

## 7618 PC DEPOT Corporation

### Overhauling the Service System Focused on Premium Members to Enter the Demand Expansion Phase

June 10, 2020

First section of Tokyo Stock Exchange (TSE)

#### Key Points

- Needs for telework and online learning are increasing in order to respond to the novel coronavirus, and sales of PCs and tablets are growing. PC DEPOT can advise customers on any topic, including teleworking from home, online learning, and remote communications.
- With regard to the New Lifestyle initiative, the following developments in particular are gaining momentum: 1) inquiries on purchasing new PCs to replace old models in order to effectively use online services and improving one's Internet environment, 2) how to use online learning and remote communications, 3) the revision of the new service usage fees, and 4) an expansion from existing to new members. Demand for the Company's services is expected to increase rapidly.
- President Nojima is telling employees that business sustainability lies where "social contributions and earning power coexist." The president himself is making all-out efforts to improve human resources, which has resulted in human resource development. PC DEPOT has now entered a new phase in which it is putting its business model into practice in order to acquire new members and to achieve business growth. The Company also plans to hire more employees as the number of job applicants is increasing.
- The Company secured the trademark rights to Digital Life Planner and will work to develop it into a brand. Three to five members will form a team (Works) to collectively develop the future digital lives for our premium members. Details of the proposal-based consulting will be stored in design sheets (future roadmap). This demand creation effect is expected to materialize gradually.
- Digital Life Plan consulting is drastically transforming the way employees work. Although the Company will continue to provide services to solve customers' problems and offer them full support, it will focus on strengthening relationships with premium members and creating future value through the provision of planned proposals for their future digital lives. Also, as the roles of PCs are now being re-examined, the Company will be able to continuously develop the market going forward.
- The transformation into the new business model is truly progressive and innovative. With a greater retention rate of premium members and an increasing number of new premium members, profitability should increase even further going forward. Since the Company is likely to post an ordinary income to sales ratio of 10% and ordinary income of 5 billion yen within the next five years, its market evaluation will presumably change for the better.

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Company rating: A

Stock price (June 9, 2020): 601 yen

Market capitalization: 31.6 billion yen (52.622 million shares)

PBR 1.20

ROE 7.9%

PER 15.1

Dividend yield: 2.2%

(Figures are in millions of yen)

Fiscal yearend	Sales	Operating	Ordinary	Net	EPS	Dividend
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	40447	2579	2685	1553	30.9	13.0
Mar. 2020	39137	2941	3018	1718	34.2	13.0
Mar. 2021 (forecast)	37500	2900	3000	2000	39.7	13.0
Mar. 2022 (forecast)	40000	3500	3600	2350	46.7	13.0

(2020.3 base)

Total assets: 33,043 million yen

Net assets: 25,259 million yen

Equity ratio: 76.3%

BPS: 500.8 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 the business; 3) risk management with respect to downward forecast revision, 4) sustainability from the ESG perspective. 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 contact someone in charge at a store or 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 dramatically shifted its business focus to services. The Company has been creating 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 such 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.

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: maintenance, call-center services, anti-virus support, a "full installation" service when customers replace old PCs, and instruction in how to use smartphones.

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

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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. This premium service is about to enter a new stage.

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 enter into a three to 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. 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.

Trend in constituent ratios of sales accessories

	2009.3		2013.3	2017.3	2019.3	2020.3	
	Sales	Constituent ratios	Sales				
Goods sales	35572	82.4	69.0	43.4	34.4	38.3	14972
PC and peripherals	24375	58.5	46.4	23.5	19.0	20.9	8173
Accessories, supplies, and software	6554	14.6	12.1	6.7	5.7	5.5	2184
Used items and others	4643	9.3	10.5	14.2	9.7	11.8	4614
Service sales	11340	17.6	31.0	56.6	65.6	61.7	24164
Solution services	8726	10.3	27.3	53.7	62.5	58.4	22878
Royalties and other revenue (FC)	522	1.3	0.3	0.2	0.1	0.2	59
Internet-related businesses	2090	6.0	3.4	2.7	3.0	3.1	1227
Total	46912	100.0	100.0	100.0	100.0	100.0	39137

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

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### **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 has been making steadfast efforts to improve its services. These efforts cultivate a service market, enabling the Company to achieve its unique business model.

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.

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 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.

### **Ahead of others in expanding subscription (monthly charge)-based business**

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

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from the Company. The core of the Company's business in particular is the support fees paid by its premium members (subscribers), making it unique in the retail industry.

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

President Nojima (age 60) 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 celebrated its 25th anniversary. 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.

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.

### **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.

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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 has been focusing 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.

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 March 2020, there are 54 directly-managed PC DEPOT stores (including 46 Smart Life stores), 13 stores outside the Kanto region run by the PC DEPOT Stores Co., Ltd. subsidiary (including 6 Smart Life store), and 3 franchise stores, for a total of 70 stores. In addition, there are 58 directly-managed PC Clinics, 5 stores run by the PC DEPOT Stores Co., Ltd. subsidiary. As such, the Company currently operates 133 stores.

PC Clinic was operated mainly by FC stores until eight 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.

Store development conditions

As of March 2020				(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	8	46	58	112
Subsidiaries	7	6	5	18
FC	3			3
Total	18	52	63	133

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.

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### **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 March 2020, in addition to 792 regular employees (versus 780 as of the end of the previous term), 815 part-timers on an 8-hour shift (versus 999 as of the end of the previous term) were working for the Company. 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: Establishing the Appointment and Compensation Committee**

At the general meeting of shareholders to be held in June, two directors will resign and one director will be newly elected on the executive side. The total number of directors on the Board will be eight (decrease by one), including three outside directors. The Company intends to downsize the Board by clearly defining the roles of each director in order to promote active discussion and speedy decision-making.

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, an outside director, has worked at the Ministry of Economy, Trade and Industry and is acquainted with IT, information and telecommunication. Ms. Yumiko Masuda is the representative director of Consumer Voice Research Institute, Limited, and is familiar with consumer-oriented management. The board of directors has held vigorous discussions at board meetings.

Established in February 2019, the Appointment and Compensation Committee consists of at least

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three directors, with the chairman and the majority of committee members being outside directors.

Most executive officers who are responsible for the 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.

### **Revolutionary incentive of stock buy-back by the owner to personally award employees**

It was reported that the stock buy-back carried out by President Nojima in order to award executive officers, regular employees, and others was completed in May. Stock awards will continue in the future.

President Nojima is personally awarding the Company's stocks to the Company's employees. Stocks valued at upwards of 600 million yen (1.5544 million stocks) at stock price (386 yen) on May 14, 2019 will be awarded to directors and regular employees of the group. Stock grant agreements have been concluded sequentially from August.

The Company saw its 25th anniversary in August 2019, and while it is drastically transforming its business model, President Nojima granted incentives to motivate employees, as well as to ensure that the employees understand the perspectives of shareholders.

Numerous employees have opened accounts with securities firms and received the Company's stock grant. Stock grants up to 1.1 million yen will not be subject to taxes, but if the grant exceeds that amount, the employee will naturally be required to pay the tax that is owed themselves. The Company hopes that the stocks will be held for a mid to long-term period, but the decision was left up to each employee as an individual.

Under normal circumstances, a stock buy-back scheme entails the purchase of stocks from the market using the company's funds. This serves as a return to shareholders because the amount of the stock buy-back increases the value of the stocks.

This time, the owner (President Nojima, owner of 36.5% of stocks as of the end of March 2020, including stocks owned through his asset management company) purchased about 1 billion yen worth of stocks from the market using his own funds. Of those, the owner is currently in the process of distributing and awarding 600 million yen worth of stocks to his employees and part-time workers. As a gift from a private individual, this act is not related to the Company, so it has absolutely no effect on the P/L of the Company.

President Nojima was convinced that, for the employees to become fully committed to the Digital Life Planner scheme that the Company is promoting, it is imperative for the president himself to offer an incentive and to deliver it in a visible manner.

