the total return ratio at 67.0%.

Sales ratio against same period last year

	(%)			
	1Q	2Q	3Q	4Q
<b>Existing stores</b>				
2016.3	-2.8	-0.3	-0.7	+1.5
2017.3	+3.0	-8.1	-13.7	-20.1
2018.3	-14.4	-7.9	+3.6	-3.9
2019.3	-3.9			
<b>Services</b>				
2016.3	+25.1	+28.1	+24.1	+23.3
2017.3	+20.8	+11.0	-10.8	-12.0
2018.3	-15.4	-14.5	+13.9	+13.8
2019.3	+12.9			

**First quarter of the term ending March 2019 showed good financial results, but the real performance is yet to come**

The Company's financial results of the first quarter of the term ending March 2019 were good, with net sales of 10,329 million yen (down 3.6% YoY), operating income of 666 million yen (up 13.9% YoY), ordinary income of 691 million yen (up 10.5% YoY), and net income of 459 million yen (up 10.6% YoY).

Starting from the current term, the Company has been fundamentally shifting its business model from sale of products and services to future value creation in customers' digital lives. It is shifting its focus from traditional "problem solving" concerning the digital divide to consulting for "members' future digital lives."

Although sales of products decreased, the number of customers visiting stores did not decrease. This means that a member normally visits a store with someone such as a family member or a family of four. Therefore, one member's visit to a store presumably means that the actual number of visitors may be 1.3 to 1.4 persons on average.

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Breakdown of sales in the first quarter

	(% , millions of yen)				
	1Q of FY ending March 2018		1Q of FY ending March 2019		
	Net sales	Composition ratio	Net sales	Composition ratio	Rate of increase/ decrease
Sales of PCs, etc.	4639	43.3	3512	34.0	-24.3
Sales from solution services	5735	53.7	6499	62.9	12.9
Others	318	3.0	317	2.9	-0.4
Total sales	10713	100.0	10329	100.0	-3.6

The Company strives to make a shift to a business model in which it can comprehensively propose a smart life at home. It is also drastically changing its employee training programs. Since the Company is at the starting point of the transition phase, it does not put emphasis on traditional sales promotions.

Although sales of products are decreasing, sales from solution services are steadily increasing thanks to an increase in sales of member-service-inclusive products. As a result, the Company's profit increased although revenue decreased.

Sales of products amounted to 3,512 million yen (down 24.3% YoY) and sales from solution services stood at 6,499 million yen (up 12.9% YoY). The percentage of sales from solution services over total sales significantly increased to 62.9% (53.7% in the same period a year earlier). Sales of member-service-inclusive products (Value Pack) released in September 2017 were good. The Value Pack is a combined product of premium services and devices.

The gross profit ratio in the first quarter stood at 46.7% which exceeded the annual plan of 45.0%. This was due partly to a decrease in sales of products. In terms of the Profit and Loss Statement of the first quarter, gross profit decreased by approximately 207 million yen compared to the same period of the previous year. Selling, general and administrative expenses also decreased by 289 million yen. As a result, operating income amounted to 81 million yen. In regard to sales, general and administrative expenses, advertising expenses and personnel expenses decreased. This is because the Company does not take the policy of boosting sales by way of increasing human resources and advertisements.

Profit and loss in the first quarter

	(% , millions of yen)				
	1Q of FY ending March 2018		1Q of FY ending March 2019		
	Net sales	Ratio to sales	Net sales	Ratio to sales	YoY
Net sales	10713		10329		-384
Gross profit	5032	47.0	4824	46.7	-207
SG&A expenses	4446	41.5	4157	40.2	-289
Operating income	585	5.5	666	6.4	81

### Transformation to a new business style is underway

In regard to creating future value, the Company gives priority to existing premium members. Its

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strategy is to increase members via introduction by way of existing members.

The Company adopted the new business style in May. The new business style is expected to produce an effect by way of this organizational ability in the second half of this year and gain momentum from next spring.

