NEXT Co., Ltd. (2120)

Third Quarter Financial Results Briefing Summary for the Fiscal Year Ending March 31st, 2015

Date & Time:	Monday, February 16, 2015 5:00pm - 6:00pm
Location:	Our meeting room
Our Attendees:	Takashi Inoue, President and CEO
	Daigo Minaguchi, Managing Officer and General Manager of Corporate Management Department
	Hidekazu Fukuzawa, Corporate Communication Group Leader, Corporate Promotion Division
Attendees:	40 people

< Main Points of This Quarter >

Our efforts and investment over the past three or four years in HOME'S, our principal domestic business, have proven effective and the business is growing robustly. We have placed prime emphasis on comprehensiveness of offerings to distinguish us from other companies, with an average of 534 million listings last December, an increase of 872,000 over the previous year, so the pace of our increase is accelerating. This is a time of active investment for us, whereby we use present profits to sow the seeds for our future.

Meanwhile our overseas business, Trovit, which we acquired in October, 2014, has also been doing well. It has expanded from serving 39 countries at the time we bought it to 43 countries, so it is progressing at a high pace. Trovit becomes a consolidated subsidiary in January, 2015.

< Financial Results for the Third Quarter of the Fiscal Year Ending March 31st, 2015 >

Consolidated sales went well during the nine months to December, 2014, with a YoY increase of 13.7%, reaching ¥11,831 million. Because of investments we had planned, operating profit decreased 6.7% to ¥2,065 million.

During the nine-month period, the total number of properties listed, our main indicator, increased 11.4% to 4.69 million properties, the member agency unit fee increased 7.9% to ¥61,145, and number of member agencies rose 10.5% to 12,032 agencies—all indicative of steady growth. As a result, monthly sales and number of member agencies both hit new historical highs. In this quarter of heavy investment, we augmented our advertising as well as our responsiveness to smart devices, thereby expanding our market share of users.

Over the nine months to December, sales of Real Estate Information Services rose in double digits by 13.6%, with Rental and Real Estate Trade in particular going up 19.3%. Employees increased over the nine-month period from 570 people to 623, a rise in labor costs of 14.4%. By actively pursuing promotion of branding through television commercials, our advertising costs rose 25.8%. Operating expenses shot up 68.0% due to a survey on user experience and purchases to improve our services. Use of systems and services to respond to smart devices increased SG&A expenses by 16.3%. We are confident that we are on track with growth and that the company is developing according to plan.

In sales by service category over the nine months to December, 2014, our main business of Rental and Real Estate Trade benefitted from our search engine optimization (SEO) working well, increasing the number of visitors and queries to our website. Our sales efforts brought the number of member agencies to an all-time high, a notable year-on-year expansion of 19.3%.

As we expected at the beginning of this quarter, new houses (up 4.2%) continued to be affected by the increase in consumption tax. The number of new condominiums on the market has decreased, so our online listings for them went down by 7.5%. Turnover of homes was brisk, with our sales efforts leading to a 5.7% increase in those listings.

Custom-built houses and renovations (down 18.5%) have been affected by the tax increase, and also for renovations the timing of a change beginning October 1st, 2014, from charge per query to charge per agreement has affected our results.

In services for realtors (up 42.1%) we successfully launched a data management platform (DMP) service in July, 2014, enhancing the effectiveness of advertising costs of large-scale developers through use of our proprietary HOME'S Audience Data.

Other services for realtors (up 36.8%) include HOME'S Nursing Care, whose sales rose 40.2%.

In profit and loss by segment, Real Estate Information Services suffered a 5.8% loss due to strategic investments, as was anticipated at the beginning of the quarter. In other businesses, we continue to deepen investment in our furniture/interior EC.

The achievement rate of our projected goals going into the end of the fiscal year stands at 65%–70%, as indicated in our revised guidance. Sales are going pretty much as planned, with the achievement rate at about 70%, excluding projected sales of ¥943 million by Trovit. Sales in other businesses in the Real Estate Information Services are at a rate of 31.5% achieved, but if Trovit is excluded the achievement rate rises to the anticipated 72%. Net profit is better than expected but basically on track. Trovit has sales of ¥943 million and an operating profit of ¥368 million. Its goodwill impairment is projected to be ¥534 million for the quarter (calculated at ¥140 per euro).