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For existing shareholders, having employees become new shareholders through stock buy-back (worth 1.0 billion yen) by the owner and becoming more motivated is equivalent to having the crew join the same boat. The Company is on the verge of transforming its business model and its direction has become clear. If the Company gains momentum at this stage, its enterprise value should see significant increase.

President Nojima will invest 1.0 billion yen through a combination of his personal funds and asset management company and share the stocks with the employees, but if this were to result in a 10% increase in stock prices, there will be no issue at all. The Company's stock price is expected to increase incrementally over the next several years, and the president and employee will mutually benefit from this.

This will be the first case of stock buy-back by the company's owner and stocks granted as an incentive to employees in Japan. President Nojima's ideas are truly innovative and unique.

## 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 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 team play. It has spent more than 10 years developing this system, which has become a business model that constitutes part of its corporate culture.

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### **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." 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 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.

### **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 conventional 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.

Store development history of PC DEPOT

	(Stores)									
Number of stores at the end of each term	1995.3	2000.3	2005.3	2010.3	2015.3	2016.3	2017.3	2018.3	2019.3	2020.3
PC DEPOT										
Directly-managed	1	10	28	43	36	28	23	16	12	8
Smart Life store					15	25	31	39	43	46
Subsidiaries				4	13	13	13	12	10	7
Smart Life store								1	3	6
FC		8	32	17	3	3	3	3	3	3
PC DEPOT PC Clinics										
Directly-managed					52	52	53	53	53	58
Subsidiaries					0	5	5	5	5	5
FC				24	6	1				
<b>Total</b>	<b>1</b>	<b>18</b>	<b>60</b>	<b>88</b>	<b>125</b>	<b>127</b>	<b>128</b>	<b>129</b>	<b>129</b>	<b>133</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.

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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. 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 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.

### **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 50 to 70 million yen in stores 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.

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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.

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 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 2005. 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.

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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.

Sales of services have grown 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.

PC technical services (example) of PC Clinics (Dr. Smart)

		(yen)	
		Premium member	General
Regular maintenance	Windows	0	48000
	Mac	0	43000
Recovery work updates	Windows	7000-11000	35000
	Mac	7000-11000	25000
Special for simultaneous PC purchase PC setup service - regular	Windows	6000	32000
	Mac	14000	35000
Data	Data backup for a PC under repair	7000	32000
	Data backup for a PC that does not start	12000	37000

NOTE: "Premium members" refer to service members of PC DEPOT; "General" refers to others.  
 Consumption tax is not included.

### Convenience of PC Clinics

PC DEPOT's PC clinic service, Dr. Smart, offers free consultation and free diagnosis for any products including those purchased at other stores without the need to make a reservation. For fixed fees, the Company provides repairs and other services for Windows, Mac, smartphones, tablets, data, and assembled computers. The Company offers highly convenient services for a variety of purposes such as initialization, configuration, upgrading, exchanging, data backup, data salvage, and security measures. As premium members will gain free access or significantly reduced fees for the available services, they will receive strong value from their membership.

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

#### New Lifestyle: Acceleration of efforts to respond to the novel coronavirus

Electronic payment using smartphones is spreading widely. As more online services become

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available, the Company is strengthening its lecture options on how to use them effectively. To improve services, a members' lounge has been established within stores.

Needs for telework and online learning are increasing in order to respond to the novel coronavirus, and sales of PCs and tablets are growing.

PC DEPOT can advise customers on any topic, including teleworking from home, online learning, and remote communications. The recent economic shock caused by the coronavirus will make clear the strengths of the Company, and demand creation will accelerate still further.

With regard to the New Lifestyle initiative, the following developments in particular are gaining momentum: 1) inquiries on purchasing new PCs to replace old models in order to effectively use online services and improving one's Internet environment, 2) how to use online learning and remote communications, 3) the revision of the new service usage fees, and 4) an expansion from existing to new members. Demand for the Company's services is expected to increase rapidly.

### **Needs for PCs will rise again and remain high**

While some observers predicted that the advent of smartphones would at some point make PCs unnecessary, President Nojima believed that needs for home PCs would rise as an important core of the platform even as cloud services became more commonplace. As this tendency has become visible, PCs are expected to sell reasonably well as a trend for some years to come. They may be sold as standalone products or as service-inclusive products.

### **Expectations for GIGA schools**

Programming education will be among the required subjects at elementary schools from April 2020 and at junior high schools from April 2021. The Ministry of Education, Culture, Sports, Science and Technology is promoting the Global and Innovation Gateway for All (GIGA) initiative to realize optimum learning for individual students by providing a terminal device for every student and utilizing a cloud-based network.

It is highly likely that educational demand will increase in relation to this development. For this reason, the Company has started to put full effort to capitalize on it by, for example, holding a grand educational PC fair for elementary and junior high school students at all stores in February. As employees are already conversant with PCs, they are now closely studying the new Course of Study to prepare for the opportunity to provide consultation services to parents and children together through adequate conversation. The Company also plans to get the solicitation of new premium members into full swing this year. Specific measures will be taken in and after this spring.

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## **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 the stability of life and productivity, as well as the enhancement of humanity and productivity. Stressing the importance of future design, he cited a consultant designer and engineer-artisan.

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 feeling of being cared for; iii) customers find gaming enjoyable; iv) customers enjoy learning about new ways of using devices; v) customers find assembling devices enjoyable; vi) customers feel secure when seeing their IT devices being inspected; and vii) 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.

## **Shift in the Company's business model**

As part of initiatives to evolve its business model, in addition to the Company's existing problem solving support service, the Company will provide customers with products and services necessary for their future digital lives in accordance with planned proposals. The Company will devise a plan with customers and their families regarding when and where to buy which products and services in the

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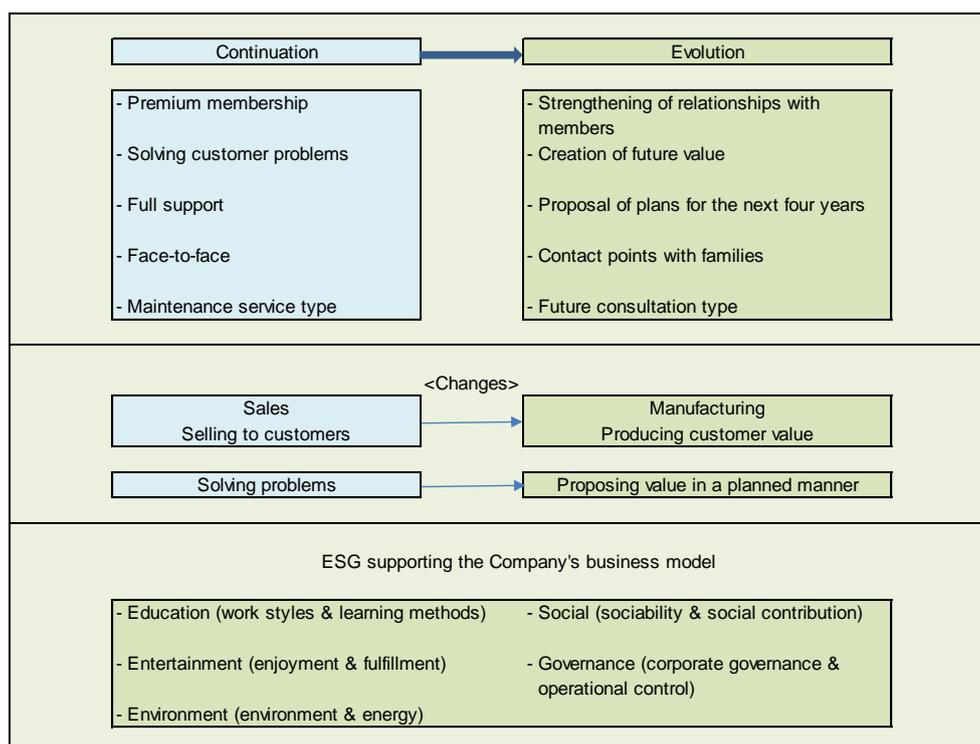
future.

