NEXT Co., Ltd. (TSE1, 2120)

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Seeking to generate higher income by attaining an increased number of properties posted and improving the matching ratio

◆Affiliated stores steadily recovering in number

In the year ended March 31, 2012, NEXT recorded a year-on-year decline in sales and profit as a result of lower sales for the "HOME'S Rental & Real Estate Trade" business and increased costs due to our head office relocation. For the year under review, consolidated sales amounted to 10,319 million yen (a decrease of 3.9% year on year), operating profit stood at 952 million yen (a decrease of 45.6%) and net profit at 465 million yen (a decrease of 57.9%). Although the number of objects posted on our website continued to perform well during the year, averaging 3.61 million for March 2012 (an increase of 0.69 million), the number of inquiries remained weak with average sales per store standing at the 52,000 yen level (a decrease of 3.9%) for the year under review. While the number of affiliated stores recovered to 9,926 (an increase of 363) following a period of decline due to the change in the pricing method, it still has a long way to go to attain a full-scale recovery.

During the year under review, SG&A expenses rose 3.6% year on year. Personnel costs amounted to 3,186 million yen (a decrease of 321 million yen year on year), an improvement over the level of a year ago. Advertising costs continued to grow as in preceding years, totaling 2,735 million yen (an increase of 274 million yen), which was due mainly to an increase of 395 million yen in website customer drawing costs and an increase of 167 million yen in TV commercial-related costs, an increase aimed at branding promotion. Depreciation and amortization rose to 479 million yen for the year under review (an increase of 112 million yen) due to depreciation and amortization arising from the head office relocation as well as to higher asset retirement obligations. Other SG&A expenses grew to 2,433 million yen (an increase of 404 million yen). Their breakdown shows an increase of 601 million yen due to the head office relocation, a decrease of 102 million yen due to lower employee recruitment costs and an increase of 44 million yen in research and development costs. Under extraordinary loss, the Company recorded 113 million yen in loss on impairment of software for the "Lococom" services.

As for the proportion of costs to net sales, cost of sales and other SG&A expenses rose to 33.4% of net sales for the year under review (a gain of 5.3 percentage points compared with a year ago) owing to higher rent resulting from the head office relocation. Advertising costs constituted 26.5% of net sales (a gain of 3.6 percentage points compared with a year ago). The personnel costs to sales ratio declined to 30.9% from 32.7% a year ago. For the year under review, operating margin fell to 9.2% from 16.3% a year ago with net sales not growing to offset higher costs.

◆Sales recovery for "HOME'S Rental & Real Estate Trade" slow in coming

A look at the sales breakdown for the real estate information services, the main service line, shows that the "HOME'S Rental & Real Estate Trade" business for the year under review posted a sales decline of 1,139 million yen year on year following a shift from the pay-per-posting-based fee structure to the pay-per-inquiry-based fee structure. Challenges were experienced by the sales promotion efforts made in the "HOME'S Rental & Real Estate Trade" business during the first half of the year under review. Although a double-digit growth was achieved by New Condominium, New Houses, Custom Built House and renovation, Renter's Network and Others ("HOME'S Estimation for Relocation" and "HOME'S Elderly Care Service"), these businesses failed to offset the weakness of the "HOME'S Rental & Real Estate Trade" business, resulting in the overall real estate information services business recording a year-on-year sales decline for the year under review. New Houses showed a particularly high growth rate during the year with sales expanding by 41.2% year on year while the number of properties posted on our website and the number of affiliated stores grew by 28.3% and 14.5% year on year, respectively. As for the "Others" category, the "HOME'S Estimation for Relocation" business attained 95 million yen in increased sales compared with the year ended March 31, 2011.

Looking at the profit and loss by segment, all business segments suffered a profit decline for the year under review due to lower sales and a head office relocation-induced rise in costs. The real estate information services recorded 1,912 million yen in operating profit while the local information services posted 633 million yen in loss. In the first half of the year under review, the Company made a change to the service business model for the local information services, coupled with an initiative to expand staffing and various sales promotion programs towards achieving profitability. In the second half of the year, however, based on the view that achieving profitability for this segment would take a certain period of time, we started to focus our efforts on reducing costs for this business category in a shift to a strategy of pursuing operations with minimum staffing. For the year ending March 31, 2013, the Company will seek to reduce the loss for this segment to approximately 100 million yen.