The dividend will remain unchanged at ¥4.92. As in the previous year, the dividend payout is set to be 20% of consolidated net profit, but with Trovit's results and the goodwill amortization expense from acquiring Trovit excluded from the calculation. As we transition to International Financial Reporting Standards (IFRS) in the next fiscal year, we will no longer be dealing with goodwill impairment. For next year's dividend we plan to pay 20% of consolidated net profit, which will include the results of Trovit.

The third quarter balance sheet and status of goodwill are markedly affected by the acquisition of Trovit. Goodwill is ¥10.951 billion. Short-term debt is ¥7 billion. Assets are at ¥20.792 billion, with some of our savings sacrificed to make the acquisition. Current liabilities have risen due to the short-term debt incurred. Book value per share is ¥200.18 (up 10.2%).

As a result of the above, cash and equivalents at the end of this quarter have decreased by ¥5.4 billion to ¥2.9 billion. If time deposits are included cash and equivalents become ¥3.9 billion.

< Looking Back on the Third Quarter of the Fiscal Year Ending March 31st, 2015>

Properties listed and member agencies in HOME'S Rental and Real Estate Trade reached record counts. The response has been favorable, with queries to increase 25% year-on-year in January, 2015, and monthly sales ready to break the billion yen barrier for the first time.

Our main efforts have been to clearly achieve number one status in Japan through branding. Television commercials were increased by 40% over the previous year, potentially reaching 35.42 million households throughout Japan. For this year's commercials we did not rely on television personalities but rather made five different versions of our own message. We also engaged in outdoor advertising, transportation advertising, and advertising tie-ups. And all this branding promotion has been bringing in customers.

Most recently we have attempted O2O (online-to-offline) tracking. Up to now we have been able to track customers from when they start looking for real estate to when they make comparisons and inquiries online, but the hard part has been to follow them through when they arrive at brick-and-mortar locations and sign on the dotted line. We are working on tracking a customer's arrival at a location by using Yamaha's Infosound and, if the customer concludes an agreement, tracking that as well by awarding Rakuten Super Points to the customer. By including the store visit and transaction in the tracking process we hope to become able to close sales at a higher rate.

Yet another effort of ours is development of our Grid Vrick room design simulation system. With this system virtual rooms are created instantly by the placement of Lego blocks on a board, and furniture, wallpaper, and flooring can be changed on the spot. The customer can then use an Oculus Rift virtual reality headset to freely walk through the completed virtual home. The usual practice with custom-built houses or renovation has required time to prepare blueprints and construct a physical model, but the Grid Vrick system makes the whole simulation possible right there in real time. With interior design included in the virtual structure, the customer can comprehend a realistic feel of the design.

< Trovit Search > Note. Since these preliminary figures before consolidation have not been audited, they may deviate from actual values.

These are just preliminary figures, but sales for the fiscal year ending December, 2014, went up 28.3% from the previous year and EBITDA rose a solid 33.7%. In Japanese yen, sales were at ¥3.15 billion and EBITDA at ¥1.13 billion, showing high profitability and growth (calculated at ¥140 per euro). As Trovit becomes a consolidated entity in January, 2015, our monthly consolidated sales will rise by 44% year-on-year.

◆ ◆ ◆ Question & Answer Session ◆ ◆ ◆

※ For the sake of accuracy, portions of the Q&A session have been corrected or revised. To see the actual events of the day, please watch the video on our web site.

Q) I'd like to ask about future growth of the existing businesses. With considerably more property listings than your competitors you are in an expansion mode. Looking over the longer term, how far do you think you can take this? With the number of listings already so high, I'm wondering if you have much upside left.

A) We envision listing twelve million more properties. Right now we have 5.34 million properties listed, so we expect to see some two and a half times that coming up. Since we have some duplication in our current listings and perhaps will have the same rate of duplication in future listings, we might revise our future expectations a little higher. The real question comes down to knowing how many uniquely identified properties we have.

Q) You talked about higher unit fees for member agencies. A look at monthly figures makes me think it could go up to ¥100,000, but how much higher *can* it be raised in the future? I don't have a very clear picture of your various advertising allocations, either.