"How can I install an electronic payment application on my smartphone and use it easily?" Such an inquiry gives Company staff members some effective cues for offering consultation services.

Many children and youths are heavy smartphones users but less familiar with PCs than older generations. Some such people may wish to have a better command of PCs. Here, consultation needs arise from inquiries like "How can I use a PC at home?" "When should I replace it with a new one?" or "How can my family share a PC more easily?"

Since summer 2018, the Company has been shifting to a digital life consultation-based business model. Premium members are supported by teams called "Works," each of which is composed of three staff members: (1) consultant designer and (2) engineer-artisan. This model has been fully operational in stores since autumn, and the employee performance evaluation scheme has been updated accordingly. The Company has been expanding this activity widely since spring 2019.

Evolution of PC DEPOT's business model



### Full-scale rollout with the trademark registration of Digital Life Planner

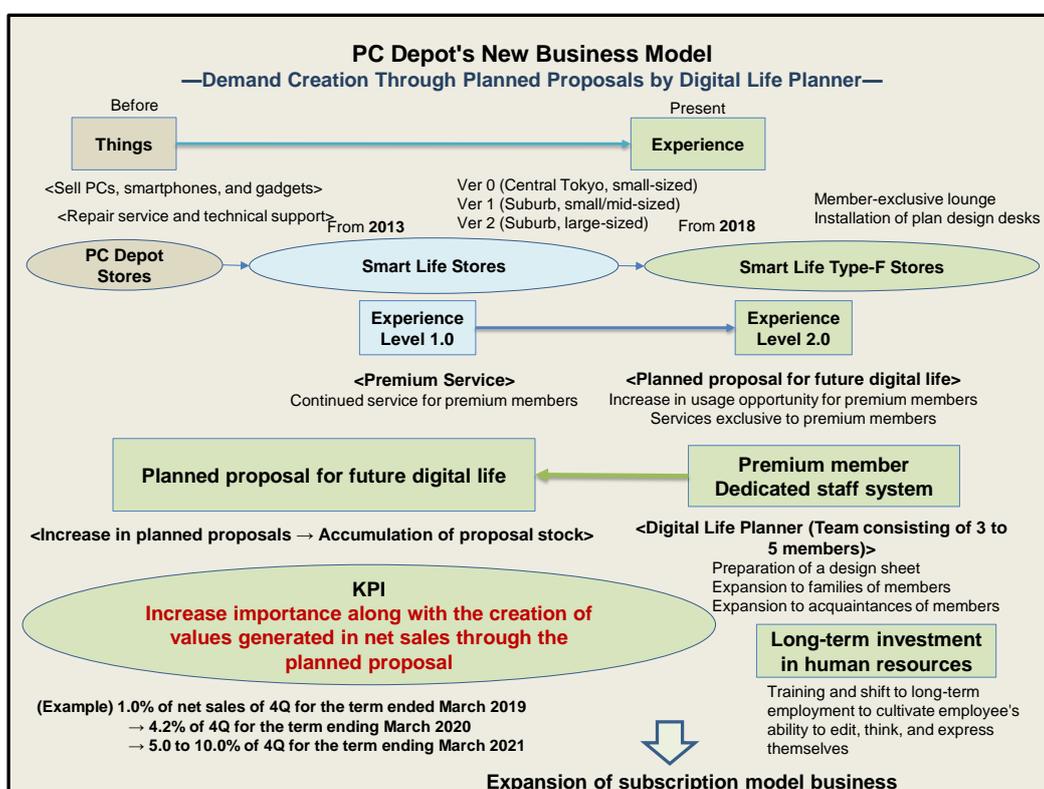
With the trademark registration of Digital Life Planner having been completed in May 2019, this term may be used only by the Company. Personnel dedicated to the Digital Life Planner will comprise a team of three to five members (Works), and this team will plan future digital life together with

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premium members. The Digital Life Planner will systematically create digital value, which focuses on the family and consists of all types of digital devices, in the lives of our premium members. The Company will expand the service through word-of-mouth with our members' friends and neighbors.

This plan will be compiled in the design sheet, which specifically schematizes a plan up to three to four years into the future and will be shared among the team members. It is a tool for the team to engage the families of our premium members, and it makes it possible to conduct careful and detailed consultations. As the relationship grows closer, the proposal will entail the things that are really necessary and that add value, and it will be actualized as planned demand.

The benefit to the user will be prioritized first, which in turn will create demand that will generate profit for the Company.



The team of Digital Life Planner will systematically provide consultation to associates of the membership system, which the Company has cultivated over the past 10 years. The Company will build this system and reinforce the cycle of subscription-based business into an even stronger model.

The key will be human resource development, and the president himself is leading this effort. This business model was borne out of the president's personal concept: how to increase the customer's digital assets and enrich their lives. It is not about the consumption of physical goods, but enhancing

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the experience. The Company named this concept "Experience Level 2.0," and it is nurturing human resources to realize this concept.

To achieve this purpose, the Company is planning for the evolution of Smart Life stores in the area of store creation. In the remodeling of stores into Smart Life Ver 1 Type-F stores, lounges that can only be accessed by premium members will be created and Plan Design Desks, where the customer will develop solutions together with the Digital Life Planner, will be installed. The Company plans to introduce two to three new Type-F stores every quarter.

### **Formation of teams for Digital Life Planner**

A team system consisting of three to five members (Works) has three benefits. 1) The working style of a Digital Life Planner is more enjoyable in comparison to conventional working styles; 2) Members of the team will work together, which will accelerate the growth of members; and 3) From the perspective of premium members, they will be supported by three staffs who all share the member's needs through the design sheet, conveying the feeling that the service level is being upgraded.

Works will have its own objective as a team, and it will contribute to increase in net sales by actualizing the demand created through planned proposals. Instead of pursuing sales in a flow, the Works only needs to accumulate future digital assets according to the plan.

### **Member-service-inclusive product line-up**

The lineup of member-service-inclusive products available only to premium members was expanded considerably in July 2018. This menu of products is exclusive to members. Members can use various products on a monthly fee basis to match scenes in customers' digital lives such as 1) making a new memory, 2) taking a step forward, 3) enjoying entertainment together, 4) enjoying putting things together, 5) using time efficiently, or 6) feeling warmth.

The Company's broad lineup offers approximately 40 items. Specific examples include a musical keyboard for a monthly fee of 500 yen, a stereo component system for a monthly fee of 1,500 yen, a printer for a minimum monthly fee of 750 yen, and a wireless speaker for a monthly fee of 750 yen. The Company will offer more products in the future.

The advent of the IoT era will cause various digital devices to spread into homes. Services that support these devices are naturally in the scope of consideration. 5G network services will start in 2020. A service launch always provides the Company with new business opportunities because it changes and increases digital life needs.

### **Establishment of a value production system**

The Company is currently focused on reinforcing its contacts with premium members. Therefore,

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the Company is refraining from advertising temporary sales campaigns and employing part-time workers to support those campaigns.

Reaching out to new customers by way of existing members will increase if the Company's consultation services take hold. In fact, such a movement is emerging. The Company will focus on enhancing its reputation and brand strength by encouraging existing customers to spread the word about the merits of its services to their friends and neighbors.

The Company hired approximately 100 new graduates in April 2020, compared to the 70 new graduates hired in April 2019. Applicants must meet all of the following requirements: 1) attend a briefing session held at the headquarters, 2) submit a report on a specified issue to move on to the second interview, 3) submit a collage to undergo a job interview with directors, and 4) receive an employment guarantee notice after the Company obtains their parents' approval. These requirements are relatively severe, making it difficult to join the Company.