For the time being, rather than finding potential customers, the company intends to discuss issues with customers face to face in order to systematically propose a digital life future to existing members, as well as summarize a future schedule and plan in a sheet. The sheet will be prepared by each family and reviewed while expecting to connect with next services.

The Company's team that can create future value for digital life is composed of consultant designers, engineer-artisans and member benefit designers, who operate as one team. At stores, the structure under which sales, technologies, operations, etc. are functionally separated has been eliminated, and persons-in-charge of consulting, engineering or quality create values under new names.

The Company puts most of its efforts into education and aims to have 800 employees out of all staff members become a substantial part of the workforce after a year. Currently, approximately 200 staff members play leading roles. The Company is cultivating human resources by providing seminars or improving the trainee system. The president spearheads the process and spends a significant amount of time on it. It was made clear that the process would produce results, and therefore the workforce will become a new power source if human resources development makes progress and successful experiences are accumulated at each store.

What the Company is doing is not aggressive or push-type sales. The Company does in fact recognize the customer as a family and draws a picture of digital life for three generations. The Company will expand its focus into various opportunities including: (1) Do they make full use of smartphones? (2) When do they replace and what do they purchase? (3) Is Wi-Fi at home sufficient? (4) Are PCs updated adequately and available for use? (5) Is a new PC really necessary? (6) If a PC is replaced, when? (7) Is there an opportunity to use a tablet? (8) Will they be connected with a printer, camera, musical instrument, and so on? (9) Will they also be connected with a TV monitor, speaker, audio, and so on?

The Company will properly summarize these items and increase the utility value for customers. It will also improve the usability and provide satisfaction. Since the Company draws a picture of the life stage together, it may understand what products or services customers require and when they need them. Therefore, it is easy for customers to speak with a person-in-charge when necessary. Development of these types of business styles has already started.

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### **This is truly work way reform**

A total of 65 new employees joined the Company last year and 28 new employees joined this year, and the retention rate of new employees is quite good. The Company plans to hire 100 new employees in the current term. Since the Company's entrance examination is unique, new graduates who passed the examination should already know about the Company. Furthermore, they have learned how value creation should be promoted but not about sales techniques. They may be motivated if they are informed that they will be appointed as a consultant designer, engineer-artisan or member benefit designer in the future. The Company's initiatives to reform work styles have been accepted.

### **Profits will also decline for the term ending March 2019**

During the first quarter, two stores were renovated to Smart Life stores. During the second quarter, one store was renovated in July. Five to ten stores a year are scheduled to be renovated. It is likely that no stores will be opened for the time being. Since employee training and instilling that training are top priority, the Company will take action after results start to appear.

The Company's forecast for the term ending March 2019 indicates that net sales will stand at 43,000 million yen (down 1.4% YoY), operating income at 2,400 million yen (down 19.5% YoY), ordinary income at 2,500 million yen (down 18.8% YoY), and net income at 1,650 million yen (down 15.8% YoY).

This forecast is conservative. The Company does not impose pressure on near-term business results because this is a year for promoting business model evolution. For the term ending March 2019, PC DEPOT will not conduct any temporary sales promotion activities, which means that the Company will not implement sales promotions in the form of sales. In terms of costs, advertising expenses will fall, but net sales will fail to rise.

For the term ending March 2019, the Company's forecast shows that operating income will be flat compared to the previous term after deducting reversal of provisions. The Company forecasts that solution service sales will grow 7.0% YoY (after declining 1.7% YoY during the previous term) and the gross profit ratio will stand at 45.0% (compared to 46.0% for the previous term) and capital expenditures at 1,000 million yen (depreciation and amortization of 850 million yen).

The gross profit ratio is forecast to fall to 45% from 46% because the Company thinks that engineering services (a high gross profit ratio service category) will decrease. Engineering services account for 25% to 30% of solution services.

Solution services consist of three types. Among 1) primary services (engineering services); 2) continuous services (premium service); and 3) solution services (service inclusive), it is engineering services, coupled with low-priced smartphone solution services, that will decline in the current term

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according to the Company's forecast. Meanwhile, premium service is likely to grow approximately 10%, so solution services are forecast to rise 7% during the current term.

