

NEXT Co., Ltd. (TSE1, 2120)

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Recovering from the pricing method change shock and moving towards expanding revenue

◆Financial results for the third quarter of the year ending March 31, 2012 (cumulative)

Looking at NEXT's recent business performance, sales for January 2012 grew approximately 20% from December 2011, which makes us think that an increasing number of inquiries have begun to translate into higher sales. Thus, while a number of issues still remain, we will continue to pursue our company-wide strategy. As for our overseas business expansion, concrete actions have been implemented in an increasingly more active manner.

In the third quarter of the year ending March 31, 2012, NEXT recorded a year-on-year decline in sales and profit, greatly affected by a decline in sales for the main service line "HOME'S Rental & Real Estate Trade" business, amidst lingering issues brought on by our previous pricing method change. For the third quarter under review, consolidated sales stood at 7,300 million yen (a decline of 9.8% year on year) and consolidated operating profit totaled 586 million yen (a decline of 67.1% year on year). Consolidated net profit for the third quarter amounted to 253 million yen (a decline of 78% year on year). The average number of objects posted on our website totaled a record 3,764,000 for December 2011 (an increase of 1.11 million, or 42.2%, year on year) as it continued to expand in line with our projection. As for "Lococom," the local community website service business, NEXT strived to reduce its investment costs and operate the business with minimal staffing for service provision while continuing with the business-downsizing initiative for the service line. Meanwhile, with regard to the real estate information service business "HOME'S," the Company continued its efforts to strengthen the operational platform during the quarter under review. In terms of its overseas business, NEXT launched in Thailand its real estate information website "HOME'S Thailand" in January 2012. Moreover, the Company during the quarter completed the process of taking equity participation in a Chinese company and a Taiwanese company, respectively.

As for the performance of our main business metrics, average sales per store during the third quarter under review declined by 5.5% year on year, representing a pending management issue. Because this sales decline is seemingly a result of our failure to attain the projected number of inquiries following our fee model change, we will continue to work hard to achieve an increased number of inquiries by stepping up our promotional activities. Although our previous migration to a pay-per-inquiry-based fee structure was followed by a number of our affiliated stores falling significantly at one time, the average number of affiliated stores for the quarter under review stood at 9,411 (i.e., the number of real estate agent outlets) with the number of affiliated stores totaling 9,753 as of December 31, 2011, up from the July 2011 low of 9,218,

which likely represented a recovery trend for this business metric.

With regard to operating profit, SG&A expenses during the quarter under review rose by 5.9% year on year due to our head office relocation, offsetting the benefits of our continued cost-saving efforts. Personnel costs showed a year-on-year decrease of 102 million yen, a result of the average consolidated number of employees for the quarter standing at 574 (a year-on-year decline of five), a reduction of 45 dispatch employees, and a 229 million yen year-on-year decrease in employees' bonus payments. Advertising costs for the third quarter under review rose by 398 million yen owing to the Company's listing advertising, SEO activities, and portal alliance initiative, while there was an absence of 79 million yen in cost spent in the previous quarter for implementing the "Toughest Question in History Campaign." The rise in depreciation and amortization for the quarter included a 107 million yen increase in depreciation and asset retirement-related asset depreciation caused by the head office relocation. Meanwhile, rises in other SG&A expenses included a 446 million yen increase resulting from the head office relocation. In the second quarter of the year ending March 31, 2012, NEXT recorded 113 million yen in extraordinary losses on the impairment of Lococom's software, affecting the second quarter's net profit.

As for changes in cost-to-sales ratios during the quarter under review, while the personnel costs-to-sales ratio improved compared with the same period a year ago, the overall profit margin deteriorated year on year due to cost increases brought on by higher advertising costs and by head office relocation costs. The substantial rise recorded in the ratio of cost of sales and other SG&A expenses to sales, from 26.8% in the same period a year ago to 35.7% in the quarter under review, was primarily due to the head office relocation. Increase in the advertising costs-to-sales ratio, from 18.5% in the same period a year ago to 24.3% in the quarter under review, resulted from investment activities. While the personnel costs-to-sales ratio declined from 32.7% in the same period a year ago to 32.0% in the quarter under review, this failed to offset the effects of lower sales and of head office relocation costs. As a result, operating profit for the second quarter under review amounted to 586 million yen, a decline from the 1,700 million yen recorded for the same period a year ago.