The Company emphasizes that it is not a mere retailer of PC products but a creator of digital life value for the new digital society through face-to-face communication with customers. Its business model is extremely advanced and epoch-making. As such, the presentation of its business is popular among students, which has led to a remarkable increase in the ability level of successful applicants.

### **Factors that have caused growth in business results to cease temporarily**

In promoting the transformation, there are two factors that led to PC DEPOT's business growth to stall temporarily. 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, which will result in a smaller contribution from initial year sales and profits.

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 three to four-year period, the customer incurs an initial cost at the start with maintenance, security, and renewal procedures occurring upfront. This cost will be recovered in three to four years. In the interim, the Company must also respond to various inquiries and provide repair service.

### **Visualizing product usage rather than focusing on new products**

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

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in person and to learn about their lifestyles. To this end, the Company fosters 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 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 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.

The Company has been implementing staff retraining, as well as quality and governance development, during the one year since October 2018. 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 the Company is seeing encouraging signs toward building the new business model, and employees view the developments positively.

### **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. However, exceptions are PC Clinics inside K's Denki stores and some other stores, such as those inside shopping malls.

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 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

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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.

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.

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.

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—"Digital life design sheets"**

Under the President's leadership, personnel will create collages of new value creation (a bird's-eye

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view summarizing ideas currently in mind) and devise roadmaps (design sheets) 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 Company 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 provided under the leadership of the President.

### **Devising future roadmaps (design sheets) is the key**

For premium services, PC DEPOT creates value based on three to four-year planned 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 new 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.

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Each officer will write customers' needs down to devise roadmaps, making it easy for customers to imagine their digital lives over the next four years. Although devising roadmaps 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.

### **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.

### **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. As large stores are shifting to Smart Life stores, demand for services will further increase.

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 (closed in January 2020 and is scheduled to reopen after relocating to Ariake in June 2020) 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. 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.

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### **The ongoing shift to Smart Life stores has been extended to large-scale stores: Experience-based menu and members' lounge**

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 remaining space being subleased to other company. The Company has also started 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.

In terms of specific actions taken to create planned demand, the Company is expanding the experience-based product menu. Members can experience and learn, among other things, PC assembly, programing, and the creation of original postcards and New Year's cards. At Smart Life stores, members can enjoy various experience in a members' lounge.

Smart Life Mishima Store, which opened in November last year, is a large store of 500 *tsubo*. It has a large members' lounge and has incorporated experience-based services using drones in which members can experience drone flight and picture taking and editing.

This is interesting. The Digital Life Planner within the team talks to members (subscribers) to find interested users among families. Therefore, the ability of this store to win customers for such experience-based services is markedly higher than other stores.

### **Remodeling large stores for further evolution**

The Tomisato Store, which was a large store that had a floor space of 800 *tsubo*, has been remodeled into a store that has a floor space of 400 *tsubo*. How to effectively use the remaining 400 *tsubo* will be determined later. As Smart Life stores provide advice on digital life, they do not display a large collection of products. Therefore, even a store with a floor space of 400 *tsubo* is fairly large. The Tomisato Store is quite wide and also has a members' lounge. The remaining space is expected to be used as a base for providing digital life services suitable for the next era.

The Morioka Store, which was also a large store with a floor space of 700 *tsubo*, has been remodeled to have a floor area of 400 *tsubo*. The number of Works will increase compared to before. The increased number of Works will enable the Company to increase the number of members.

### **Started to open PC Clinics**

The Company has started to open PC Clinics in K's Denki stores. New clinics opened inside K's Denki Ageo Store and K's Denki Honjo Store in October last year.

PC Clinics are precisely the places for providing support about PCs, tablets, and smartphones. If a customer who has newly purchased hardware equipment at K's Denki wants to receive support service for it (such as data migration), all he or she needs to do is to become a premium member.

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The staff at K's Denki stores guide customers to come to the PC Clinic if they have PC-related needs. In other words, opening such new stores leads directly to increases in members (subscribers). Although the balance between the degree of human resource development and the needs of K's Denki is a factor to consider, we are paying attention to them as a promising form of new store opening from now on.

### Future store network expansion: Remodeling into Smart Life stores

While seven stores, including the large stores in Tomisato (Chiba) and Morioka, were being remodeled into Smart Life stores, PC DEPOT Smart Life in Books Kinokuniya LaLaport Toyosu Store was temporarily closed because the entire shopping facility is to be relocated to Ariake. As a result, the number of Smart Life stores increased by 6 to 52. The Company also plans to complete the remodeling of five stores into Smart Life stores during the current term, and expects to complete remodeling of all stores within the next three years.

In addition, the Company opened five new PC Clinics. Three to five PC Clinics together are expected to generate a business scale equivalent to that of one Smart Life store. Following the opening of five stores during the previous term, the Company plans to open another five PC Clinics during this term, which should start contributing to sales growth after two years.

New store openings and shift to Smart Life stores

	(Stores)							
	2014.3	2015.3	2016.3	2017.3	2018.3	2019.3	2020.3	2021.3 (forecast)
PC DEPOT stores								
Directly-managed subsidiaries (new)		3						
Smart Life store (new)		1	3	2	1			
Smart Life store (renovated)	4	10	7	5	8	6	6	5
PC Clinics								
Directly-managed (new)		2		1			5	5
<b>Total</b>	<b>4</b>	<b>16</b>	<b>10</b>	<b>8</b>	<b>9</b>	<b>6</b>	<b>11</b>	<b>10</b>

NOTE: Figures marked with (forecast) are the Company's forecast.

### Responding to service demand: The menu for premium services

Member service options are offered as plans that are based on the usage amount rather than the number of devices owned, which was the basis of the previous service plans.

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

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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.

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

Premium service

(yen/month)

Plan (From February 2017)	3 year plan Monthly fee	2 year plan Monthly fee	1 year plan Monthly fee	Usage environment
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.

### Provision of "Member-service-inclusive products"

Of sales generated through our solution services, the percentage of service-inclusive products is only a little over 10%. It is a consultation service based on planned proposals, so it does not involve pushing products onto the customer. We expect this ratio to gradually increase over time.

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

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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.

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 makes great efforts at the time of sale to offer 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.

According to the current plan:

(1) Value Pack provides a multi-network plan of premium services (4,500 yen per month) with the Apple MacBook Pro (2019) (16 inch, 512 GB) for a one-time deposit of 40,000 yen paid at the store, followed by a monthly fee of 9,000 yen. On the iPhone, it is possible to share images and data via MacBook. MacBook Pro's data allows a smooth transition from iPhone 7 to iPhone 11.

(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 11 in addition to a series of premium services. For example, by combining the multi-network plan with iPhone 11 (64 GB), the user can use network services for a monthly fee of 3,250 yen (under a four-year plan; not including the network communication fee) after paying 15,000 yen for the phone when purchasing the product. Since usability will be improved by connecting the iPhone and MacBook, the Company will promote the sale in such combination.

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.

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(3) When members subscribe to the Company's premium services, they can use an iPad Pro (11 inch, 128 GB) for a monthly fee of 2,500 yen (3-year plan), after paying a one-time fee of 15,000 yen for the device itself to enter into a contract. 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.

### **Various support is available for IoT and AI**

In the medium-term, the 5G network services will start in earnest 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.

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.

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, such as the Premium Member Solution Hardware. 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.

### **Started to provide PC assembly and programing learning experience as a family activity kit**

In August 2019, PC DEPOT launched a new experience-based product "PC Assembly Kit for Parents and Children to Experience Assembling PC" with which customers can assemble a PC by themselves. This product is targeting premium members and their children who can learn about computers by assembling one and can take home the PC they have just completed.

First of all, customers can enjoy experience-based learning. With an advance appointment (in which parents and children are always together), a parent (member) and a child (two persons in total with a child from 5th grade to university) can learn a lot in a 90-minute course. Upon completion, an assembly

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certificate is issued, and a commemorative photo is also taken. This is indeed a major shift from selling products to enjoying activities.