With regard to the consolidated balance sheets, net asset per share as of March 31, 2012 was 4.4% higher than the level of a year ago as the Company continued to remain free of interest-bearing debt. The balance of investment securities as of March 31, 2012 showed a year-on-year gain of 333 million yen, reflecting our acquisitions during the year under review of shares in Chinese companies, Real Estate Mobile Inc. and Next Property Media Holdings Limited as well as in Taiwanese company, Rakuya Inc. These share acquisitions were made with the aim of developing our overseas business. As for goodwill amortization, the Company completed amortization of goodwill for former Willnic Co., Ltd. in the year under review.

A look at cash flows shows that the balance of cash and cash equivalents as of March 31, 2012 stood at 3,413 million yen. If time deposits had been included, the total balance of cash and cash equivalents would have amounted to 5,413 million yen as of March 31, 2012. Cash flows from operating activities totaled 1,512 million yen for the year under review (a year-on-year increase of 852 million yen).

◆Launched a real estate information website in Beijing and Shanghai, China

As part of our initiatives for the Three Months ended March 31, 2012, we implemented cross-media sales promotion efforts in the real estate information services business. Among these efforts was the running during the quarter of a TV commercial that featured the comedy duo “Heisei Nobushi Kobushi.” This TV commercial went down well with TV viewers, which served to help raise the profile of our brand and to facilitate our user acquisition initiative. This TV commercial airing was accompanied by the implementation of our cross-media promotion activities involving the simultaneous use of other types of media, a move intended to demonstrate the same service appeals efficiently. Thanks to these efforts, monthly sales began to show a year-on-year pickup starting from February 2012.

In April 2012, the Smartphone Site Usability Survey conducted by a third-party entity ranked the “HOME’S” website number one due to its website clarity, making “HOME’S” the top-ranked site in three categories consisting of website clarity, the number of properties posted and site visitor counts. The number of properties posted on the “HOME’S” website is more than twice that of the second-ranked site in this category. Meanwhile, site visitor count data show the “HOME’S” website run by NEXT is visited by 3.87 million users in comparison to 3.24 million visitors for the second-placed “suumo” run by Recruit. While the third-ranked “Infoseek Real Estate” of Rakuten is visited by 2.04 million users, this website contains the property information of the “HOME’S” website, meaning that “HOME’S” is effectively visited by 5.91 million users in total. Marking the winning of top site rankings in three categories, we are now in the process of implementing the “Triple Chance! HOME’S Property Search/Relocation Support Campaign,” which will run until July 2012 for the purpose of assisting affiliated stores in drawing customers from April onwards, a post-peak moving season.

As for the progress for our overseas business development, NEXT took an equity participation in an Indonesian company following on from doing so in Thai, Chinese and Taiwanese companies in an effort to lay the groundwork for making “HOME’S” a global brand. In April 2012, we launched the real estate information website “homescn.com” (China version of “HOME’S”) in Beijing and Shanghai, China. Meanwhile, in the same month, we made Indonesian company PT. Rumah Media our subsidiary.

The number of properties posted on the “homescn.com” website stood at 1 million as of April 2012. We seek to attain by the end of fiscal 2012 as many as 2.25 million in the number of properties posted on this website with a view to generating annual sales of 3.0 billion yen to 4.0 billion yen in fiscal 2014. Indonesian company PT. Rumah Media is a joint venture 50% owned by NEXT and the other 50% owned by PT. Corfina Mitrakreasi. We will launch in May 2012 real estate concierge services for Japanese nationals living in Indonesia while continuing our preparations for launching a new website in the country in September 2012. The fiscal 2014 sales target for this Indonesian joint venture is 30 million yen to 40 million yen.