Overall sales for the third quarter under review showed a year-on-year decrease with strong sales in the "New Condominium" and "New Houses" businesses failing to offset lower sales in the "Rental & Real Estate Trade" business. A 791 million yen year-on-year decline in overall sales for the quarter under review included a 544 million yen sales decrease for the "Real Estate Information Services" (third quarter sales: 7,238 million yen). Sales for the "Rental & Real Estate Trade" in "Real Estate Information Services" recorded a year-on-year decline of 1,182 million yen while sales of the "New Condominium" and "New Houses" businesses rose by 200 million yen and 300 million yen year on year, respectively, providing certain support. Year-on-year sales gains were also posted by the "Custom-built Houses and Renovation" and "Renter's Network" businesses. These developments served to highlight issues that need to be addressed by the management.

As for the earnings status of individual segments, reduced sales, coupled with the head office relocation-induced cost increase, resulted in all segments recording a year-on-year sales decline for the

third quarter under review. In the local community services business, NEXT shifted in this quarter to a minimal staffing-based operational platform while continuing to curb its investment spending, an effort that has allowed the Company to reduce the level of its projected total full-year investment to 573 million yen compared with the original projection of approximately 800 million yen.

In February 2011, NEXT launched two new businesses, “MONEYMO,” a financial portal site service, and “eQOL Skincare,” an information services business line designed to serve the needs of atopic patients. Upfront costs for these businesses and the “property and casualty insurance agency business,” among others, grew during the third quarter under review.

◆Third quarter initiatives

In the quarter under review, the main website “HOME’S,” the real estate information services site, became Japan’s number-one website of its kind in terms of the number of objects posted. This website achieving a number-one position by a margin of about 2 million over the runner-up is a result of NEXT having migrated to a pay-per-inquiry-based fee structure, in our view. The “HOME’S” website was also ranked number one in terms of the number of unique users (the number of unique website users) while the number of its monthly users totaled 3.28 million. As of December 12, 2012, the number of downloads of the smartphone-based residential property information search application, available on the “HOME’S” website, hit the 1 million mark. This application is designed for iPhone users, Android-enabled devices, and Windows Phone. The number of such downloads has since continued to remain solid, supported by individual campaigns held after the above-mentioned achievements.

As for the overseas business, NEXT has so far set up operations in Thailand, China, and Taiwan under its medium- to long-term overseas business strategy focused on the provision of global real estate information listing services mainly in East Asia and South East Asia. It was in September 2011 that NEXT launched its local subsidiary in Thailand, followed in December 2011 by its acquisition of shares in Real Estate Mobile Inc. (REM), a Chinese company providing services to real estate business operators in China, before launching in the same month Next Property Media Holdings Limited, jointly with REM. Meanwhile, in Taiwan, NEXT subscribed for shares in Rakuya International Info. Co. Ltd., a major Taiwanese real estate information website operator, in a third-party allotment. Separately, in Thailand, NEXT established the “HOME’S Thailand” website in January 2012. The Company is currently in the process of preparing to launch a website in China in April 2012 with the cooperation of Next Property Media Holdings.

◆Status of progress against the consolidated performance forecast for the year ending March 31, 2012

Having already achieved its profit forecasts for the year ending March 31, 2012, NEXT will strive to maximize sales for the fourth quarter of the fiscal year in progress. Sales for the first nine months of the year ending March 31, 2012 reached a level equivalent to 73.4% of the full-year forecast, more or less in line with our expectations. Total SG&A expenses for the first nine months of the year in progress stood at a level equivalent to 72.4% of the full-year forecast with an increasingly more disciplined approach taken for these expenses. Operating profit of 586 million yen for the first nine months of the year ending March 31,

2012 exceeded the full-year forecast of 567 million yen. Sales by service in the third quarter under review were more or less in line with our expectations, including sales in the real estate information services business. Sales in its sub-categories continued to perform well, reaching levels more or less equivalent to 75% of the full-year expectations, respectively, during the fiscal year in progress.

With regard to the Company's plan to achieve 15.0% in the FY03/2012 dividend ratio compared with 10.0% for the year ended March 31, 2011, we now forecast a dividend cut of 4 yen for the year ending March 31, 2012 owing to a decline in sales and profits during the year. It must be noted that the amount of dividend is presented as a forecast since it is subject to change according to the amount of net profit.

◆Fourth quarter initiatives

NEXT is currently in the process of a full-scale revamp of the "HOME'S" website into the "HOME'S" information search system Version 5, named "HOME'S Zubatto Kensaku," which allows users to search information on about 3.8 million properties across different property categories all at once just by freely inputting their property preference keywords. Already advertised through TV commercials, the "HOME'S Zubatto Kensaku" website enables users to instantly find a property perfectly suitable for themselves on the basis of a cross-category search, which represents a type of service that can be made available only by NEXT. We will fully leverage this service to attain an increased number of objects posted on our website as well as an expanded number of inquiries. A 20% month-on-month sales growth for January 2012 was in line with our previous projection, and we will continue to grow sales through conducting further sales promotion and investment activities.