The experience kit for an introductory model is priced at 85,000 yen. Other kits, such as e-sports kit (150,000 yen) and e-sports/video editing kit (195,000 yen) are also available. Through these offerings, the Company should be able to engage in lively dialogue with members.

Next, the Company also launched a product with programming experience called a "PC Set for Parents and Children to Experience Programming." In this product, a PC and BBC micro:bit (introductory programming kit) are sold as a set, and children from the age of 10 years old up to high school age can enjoy programming together with their parents. The price of this product ranges from 100,000 yen to 185,000 yen and includes a 90-minute programming experience. Several product options are available depending on the size and performance of the PC. This certainly sounds interesting.

Qualified and dedicated PC DEPOT employees provide guidance and consultation for an effective learning experience. The in-house staff who can guide experience-based learning is one of the strengths of the Company. Kit products are also developed in-house. The family experience is the important feature that can impress customers with the advantage of membership.

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

The Company does not merely sell hardware such as PCs and tablets, but offers services. 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 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

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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.

	2014.3		2016.3		2018.3		2019.3	
Overall sales (consolidated)	53772	100.0	51729	100.0	43590	100.0	40447	100.0
Service sales (consolidated)	16194	30.1	24631	47.6	24566	56.4	25270	62.5
Goods sales (consolidated)	37578	69.9	27098	52.4	19024	43.6	15177	37.5
Cost of services (Isolated, Estimate)	4676	28.9	7443	30.2	6845	27.9	7405	29.3
Overall gross profit (consolidated)	18273	34.0	21715	42.0	20044	46.0	21784	53.9
Service gross profit (provisional)	11518	71.1	17188	69.8	17721	72.1	17865	70.7
Goods gross profit (provisional)	6755	18.0	4527	16.7	2323	12.2	3919	25.8

NOTE: Goods sales include 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.

### 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. After transforming to Smart Life stores, stores experience changes in comparison to 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 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

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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 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.

#### **In new solution services, accounts receivable is on the increase**

Looking at the balance sheet of the term ending March 2019, demand has started to increase due to the planned proposals delivered to premium members, and this in turn has led to an increase in accounts receivable from an increase in sales of service-inclusive products. On the other hand,

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inventory assets are declining as a result of converting stores into Smart Life stores.

Balance sheets

(millions of yen, %)

	2015.3	2016.3	2017.3	2018.3	2019.3	2020.3
Current assets	19771	25381	26123	25702	24589	23823
Cash and deposits	2370	4754	7726	10597	9542	8383
Accounts receivable-trade	9609	13249	11202	8514	9039	9421
Inventories	6548	6128	6103	6125	5642	5695
Fixed assets	9336	9622	9506	9351	9031	9220
Tangible fixed assets	5013	5041	4857	4440	3977	4362
Guarantee deposits	1639	1810	1750	1703	1647	1639
Lease deposits	1275	1323	1403	1332	1338	1226
Total assets	29108	35004	35629	35053	33620	33043
Current liabilities	11647	12271	6786	6279	5499	5059
Accounts payable-trade	1691	1245	1230	964	958	875
Short-term loans payable	4520	5200	0	0	0	0
Long-term loans payable (within one year)	1447	1044	2125	2243	1594	1286
Fixed liabilities	2428	1347	5830	5523	3962	2725
Long-term loans payable	1796	751	5265	4952	3358	2071
Net assets	15032	21334	23011	23250	24159	25259
Interest-bearing liabilities	7764	6996	7391	7195	4952	3358
Interest-bearing liabilities ratio	26.7	20.0	20.7	20.5	14.7	10.2

Despite the remodeling of stores into Smart Life stores and their more advanced form of Smart Life Type-F stores, the amount of investment required is not so large. Once the store composition shifts towards Smart Life stores, it will no longer be necessary to keep an inventory like before. In addition, as the weight of planned proposals increases, it will become easier to see the mix of required products. Inventory will not include products, which are not in much demand, but will include accessorial and peripheral products that are likely to be in high demand. As we enter the 5G era, the content of products and services will change, and the Company will be required to adapt to those changes.

The Company allocated 1.29 billion yen as capital investment for the term ended March 2020, compared to 940 million yen in the previous term. The Company plans to make a capital investment of 1.1 billion yen for the current term ending March 2021. This includes expenditures that are regarded more as an expense that will not remain on the books as tangible or intangible fixed assets (software).

Although it depends on the store's location and size, 400 to 500 million yen is required to construct a new store from scratch, while 100 to 200 million yen is necessary to remodel an existing store into a Smart Life store, and 30 million to 50 million yen is required to further remodel a Smart Life store into a Type-F store.

In Smart Life-based businesses, it takes 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 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.

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In other words, this means that accounts receivables grow on the balance sheet.

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.

Cash flow trends

	(millions of yen)					
	2015.3	2016.3	2017.3	2018.3	2019.3	2020.3
Cash flow from operating activities	-2512	516	4292	5045	2563	2029
Net profit after tax	1790	2742	1325	2282	1348	1905
Depreciation	781	897	943	919	834	752
Accounts receivable	-2903	-3640	2034	2687	-525	-381
Inventories	-772	420	24	-21	482	-53
Accounts payable	-1816	-449	-16	-282	14	-80
Cash flow from investing activities	-1436	-970	-1090	-297	-721	-949
Tangible fixed assets	-797	-604	-830	-450	-369	-729
Intangible fixed assets	-260	-291	-178	-68	-297	-272
Free cash flow	-3948	-454	3202	4748	1842	1080
Cash flow from financing activities	1637	2837	-229	-1876	-2897	-2238
Long-short term borrowings	1892	-767	394	-195	-2243	-1594
Common stock issuance		3983				
Common stock repurchases	-1	0	-5	-1006	1	5
Cash dividends paid	-253	-380	-612	-660	-652	-644
Cash and cash equivalents at end-term	2370	4754	7726	10597	9542	8383

### Placing priority on cash partly due to response to the novel coronavirus

As net sales have decreased, the Company now has a lower need for working capital. Because the Company can sufficiently fund the capital investment for store remodeling with its internal funds (retained earnings and depreciation), more and more debts are being repaid. As a result, the equity ratio has risen further.

Although free cash flow is positive, unlike the previous term, the Company does not plan to repay debts further in the current term. Taking into consideration the need to respond to the novel coronavirus, the Company intends to maintain sufficient cash and deposits in order to be ready to take

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the next actions on offense.

There are no major financial concerns. So, how should the Company make efficient use of its free cash flow going forward? The Company will be able to put more effort into investing in human resources and start to create the next business model as well as consider R&D-type open innovation. 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%. Thus, it has sufficient capacity to make further investments.

#### **4. Human resource development—Unique micro-governance and development of related population**

##### **Shifting focus to acquiring new premium members (subscribers) while developing human resources**

With the progress in education and training of employees, the approximately 300 Works (teams) in total across all stores are deepening their contacts with members (subscribers). Starting in the current term, the Company will shift its focus to expanding the number of new members.

In the last two years, the Company has worked to develop human resources for Works while strengthening services for existing members. As the core human resources have now been developed, the Company will hire more employees (new graduates and mid-career). The Company aims to hire considerably more employees in the current term compared to the previous term.

##### **Devotion of full efforts to human resource development**

Human resource development is the key for team building. President Nojima has been devoting 70–80% of his time to human resource development. Opportunities for all the staff to get together and listen to plan announcements for discussion have increased from once a year to three times a year. Part-time and other non-regular employees as well as regular employees engage in dialogue to directly discuss the ideas of the top management.

##### **Building team strength**

A Works, which is a team comprised of persons in charge, draws up the future roadmaps (design sheets) of members (subscribers). It is these roadmaps themselves that are the assets that will generate demand sooner or later. President Nojima says that this future plan consultation is the very business model that PC DEPOT should pursue and is the Company's response to Experience Level 2.0. We highly evaluate the fact that the Company has a clear idea of its future business model (BM2).