◆In Japan: Prioritize the enhancement of the “HOME’S” website

Consolidated sales for the year ending March 31, 2013 are forecast at 10,332 million yen (a year-on-year increase of 0.1%). This forecast was made on a conservative basis in consideration of the high business volatility involved in the pay-per-inquiry-based fee structure. Another point to note is that we did not factor into this forecast the potential sales expansion resulting from our branding enhancement efforts. As for sales by segment, sales for the real estate information services are expected to remain flat year on year while sales for the local information services and “Others” are likely to post year-on-year growth, respectively. Operating profit for the year ending March 31, 2013 is forecast at 535 million yen. Advertising costs are expected to increase due to the implementation of our branding enhancement programs. Net profit for the year ending March 31, 2013 is projected at 215 million yen. We factored into this forecast 90 million yen in loss on equity method investment in overseas affiliates under non-operating expenses.

Cost of sales for the year ending March 31, 2013 is forecast to grow by 62 million yen compared with the year ended March 31, 2012 owing to increased production costs for special feature web page contents relating to condominiums and new houses. As for SG&A expenses, personnel expenses are likely to decline by 117 million yen year on year due to the Company’s efforts to achieve improved productivity. Advertising costs for the year ending March 31, 2013 are projected to increase by 393 million yen year on year. Operating expenses are expected to rise by 103 million yen due partly to higher real estate information service campaign costs. As a result, operating margin is forecast at 5.2% for the year ending March 31, 2013.

While we expect to pay 1.70 yen in dividend per share for the year ending March 31, 2013 in consideration of the projected profit decline, the actual payment will be subject to change according to the level of consolidated net profit, on the basis of the dividend payout ratio of 15% or so.

Our number one priority for the year ending March 31, 2013 is to enhance the “HOME’S” website in Japan. The number two priority is to develop our overseas business while the number three priority is to achieve profitability for our new domestic businesses. The pillar of our medium-term business development strategy is to strive to become a global company under the philosophy of “DB plus CCS.” We will seek to develop our domestic and overseas databases (DBs) containing not only housing information but also local area information and other types of information, thereby delivering communication-based services as well as concierge services (CCSs).

Our business growth scenario for the “HOME’S” website is based on the expanding of the affiliated store membership and the implementing of up-selling. Through the efforts to broaden the scope of our affiliated stores and stimulate the user’s website use frequency, we wish to achieve an increased number of properties posted. Moreover, we will engage in measures for attracting users to the website, including branding promotion enhancement programs. At the same time, we will seek to attain higher matching rates and an increased number of inquiries, thereby achieving expanded sales.

◆Integrate Asian real estate information

NEXT will strive to efficiently achieve an increased number of properties posted, driven by function-based marketing business units. Our specialized teams will perform their new affiliated store prospecting activities for promoting new enrollment. At the same time, we will seek to broaden our affiliated store network in rural areas by using proxy marketing services. We will provide our existing affiliated stores with consulting-based marketing services through regular visits as well as telephone calls. Also implemented will be up-selling activities towards such affiliated stores, coupled with the effort to curb affiliated store membership withdrawals.

In order to draw more visitors to the “HOME’S” website, NEXT will seek to raise its profile through implementing SEM/SEO measures, non-virtual events, campaigns, smartphone-targeted promotion programs, sponsoring activities and social media-related initiatives. Moreover, we will strive to enhance the branding for the “HOME’S” website by utilizing TV commercial and display advertisements. As the steps towards accomplishing higher matching rates (CCS enhancement), we will develop smart device-related services, roll out recommendation engines and enhance the site contents while upgrading the functions to facilitate communication between the website user and the real estate company.

As for its overseas business, NEXT aims to provide multi-language-search-based comprehensive information site services, supported by an integrated Asian real estate information database. The priority points for our overseas strategy are composed of property comprehensiveness and the provision of borderless multi-language concierge services. It is our wish to integrate diverse real estate information into one single database and make available a multi-language common platform that allows the user to search Asian real estate information from any location in the world.

In the coming months, we intend to put on a stable footing of our business in the countries we have already expanded into while considering in earnest what countries to expand into, going forward. The list of prospective names would include India, a country with a huge market, as well as Vietnam and the Philippines, nations offering a prospect of strong growth for the future.

◆Q&As◆

It appears that momentum for the number of properties posted on your website and sales for March 2012 weakened compared with February 2012. I suspect March is normally a stronger month. What is the normal trend?

Please note that, as a general seasonal trend, the momentum begins to moderate starting from the middle of March.