A) That's not very easy to answer, but consider that the current fees for member agencies handling rentals and sales is ¥60,000. The continuation of a shift from printed brochures to the internet works in our favor. How much we can raise the unit fee will depend on how much added value we can provide. If our system evolves into a medium where deals are closed at a high rate and if we provide tools to support heretofore infeasible tasks, tools to manage customers and to automatically generate web pages, then we might well become able to demand a unit fee exceeding ¥100,000.

As for your question about how much we should put into advertising to garner a given percentage of the entire market, in the case of realtors handling rentals and sales I would think we should put into advertising about 15% of the proceeds we obtain in commissions from them.

Q) Given that Trovit will be included in your consolidated results in the next fiscal year, you look to have an operating profit of ¥3.8 billion plus what you can get from the growth of your existing businesses. How do you foresee mid-term organic growth of those existing businesses? As their services earn greater recognition the proportion of advertising costs should decrease, leading to greater profitability. Do you see it that way? On another note, as property listings increase and member agency unit fees rise, how far do you think you can keep profits growing in those existing businesses?

A) With so much volatility in our results from what we have invested thus far, we do not currently have any specific mid-term projections. We expect to see about ¥18 billion in sales by the end of March, 2015. I am hoping we reach 25% in operating profitability in the future, with profit growth about tripled.

Q) You described how rentals and sales are growing, but can you talk about them separately? In the case of sales, investment properties and foreign investment involve buyers who can come back for more, as opposed to first-time buyers. Does that advantage have any traction in your business? In the same vein, as IPOs have recently increased in the area of real estate information, might your company also venture into the investment market?

A) If we compare rentals versus sales, the rental business is doing better. Rentals increased over the previous year by 22%–24%, sales by 15%. Investments, which are included in real estate sales, are not increasing at this time. I would like to see those increase. By acquiring Trovit we now have a worldwide network before us, and my idea with that is not so much to match real estate properties to individual user requests as to provide a platform for properties to be investment vehicles in the global marketplace. Investors do come back for more business and, with foreign investors flocking to make inroads into Japan and Japanese investors busy exploring possibilities in southeast Asia, we would like to be in on the action. While our priority is still to be the definitive number one portal for individual buyers, it would be nice to get into the investor field, too.

Q) Recently I have noticed a lot of advertising on vehicles where you are tied in with another company and was wondering how much you are involved in advertising tie-ups this fiscal year. Is this just a freebie cooperative chance or are you charging a fee?

A) It's just a drop in the bucket of what we do. A side option, so to speak. Not especially in our plans to reach a given sales goal. We're just cooperating with a client. And yes, we do charge a fee for that.

Q) You talked about rolling out a Japanese version of Trovit this spring. How is that coming along? Will it include ads for jobs and used cars?

A) Just as we have previously announced, we are on target to get it up and running this spring with the three categories of real estate, used cars, and job offers.

Q) I'd like to ask about how Trovit is growing. If you divide it into number of clients and unit fees, how is the growth in those two areas?

A) Unit fees are not growing very much. Paying clients are up to some 600 sites around the world. The number of paying customers is increasing gradually. The number of countries involved is increasing, as is the number of clients in them. The unit fee differs according to the country and it will take a little time for things to even out. I have heard that unit fees in Brazil and other South American countries have gone up.

Q) How will the allocation of advertising expenses in the next fiscal year compare with this year's?

A) We plan on lightening the advertising budget. Up to now we put a cap at around 30% of sales and have actively put out ads up to that limit. After three or four years, though, our name has become recognized and responsiveness to our advertisements should begin to wane, so we're going to allocate less for ads. We're thinking of reining the limit in about one percentage point each year.

Q) I imagine that in the market of newly built housing the effect of the increase in consumption tax on condominiums has died down. How has the effect been on your company? Do you expect this segment to begin to take off?

A) With the shrinking population and decrease in number of households, I don't think you should expect to see a really big growth in new condominiums. Many publicly traded developers seem to be thinking along the same lines. New housing will probably grow begrudgingly up to the year of the Olympics, but any appreciable growth beyond then looks pretty slim. I think you should be more interested in how the market for existing homes and renovations will be growing.