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Members (subscribers) are invited to come to the store to discuss their family's future digital life plan with a dedicated team of three to five persons in charge. It takes a long time at first, and not much business is generated for the amount of effort made. However, as the roadmap gradually becomes clear, members will understand what digital life can be incorporated to create joy for themselves and their spouse, children, and parents.

### **Leveraging micro-governance**

The team building of Digital Life Planners based on micro-governance at the level of the actual shop floor is making progress. This initiative is quite unique.

For example, the persons in charge of IR belong to the General Stakeholder Relations Office of the head office, and each of them, including officers, also belongs to a different team at a different store. They participate in the development of future roadmaps of members (subscribers) as a member of that team.

At the same time, they are challenged to demonstrate team strength as the IR team as well. Counting team performance at the store as the performance of an individual member of the IR team, the performance of a team of, for example, three members in the head office IR is counted as the performance of the IR team.

What will happen then? The three members each bring case studies, for example, that a team at a store is conducting such and such activities to accumulate future roadmaps (assets), which is linked to future performance in such and such a way. The results of exchange of opinions on them will be provided to each store as feedback.

### **Mothers of child-bearing age as competitive resources**

President Nojima talked about the activities of Digital Life Planner in front of a group of mothers of child-bearing age who are currently working for the Company as part-time employees. These mothers are excited about these discussions and started to come up with various ideas. Each of them is a member of a team of a store. There have already been cases that resulted in the new subscription of a member (subscriber). These mothers of child-bearing age who are currently working for PC DEPOT on a part-time basis will eventually become great resources for the Company if they want to work for PC DEPOT on a full-time basis once their children grow up. The Company is trying to create a workplace where work is done professionally and also with fun.

### **Motivate for self-led actions**

Team members are expected to learn together 1) to always prioritize value to members (subscribers), 2) not to do anything unreasonable based only on one's own belief or for self-satisfaction, and 3) to

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cooperate with each other to steadily accumulate future roadmaps of members. This is what controls team activities as offensive and defensive governance. In this way, they will not take any unreasonable actions based on the direction of a superior. They will not engage in high-pressure sales activities to secure results.

### **Initiative to increase the related population**

President Nojima calls the amoeba method the creation of the related population. This is to increase the population of people who are involved in the work of PC DEPOT and to create new values from the network in the population. PC DEPOT aims to become a creative company that increases related population.

### **Pursuit of uniqueness**

President Nojima has devised unique strategies to avoid competition as much as possible. He has created a way to avoid competition with both the e-commerce of Internet companies and mass retailers of home electronics. Even now, the Company does not provide customers with any rewards points for sales. It intends to compete in terms of gross margin ratio rather than sales amount.

Although the term ended March 2020 was a period of transition to the new business model, its direction and contents have been much clarified. As consumption of services is strong, support needs for devices continue to be high. Although mass retailers are also trying to shift to a service-based business model, they have in reality not been successful.

What is the difference? In a business model in which gross profit is earned by product sales, companies cannot secure short-term profit unless they pursue flow-type profit. It is difficult for them to patiently pursue stock-type profit completely ignoring flow-type profit. It is nearly impossible for them to be patient for several years accepting current losses.

### **Why PC DEPOT can do it?**

In fact, a stock-type business model has been pursued by many securities companies in their face-to-face services, too. However, they are still struggling in breaking away from the flow-type business model. Why can't they do it? Because they cannot cross the "valley of death" from flow to stock by accepting losses for several years.

Then, why can PC DEPOT now realize the shift to a future Digital Life Planner business model? Because the subscription by premium members has already been well established. The Company has a strength as a forerunner that is 10 years ahead of others. For this reason, while PC DEPOT can realize such a shift, it is considerably difficult for other companies, such as mass retailers of home electronics, to do it.

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### **Solution first**

The meaning of customer contacts is different for PC DEPOT. In the past, each time a new device is introduced for sale, the Company promoted it to customers to sell it. Now, the Company need not sell today's new product to customers today.

That is merely the logic of the seller, and is not the needs of customers who are members. As the Company is now working with members to develop their future roadmaps, devices can be replaced or purchased additionally at the right time for the members as per the roadmaps.

The Company's focus is on solution first, rather than device first. In other words, the Company will support solutions to customers who are members to help them to realize what they really want to do in their digital lives.

The concern that the development of digital life roadmaps may eventually end up with high-pressure sales of products and service need to be examined from two aspects. First, the team works with the member to develop roadmaps together and does not draw such roadmaps without permission. Second, the Company is creating a culture to regard such roadmaps as its biggest assets. The Company intends to put the spirit of human resource development into such micro-governance at the level of the actual shop floor.

### **What is planned demand?**

Normally, customers come to the store based on their own planning of replacement or additional purchases. The Company will of course accept such demand, but it is not planned demand as defined by the Company. Planned demand as referred to by the Company is defined as actual demand generated as a result of the dialogue between a member (subscriber) and the Company's dedicated Works, which is documented in a roadmap.

Once a roadmap is drawn, demand can be expected in a planned manner. It is these roadmaps that are stock (assets), and demand is generated as the stock is accumulated.

For the fourth quarter of the term ended March 2020, the ratio of planned demand in total sales was at 4.2%. The Company's target is to raise it to 50% in the fourth quarter of fiscal 2024.

In the past, the Company succeeded in raising the ratio of service sales from 3% to 50% in 10 years. Given the business model (BM) transformation in the past, there is a sufficient chance of success in the next shift to BM2.

Once the ratio of planned demand rises higher, expected benefits include: 1) Promises will lead to sales; 2) Members' subscription period will be longer; 3) Members will come to the store more often, 4) The number of inquiries to call centers will decrease; 5) Member withdrawals will decrease, and 6) Insert flyers will decrease. Therefore, enterprise value is expected to increase significantly.

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Percentage of sales based on planned proposals  
 - KPI for the new business model -

	2019.3	2020.3				2021.3	2024.3
	4Q	1Q	2Q	3Q	4Q	· · · 4Q (forecast)	· · · 4Q (forecast)
Percentage of sales based on planned proposals to total sales	1.0	1.5	2.0	3.0	4.2	5–10	30–50

NOTE: Figures marked with (forecast) are analyst forecasts.

However, there will be a slight delay in the rise in the percentage of sales based on planned proposals during the current term due to the effect of the novel coronavirus. This is because sales based on the planned proposals have been postponed due to the effects of the novel coronavirus. The Company is having existing members wait if possible for non-urgent needs. Therefore, the pace in the rise in this measure will be rather slow during the current term.

#### **Aiming to expand the customer base: New member development has also been started**

There are not many people in their twenties among the members of the Company. They are mostly people with children who want to enjoy a digital life. Seniors who are parents of these people are also active as digital seniors. As it is women who are usually the key people in a family, the Company is also putting effort into support for women's digital life.

New member development in addition to existing members (subscribers) has also been started. While existing members are the main segment, demand creation is led by products. Once the subscriptions of new members increase, costs for the provision of services are incurred first and will be recovered later.

#### **Strengthening new member acquisition based on planned proposals**

The shift to the business model in which the Company supports customers' digital lives and makes planned proposals to create demand is making steady progress. Thus far, the Company has prioritized services to existing members, but it will place greater focus on the acquisition of new members because the internal structure to support such efforts has been improved.

Until December 2019, the Company focused mainly on the promotion of new member acquisition via referrals from existing members and upon PC purchases. Since January 2020, the Company is putting more effort into acquiring new premium members through advertising and other means. In fact, the Company is also focused on providing experience-based products.

However, since March, due to the effects of the economic shock caused by the novel coronavirus, the Company has been forced to shorten its business hours at some stores and is asking current members to postpone their non-urgent needs in order to prioritize urgent needs with respect to planned

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proposals. Nevertheless, the number of new members is increasing.