You stated that volatility is high for the “HOME’S Rental & Real Estate Trade” business. Did volatility and risks for your business increase after you shifted to the pay-per-inquiry-based fee structure?

Under the pay-per-posting-based fee structure previously employed, our sales level did not fluctuate according to the changing number of website user inquiries. On the other hand, under the pay-per-inquiry-based fee structure currently in place, it is the number of inquiries that needs to grow in order for our sales to expand, while the increase in the number of properties posted does not translate into higher sales. This means our sales are now dependent on the ups and downs in the number of inquiries.

This has made it more difficult for us to forecast our future sales with business volatility levels risen, which is why we devised our business forecast on the basis of conservative trial calculations.

The pay-per-posting-based fee structure, albeit offering a prospect of stable business growth, will not allow NEXT to achieve a drastic growth. In our view, the key for us to attain a significant earnings growth in the coming years is to continue to step up our sales promotion efforts while adhering to the existing pay-per-inquiry-based fee structure.

Did you observe any change in website users' perception of, and their action concerning, rental condominiums after the Great East Japan Earthquake?

It was for a period of about one month to one month and a half after the earthquake that our business was affected to any degree. Such period was followed by a period of rapid business recovery to ordinary year levels. While circumstances differed slightly from one regional market to another, it was then the new house market segment that experienced a rather long period of the earthquake's aftereffects. As we recall, demand for rental properties in the Tohoku region was found to be relatively strong with many Tohoku residents relocating within the region.

My question concerns your China business. Could you tell us about your fiscal 2012 sales and operating profit targets for the China business, or the expected operating margin to be attained for the China business in the event of your China sales growing to 3.0 billion yen to 4.0 billion yen levels in fiscal 2014?

We forecast our fiscal 2012 China sales at several tens of millions of yen or so. The projected 90 million yen in loss on equity method investment (Note on Page 20) is associated with our China business. This projection is based on our assumption that the local affiliate in the country will incur a little less than 200 million yen in loss.

In the event of our China sales growing to 3.0 billion yen to 4.0 billion yen levels, the operating margin for the business would be on par with our current domestic business operating margin of 20% to 30%.

(Referring to Page 44) I note that overall sales failed to grow despite the higher number of affiliated stores and increased sales per store. Why is that?

An increase in the number of affiliated stores brings in revenue of 10,000 yen per store in monthly base membership fees, contributing to higher sales in a fixed manner. Thus, we will continue the effort to acquire new affiliated stores and curb membership withdrawals.

Our shift to the pay-per-inquiry-based fee structure has resulted in the number of properties posted on our website continuing to grow in line with our expectations, supporting our differentiation strategy based on our overwhelming superiority over rivals in terms of the number of property postings. It must be noted here that, even with a rising number of properties posted and affiliated stores, sales do not grow unless the number of inquiries to such stores likewise expands. Starting from the first half of the year under review, we began to implement various measures aimed at achieving an increased number of inquiries, which allowed us to finally achieve certain results in the second half of the year.

In the fourth quarter of the year ended March 2012, sales for the main service line real estate information services showed a year-on-year growth. Was it attributable to the positive effects of the TV commercial alone? I would like to have your view on this point.

Achieving a year-on-year sales growth for the fourth quarter gave us increased self-confidence. This achievement was a result of our continued efforts consisting not only of the TV commercial airing but also of other efforts. The running of the TV commercial is essentially intended to serve as a step to generate synergistic effects for different activities performed by the Company. As a matter of fact, the airing of the TV commercial resulted in CPA unit price levels declining and the number of UUs increasing, an achievement accomplished thanks to the combined effects of the TV commercial and various other initiatives, including other web-based advertising programs, SEO measures, campaigns. Sale for April will be made public on May 21 through our regular monthly report.

I understand the pay-per-inquiry-based fee structure entails high business volatility for NEXT. Having said that, your firm's recent conditions suggest a rise in the number of properties posted has come to lead higher sales. Is it premature to conclude that way?

Our business performance has been improving of late, yet our earnings forecast for the year ending March 31 was made on a conservative basis without factoring into the sales forecast the potential benefits from the advertising cost expansion of 400 million yen for this fiscal year in comparison.