Since the Company has decided to shift to a sales format that conforms to users' lifestyles, service growth will be slower in the current term, but growth will rise again from the next term onwards. Even so, looking at the financial results in the first quarter, it is likely that business results exceeding the Company's plan will be achieved in the current term.

Comparison of earnings forecasts

	(millions of yen, %)									
	2016.3		2017.3		2018.3		2019.3 (forecast)		2020.3 (forecast)	
Net sales	51729		46417		43590		43000		45000	
Gross profit	21715		21249		20044		20200		21400	
Ratio to sales	42.0		45.8		46.0		47.0		47.6	
SG&A expenses	17628		17846		17062		17400		18000	
Ratio to sales	34.1		38.4		39.1		40.5		40.0	
Operating income	4086		3402		2981		2800		3400	
Ratio to sales	7.9		7.3		6.8		6.5		7.6	
Ordinary income	4139		3467		3079		2900		3500	
Ratio to sales	8.0		7.5		7.1		6.7		7.8	

### Moving to profit growth from the next term

President Nojima's intent is to run the Company so as to achieve the medium-term goals of a 15% return on equity (ROE) and 10% operating income ratio within the next four to five years.

First of all, due to the shift from a sales-based business model to a production-based one, PC DEPOT will arrange for current members to receive ample services. It will make increased efforts to propose plans while prioritizing premium members. The Company will get families to visit its stores and discuss plans for the entire family. A higher number of customers will come to the stores, causing seating shortages, which in turn will require the Company to carry out small-scale renovations. Even first-time customers coming in just to shop will be familiarized with the premium membership system. Some may find the system a good fit, while others will find the premium service to be unnecessary. During this process, the Company will categorize customers.

The business model shift, if it progresses, will cause premium services to grow. If customer contact points increase for families, then market expansion will likely result.

PC DEPOT will rigorously work to implement the new business model based on its existing stores and customers. Thus, on a financial basis, the Company aims to post an ordinary income to sales ratio of 10% or more and ROE of 15% or more. These are goals that PC DEPOT can achieve four years after the model cycle.

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## 5. Evaluation: Regaining customer trust and shifting to an active approach

### Steadily dealing with issues

The Company in its management policy raises six business issues to deal with. These are: (1) Fulfillment and strengthening of human resources, (2) Promotion of sales based on CSR activities, (3) Improvement in the quality of "Membership Services" provided by the Group, (4) Stable management and opening of stores, (5) Expansion of sales and development of solution-type products, and (6) Responding to the IoT market and environmental changes.

The contents also indicate awareness and related countermeasures as management issues, and therefore these may be considered to be the fundamental direction of the management strategy from here onwards. Their points may be interpreted as follows:

#### 1) Human resources development

The Company will make efforts to recruit and develop high-quality human resources who can create future value for premium members through face-to-face communication. President Nojima is at the forefront of developing new human resources. Staff members design their own lives and at the same time create future value with customers.

#### 2) Management based on CSR activities

Since value creation for customers is considered to be a primary goal, stores are not places to conduct sales but places to create value. Based on the ideas and principles of Corporate Social Responsibilities (CSR), the Company conducts management from the shareholders' standpoint.

#### 3) Improvement in the quality of membership services

The Company will improve services to premium members. In order for members to obtain the benefits and continue to use services, the Company will make efforts to expand the service menu, strengthen quality management of services, and improve the quality of stores and call centers.

#### 4) Renovation of stores

The Company will increase the degree of perfection of Smart Life stores. It is important for smart devices to link closely with customers' life value and the demand for these stores will increase. The Company will make efforts to put up new stores, provide services to customers and renovate stores so that these needs could be satisfied.

#### 5) Development of solution-type products

The Company strives to differentiate itself from others by providing solution-type products in which the Company's own services have been combined with other makers' products or services, and therefore it will further promote this strategy.