## 5. Near-term operating results: Shifting to a new structure that bears fruit on a full-scale basis going forward

### Response to the novel coronavirus

Regarding the response to the novel coronavirus, 1) store staff members are getting accustomed to practicing infectious disease control measures by learning as they go.

2) As the Works (teams) are responding to members' needs, they are increasing member satisfaction regarding services by distinguishing members' urgent needs from needs that can be postponed slightly. As the Works can learn customer needs very well through close conversations, they will not lose customers' business even if they have customers wait.

3) Stores are being visited by an increasing number of customers in their 30s and 40s who come with their family members. This is because of the increase in home computing needs. As the Company's customers seek accurate services rather than cheap products, many customers become new members.

4) Although the hiring environment in general has deteriorated due to the effects of the novel coronavirus, the Company considers this to be an opportunity. As the number of job applicants is increasing, the Company is expected to hire more employees. This is a good time to secure excellent human resources because the Company has just entered a more aggressive phase. Recruitment is conducted entirely via an online process, including the interview with the president.

5) The economic shock caused by the coronavirus has provided an opportunity to reinvent how PCs are used. This trend is expected to continue for some time. Most people who intend to improve their network environment by purchasing a PC from the Company will also become members.

### Confirmation of reaching the bottom in the term ended March 2019

For the fiscal term ended March 2019, the Company had net sales of 40,447 million yen (down 7.2% YOY), operating income of 2,579 million yen (down 13.5% YoY), ordinary income of 2,685 million yen (down 12.8% YoY), and net income of 1,553 million (down 20.7% YoY).

The immediate net sales declined because consultation consisting of planned proposals for future digital life plans is being delivered to premium members.

Looking at the detailed breakdown of net sales, the total has declined by 3,143 million yen in comparison to the previous term, while product sales has decreased by 3,824 million yen and sales from solution services has increased by 704 million yen. The key will be for product sales to gradually

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recover and for solution services to make a comeback like before at the same time.

Quarterly results

(millions of yen)

	(Fiscal year)	1Q	2Q	3Q	4Q
Products	2016	5465	4278	4955	5400
	2017	4639	4284	4519	4278
	2018	3512	3335	3552	3496
	2019	3270	3792	3706	4204
Solution services	2016	6807	6657	5792	5728
	2017	5755	5693	6598	6519
	2018	6499	6171	6363	6237
	2019	5803	5756	5577	5742
Internet-related	2016	314	322	316	306
	2017	302	315	305	319
	2018	300	307	304	305
	2019	296	311	298	322
Total net sales	2016	12606	11277	11100	11433
	2017	10713	10305	11440	11132
	2018	10329	9828	10235	10055
	2019	9385	9875	9594	10283
Operating income	2016	1344	789	577	692
	2017	585	595	683	1118 (788)
	2018	666	607	753	553
	2019	674	702	854	711

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

Due to declining net sales, the gross profit declined by 1,381 million yen. On the other hand, selling and administration expenses also declined by 978 million yen, so the decline in operating income reached 402 million yen. Due to the low gross profit of products, the effect of decline in sales is relatively small.

In selling and administration expenses, advertising expenses and personnel expenses declined significantly by 281 million yen and 409 million yen, respectively. The Company refrained from printing ad hoc fliers to advertise product sales, as well as hiring part-time workers to distribute those fliers. Instead, it focused its resources on providing continuous consulting services.

### Increase in net profits in the current term ended March 2020

For the term ended March 2020, the Company has reported net sales of 39,137 million yen (down 3.2% YoY), operating income of 2,941 million yen (up 14.0% YoY), ordinary income of 3,018 million yen (up 12.4% YoY), and net income of 1,718 million yen (up 10.7% YoY), which represent a decrease in net sales and an increase in profit at all levels.

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Financial ratios have improved. For example, the ordinary income to sales ratio was 7.7% (6.6% in the previous term), while ROE was 7.0% (6.6% in the previous term). The equity ratio was 76.3% (up 10.7% compared to the previous term).

The gross margin on sales also increased to 47.2% (46.1% in the previous term). The gross margin has been increasing for the last several years. The percentage of subscription-type membership fees out of total sales of solution services is steadily increasing. In addition, unlike in the past, the Company is now able to secure a certain level of profit in product sales as well.

Factors contributing to changes in profit

(millions of yen, %)

	Term ended 2019.3		Term ended 2020.3		
	Net sales	Profit margin	Net sales	Profit margin	Change
Net sales	40447		39137		-1310
Gross profit	18663	46.1	18453	47.2	-210
SG&A expenses	16083	39.8	15512	39.6	-571
Advertising expenses	749		638		-111
Salaries & allowances	5737		5296		-441
Operating income	2579	6.4	2941	7.5	+362

In the current term, gross profit declined due to a decrease in net sales. However, this was more than offset by a decrease in advertising expenses and personnel expenses (for part-time and other non-regular employees) among selling and administration expenses, which resulted in positive operating income.

In the process of business model transformation, human resources have been developed who can provide advice on the digital life plans of members (subscribers). The Company no longer promotes sales through advertisement, nor does it promote sales by increasing the number of part-time and other non-regular employees.

Meanwhile, the term ended March 2020 saw a last-minute surge in demand before the consumption tax rate hike in October, an increase in demand for replacements related to the end of support for Windows 7, and an increase in demand for PC networks to support working and learning from home in order to respond to the novel coronavirus.

As a result, product sales increased while solution service sales decreased for the first time in a while. In solution services, sales of service-inclusive products have decreased. As the Company is now in a transition period, this is no problem at all.

The Company recorded a settlement package of 300 million yen as an extraordinary loss. This is related to the use of a license from a business partner. As this is a non-recurring item, there will be no impact on future periods.

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**The current term ending March 2021 is trending flat partly due to the effects of the novel coronavirus**

In the previous term, product sales were up 7.8% year on year and solution service sales were down 9.5% year on year. In the current term, product sales for April and May were up 32.2% and 41.9% year on year, respectively, while solution service sales for the same months were down 6.9% and 3.1% year on year, respectively, on a monthly quick report basis. Partly due to the effects of the novel coronavirus, this trend is expected to continue for some time.

Continuing from the previous term, the trend will persist in the term ending March 2021. The New Lifestyle initiative to control the novel coronavirus is accelerating. Practices such as telework, working online, learning from home, and remote communications will become increasingly common. These are within the field of the Company's strengths, and the Company has been preparing for such practices for the last several years.

In the current term, the Company will be hit by the deterioration in business conditions due to the effects of the novel coronavirus. The Company will also be affected somewhat by the absence of the last-minute surge in demand that occurred during the previous term. Smartphone replacement needs have subsided. On the other hand, to achieve the non-contact type work balance to respond to the novel coronavirus, demand for PCs and tablets with online capabilities is expected to increase. As the Company has developed human resources, it is now able to allocate resources to focus on new member acquisition.

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	-3.6	-3.9	-10.5	-4.7
2020.3	-9.1	+0.5	-6.3	+2.3
<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	+8.4	-3.6	-4.3
2020.3	-10.7	-6.7	-12.3	-8.0

The Company's forecast for the term ending March 2021 indicates that net sales will stand at 37,500 million yen (down 4.2% YoY), operating income at 2,900 million yen (down 1.4% YoY), ordinary income at 3,000 million yen (down 0.6% YoY), and net income at 2,000 million yen (up 16.4% YoY). Both net sales and profit are forecasted to decline, but ordinary income will be nearly flat. While

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solution service sales will continue to decrease, personnel expenses and advertising expenses will also decrease. On balance, operating income will not decrease significantly.

### Profit will start to increase significantly in the next term ending March 2022

Personnel expenses and advertising expenses will likely continue to trend downward in the current term ending March 2021, but this trend will reverse direction considerably sometime in the second half, when a new movement to acquire new members will start in earnest.