Q&As

May I understand that, in the year ending March 31, 2013, NEXT's earnings structure will be such that it will be capable of generating 1.7 billion yen or more in annual operating profit?

While the 20% month-on-month sales growth for January 2012, attained on the back of the pay-per-inquiry-based fee structure, represents a positive sign, NEXT will monitor further developments for February onward with due care given to potential volatility before making an assessment. With better potential business opportunities typically in store during the industry's annual peak season, we will wish to determine whether to firmly secure profits at this juncture or, rather, to further expand sales in areas that have surprised on the upside by investing in relevant sales promotional activities, while seeking to strike a good balance between these potential steps. Based on this thinking, we have not made any changes to our consolidated business forecast for the year ending March 31, 2012.

How do you see the current state of the Chinese market? What is your forecast of the Chinese market with regard to its size and NEXT's business development potential there?

China already has an enormous real estate market with the number of new condominium construction starts/supplies standing at a level 20 to 30 times larger than that in Japan, according to experts. Despite the Chinese government's certain anti-bubble regulatory tightening efforts, long-term housing demand has continued to remain solid. Given the persistent shortages of housing of a certain level of quality for citizens migrating from agricultural areas to urban areas, we expect to see a continuation of strong new construction starts particularly in the country's inland regions. It must be noted that a certain portion of newly supplied

properties will eventually end up being put on the previously owned real estate market and the rental market. Although China's rental real estate market has so far been dominated by high-end rental properties designed for a small group of foreign businesses, we anticipate substantial growth of the rental market for ordinary Chinese citizens in the coming years. Based on this understanding, we are considering devising a strategy of establishing a strong position early in the fast-growing previously owned and rental real estate markets in the country.

How has the response rate improved? What will be its contribution to revenue?

This is an area where we have been confronted with serious challenges. Conversion rate (CVR) typically refers to the number of persons per 100 site visitors who ultimately make an inquiry in connection with the ultimate action. Based on the view that there was potential room for improvement in the premature site user withdrawal rate, NEXT continued to retune its website, in turn achieving a predominant proportion of the targeted improvement. With a superior level of CVR having already been achieved, we started in the second half of the current fiscal year a strategy of generating new inquiries at an enhanced CVR achieved through an increased number of unique users (entry point population), particularly focusing on the annual peak season. It appears that these efforts have begun to produce synergistic effects. Meanwhile, advertising through TV commercials, one of the steps taken under this strategy, should meaningfully facilitate our efforts to acquire a higher number of unique users. We believe the recent strength of our performance is a result of our previous initiatives relating to website revamping and online service and branding, coupled with our success in demonstrating the appeal of these service features to users.

What are the costs you spent on promotional efforts? What will be the actual benefits of the investment?

Although the benefits of online media-based promotional efforts can be calculated in detail, it is difficult to forecast the actual benefits of promotions conducted through the mass media and branding media. While these promotional efforts can bring about a certain level of benefits, any exposure-enhancing benefits beyond that level seem to be fairly limited, based on our general analysis involving a check of individual areas and of broadcasted and non-broadcasted areas, respectively. Thus, we are seeking to strike an optimal balance for these initiatives while paying attention to the potential timing of benefits peaking out.

What is the ultimate goal for the "Lococom" business?

There is a consensus among IT industry professionals, both in Japan and the US, that consumers' O2O (on-line to off-line) trend, a trend of checking a product/service online before visiting a non-virtual store or event venue, will eventually come to constitute an enormous market exceeding in size the conventional online shopping search market. Still, we have been unable to determine when the trend will reach its tipping point. Industry players such as eBay have already started to make aggressive big money acquisitions of O2O business operators while Facebook has been continuing to put its resources into check-in and face-to-face services, types of services with strong local-based features, with similar steps being taken by Google. Although these moves will likely accelerate further in the coming years, NEXT intends to wait for the expected O2O trend tipping point while continuing to spend a minimal level of relevant costs, based on our company-wide consensus that making a continued major investment is currently difficult for the

Company given the level of its corporate resources. The "Lococom" operations will be downsized to an eight-strong-team level as of April 1, 2012. What has enabled us to achieve this downsizing has been our previous migration to a business model that allows us to steadily develop our business at a stable pace and in a trouble-free manner, following the initiative conducted throughout the year ended March 31, 2011 that had been designed to effect a major business model change as well as relevant IT system revamps.

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