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## 6) Responding to the IoT market

Predicting changes in the IoT market, the Company continues to develop new products and services, and provide them. At the same time, the Company will respond to compliance issues.

### **Business model evolution for the chance to win**

The Company has set the mid to long-term goal of an ordinary income to sales ratio of 10% which is not a difficult figure to achieve. Although likely to decline to 6.7% during the current term, this is probably the bottom.

Solution services are accepted by customers and the need for these services will continue to broaden. The profitability of member services will improve as membership increases. More customers will want to use member-service-inclusive products together with support plans.

The sales mix of the Company will continue to shift to more solution services, and the content of these services will also change. Over the medium-term, the Company will probably be able to aim for net sales of 50 billion yen and an operating income of 5 billion yen.

The Company's business model will evolve. Since the Company will upgrade the service system that further meets customer needs, a more rigid system will be established. In this system, more demand for services will be captured and more repeat customers will be retained. Profit is therefore highly likely to recover and grow higher than before. Since the Company's fundamental business model is sound and solid, it will likely post record profits after several years.

### **Regained trust and future expectations**

The Company carried out a market purchase of treasury stock (share buyback) for approximately 1.0 billion yen (equivalent to 2.9% for a maximum of 1.5 million shares) in August 2017. This share buyback was regarded as an indication of confidence in its operating results and was viewed favorably by the markets.

The Company temporarily narrowed down its product offerings considerably. However, the Company will become even stronger if employees become accustomed to new governance, including 1) quality management of customer services, 2) promotion of customer services to improve customer satisfaction, 3) an internal framework for legal affairs and compliance, 4) the functioning of future consultation services, and the fact that such governance works effectively. Service demand is high and the Company can enhance product offerings if the new system gets on track.

President Nojima is confident that the results will recover to former levels when the internal structure gets used to the new framework and service capabilities improve. Trust from existing members and the local communities is still in the recovery phase. We intend to pay close attention to

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find ways to further enhance PC DEPOT's business model two years from now.

The Company 1) sold traditional goods (products), but 2) changed to selling services that make the usage of goods convenient, and 3) is proposing services that are integrated with goods (solution services) now. If existing stores are able to increase sales as a whole by accommodating demand for services, the Company will manage to maintain growth by rolling out four to five stores a year steadily.

Service subscribers will continue to increase. The Company has been rebuilding trust and is focusing its attention on heightening the effect from its stock. Customers of the service system exhibit several usage patterns: some users own several pieces of hardware, while others subscribe to the service system so that their family members can use it. By making these users members of its service system, the Company will have a greater scope for offering services in the future.

It was in 2005 that the Company took the decision to shift its revenue source from selling PCs to providing services. Over the past eight years, the Company has promoted the shift of its business model. Now, management is overseeing the evolution into the next business model. It is almost certain that the Company's business model will retain its niche existence after it overcomes this problem. The Company has been promoting a shift to a stock-type profit structure based on service sales. In order to take more time to confirm the effect of trust building, the Company is rated B. (Please refer to the front page for an explanation of corporate ratings.)

The number of shareholders was 6,256 as of the end of March 2018. The shareholder special benefit plan issues a 1,000 yen gift certificate (or 2,000 yen PC Clinic store voucher) for 100 shares, a 2,000 yen gift certificate (or 4,000 yen PC Clinic store voucher) for 400 or more shares, or a 3,000 yen gift certificate (or 6,000 yen PC Clinic store voucher) for 1,000 shares or more. Since shareholders can use gift certificates for online shopping, PC DEPOT stores need not be nearby. Increasing that number further will prove effective in unifying customers and shareholders.

Based on a stock price of 530 yen as of September 4, 2018, PC DEPOT has PBR of 1.14, ROE of 8.1%, and PER of 14.0, with a dividend yield of 2.5%. The Company's stock price will be greatly adjusted in the market, reflecting factors such as the progress of service improvements for about 400,000 members, an increase in the number of new members, trends in service sales, and the timing for improving earnings.

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