Beginning from the next term ending March 2022, planned demand will increase and the number of new members will also increase. As a result, the profit and loss statement will clearly reflect an offensive strategy that involves an increase in net sales as well as an increase in selling and administration expenses. Sales of service-inclusive products will also increase. As the gross margin ratio will rise, operating income is expected to increase considerably.

Comparison of earnings forecasts

	2016.3	2017.3	2018.3	2019.3	2020.3	(millions of yen, %)	
						2021.3 (forecast)	2022.3 (forecast)
Net sales	51729	46417	43590	40447	39137	37500	40000
Gross profit	21715	21249	20044	18663	18453	17800	19300
Ratio to sales	42.0	45.8	46.0	46.1	47.2	47.5	48.3
SG&A expenses	17628	17846	17062	16083	15512	14900	15800
Ratio to sales	34.1	38.4	39.1	39.8	39.6	39.7	39.5
Operating income	4086	3402	2981	2579	2941	2900	3500
Ratio to sales	7.9	7.3	6.8	6.4	7.5	7.7	8.8
Ordinary income	4139	3467	3079	2685	3018	3000	3600
Ratio to sales	9.0	7.5	7.1	6.6	7.7	8.0	9.0

### Effects of Digital Life Plans to gradually become evident

The framework of the Digital Life Planner business model has been completed. Stocks of roadmaps have been accumulated as well. Team-based human resource development is ongoing. While maintaining dialogue with premium members, a team of three to five members supports recruitment activities, invites a successful candidate to join the team, and then divide itself into two teams to create a new team, in an amoeba-like manner.

In other words, the Company has put a teal (evolutionary) organization model into practice, rather than seeking to drive the organization in a conventional, top-down manner. The today's younger generation is sympathetic with this type of organization model more than others. This is a suitable mechanism for the Company to promote the business to support the GIGA initiative, which aims to provide a PC together with the telecommunication capability to every elementary and junior high school student and to utilize them for education.

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### **Aims to enter the expansion phase with the concept of *icchi soshin* (team-based value creation and innovation)**

President Nojima is telling employees that business sustainability lies where social contributions and earning power coexist. Now that human resources have been developed, the Company is about to enter a new phase in which it will put its business model into practice to achieve business growth.

The Company is ready to push forward with new business strategies by leveraging value creation as a member of a team (Works) and through the expansion of Works. President Nojima calls this "*icchi soshin* (team-based value creation and innovation)." To put it plainly, team members will be united to work together to create benefits to customers (value) and business profit (value) by bringing a new mechanism (innovation) there and putting it into practice. This requires autonomous management and ethical standards. The Company is also working on employee education to realize this.

The Company aims to enter the expansion phase in the current term ending March 2021. The Company will increase the number of teams (Works) to be able to accelerate the new subscriptions of premium members. Service sales are also expected to increase year on year, and personnel expenses and advertising expenses will increase accordingly.

### **Transition to a new business model is underway**

The net sales of 51.7 billion yen with an operating profit of 4.08 billion yen reported for the term ended March 2016 is the highest achieved in the Company's history, but under the new business model, net sales of 50 billion yen with an operating profit of 5.0 billion yen should be achievable without any new store openings.

In regard to creating future value, the Company has given priority to existing premium members. It now focuses on acquiring new members, including via introduction by way of existing members amid the acceleration of the New Lifestyle initiative.

The Company does in fact recognize a new customer also 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. The

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development of such business styles is already popular.

## 6. Evaluation: Shifting to an active approach in view of the increasing number of new members

### Priority measures

As measures for the current term, President Nojima stresses the following three points. The first measure is new member acquisition. This is supported by the fact that the necessary human resources have already been developed as well as the shift to the New Lifestyle to control coronavirus infection, which will be a tailwind for the Company.

The second measure is to strengthen recruitment because it will be easier to hire more employees since the number of job applicants is increasing. The Company is confident that newly hired employees can be trained within Works, and will strive to increase the number of Works.

The third measure is store concept innovation. While the Company has pushed ahead with the shift to Smart Life, the current era is driving the Company still further. The Company plans to establish a new concept that will encompass new fields and create a new store design to embody this concept.

### Establishing the Digital Life Planner brand

The Company secured the trademark rights to "Digital Life Planner" in May 2019. The Smart Life trademark is used as part of a store name and has been widely recognized. The Company has already initiated a shift to a future planning-style consulting business model and is in the process of developing employees working in these stores as future planning-style consultants. The Company is expected to use this tradename in its communication with customers to develop it into a brand.

If you obtain a premium membership, you become a service subscription member to pay monthly dues. Then, you are entitled to consult with the Company's consultants about any topics of digital life from anywhere. When you visit a store, a team in charge will cater to the needs of you and your whole family at the members' lounge. They will also provide you with on-site support if needed.

They will give you various lectures on easy operations, not to mention troubleshooting tips. They will respond swiftly to your maintenance and repair needs. You can purchase products and services in a planned manner after receiving advice on what to buy next. It is also important to put to effectively use any equipment that has been left unused or idle at home. You can also evaluate whether your digital assets are useful or unnecessary with their advice.

### Future business development outlook

The Company went public in 1999 and has been selling PCs. In 2006, the Company started the

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current business model based on service charges (subscription), rather than outright product selling. As the ratio of these service sales rises, the gross margin ratio has been also rising. It has risen from the initial 14% to the current 47%. The Company aims to achieve a gross margin ratio of 50%, an SG&A ratio to sales of 40%, and an operating income margin of 10% in the future. The direction to these goals is mostly clear.

The path to value creation is now visible. With sales increases by the creation of planned demand, an operating income margin of 10% and a ROE of 15% will be in sight. The Company intends to maintain shareholder returns at or around the level of 30% payout ratio.

### **Shifting the business model for the chance to win**

In human resources development, the Company is making 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.

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

In the renovation of existing stores, the Company will continue to perfect 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 is making efforts to put up new stores, provide services to customers, and renovate stores so that these needs are satisfied.

As for the development of solution-type products, the Company is striving to differentiate itself from others by providing solution-type products in which the Company's own services are combined with the products or services of other manufacturers, and it is further promoting this strategy now. Furthermore, in anticipation of changes in the IoT market, the Company will continue to develop and provide new products and services. At the same time, the Company will respond to compliance issues.

The sales mix of the Company will continue to shift to more solution services, and the content of these services will also change. The Company's business model will continue to evolve and it will strengthen its service structure to match the customers' needs more, which will result in an even more robust system than before.

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 is likely that the Company will post record profits in several years.

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The Company's major shareholders include Invesco Asset Management (Japan) Limited and Tokio Marine Asset Management Co., Ltd. They seem to hold PC DEPOT stock in the small- and mid-capitalization stock portfolios of their actively managed funds for the medium- to long-term.

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. As the transformation of its business model through human resources training is now largely within sight, we have upgraded the Company's corporate rating to A. (Please refer to the front page for an explanation of corporate ratings.)

The number of shareholders was 7,999 as of the end of March 2020, including individual shareholders and overseas investors who account for 28.0% and 13.5%, respectively, of the total shareholding. 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.

In contrast, we enhanced the shareholder special benefit for shareholders who are also premium members. An ordinary shareholder of 100 shares would be eligible for a gift certificate worth 1,000 yen in merchandise or 2,000 yen in technical service, but if they are a premium member, the gift certificate will also be good for 2,000 yen worth of merchandise purchases. This is done in a bid to entice premium members to also become shareholders of the Company.

Based on a stock price of 601 yen as of June 9, 2020, PC DEPOT has PBR of 1.20, ROE of 7.9%, and PER of 15.1, with a dividend yield of 2.2%. As the Company's business expands due to enhanced services delivered to approximately 400,000 members, an increase in new membership, and increasing net sales of solution services, ROE will exceed 10% and the stock price will be revised upwards significantly with the demand increase brought about by the cumulative effect of the planned proposals.

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