My understanding concerning the sales growth cycle is that the key to growing sales is to attain an increased number of inquiries. Yet I am not quite sure why achieving an increased number of affiliated stores serves to be the starting point for the sales growth cycle. Could you please tell me why?

We intend to expand our affiliated store network given that we still have the potential of prospecting and acquiring new affiliated stores and that our income is helped by the receiving of the base monthly fee of 10,000 yen per store from those affiliated stores. Our strategy of first putting our business on a firm footing in Japan remains intact. Currently, our coverage rate is high for urban area properties but is low for rural area properties. Thus, we wish to continue to pursue our business efficiently.

I understand the "HOME'S" website was ranked top in terms of the number of properties posted, site visitor counts and usability. Yet I am not sure why the top ranking in usability is important. Could you please tell me why?

Please note that site usability serves as an appeal for the website user. We intend to demonstrate to the user our website's appeal of being ranked top in the number of properties posted, site visitor counts and superior site usability. While the "HOME'S" website's latest top ranking in site usability was attained concerning smartphone-related service, it had been ranked top in the same category in the past also in terms of PC-based rental property information service, PC-based previously-owned property trading information service and mobile device-based real estate information service in a survey conducted by Gomez Consulting Co., Ltd. (Morningstar Japan K.K.).

Unlike its top rank position in the number of properties posted, the "HOME'S" website's top rank position in site visitor counts is not an overwhelming one with the 2nd-ranked website trailing it by a seemingly small margin. So it would be desirable for "HOME'S" to extend its lead over the 2nd-ranked site. What do you think about that?

We wish to extend our lead further. Extending the lead will require us to enhance the branding for the website, so we will continue to make branding-related investment for the year ending March 31, 2012. Google's AdWords advertisement does not allow us to efficiently demonstrate our superior position in the number of properties posted. Thus, as a means of demonstrating our appeal to the user, we will use branding advertising vehicles like the TV commercial that are suitable for communicating our message, thereby extending our lead over the second-ranked player.

During your second quarter financial results presentation meeting, you expressed skepticism about the benefits of airing the TV commercial alongside other major advertisers like Recruit that continue to run a massive number of TV commercials on the back of their big advertising budgets. The strategy you outlined at that presentation meeting was the strategy of achieving improved website usability as the top player in the number of properties posted, based on the view that offering such superior usability will serve to naturally draw website users. In that respect, please clarify if you have changed your strategic policy.

As you said just now, under the policy we had originally adopted, we had sought to achieve high levels of website service differentiation through our information quantity-based overwhelming superiority, which we had aimed to attain by changing our pricing method, a move that actually resulted in a jump in the number of properties posted. Although we had thought such information quantity-based superiority would naturally serve to draw more users, the number UUs and inquiries failed to increase. That was why we altered our original policy.

We concluded that in the near term priority must be given to improving our CVR level over attaining an increased number of UUs. Accordingly, we adopted a new policy under which our website was revamped in the first half of fiscal 2011, followed by the implementation of a branding enhancement initiative in the second half (busy season), based on certain effects of the site renovation. This initiative was intended to demonstrate directly to users that the "HOME'S" website was ranked top in the number of properties posted. As the TV commercials we had aired on two or three occasions in the past had failed to bring about any positive results for us, we decided to take during the second half a different approach of creating a commercial that strongly focused on our service appeals, an approach that produced positive results that time round.

My question concerns cost effectiveness. A big difference between the third quarter and the fourth quarter seems to lie in the amount of advertising costs spent. Although sales for the fourth quarter rose significantly quarter on quarter, operating profit looks more or less flat compared with the third quarter. I would like to have your view on this situation from the standpoint of cost effectiveness.

We are continuing to make investment while seeking to control SG&A expenses with due regard to CPA and per-unit sales value. Our latest branding enhancement initiative gave priority to helping attain an increased number of inquiries over helping achieve higher profits. It was through such approach that we accomplished positive results.

We have no intention of continuing to run the TV commercial throughout fiscal 2012. We are planning to air the commercial at such timing as would lead to positive results.

For the year ended March 31, 2012, the number of properties posted grew by 36% to 37% compared with the year ended March 31, 2011. May I have your rough forecast on the growth rate for the year ending March 31, 2013?

Previously, growth in the number of properties posted had been driven by our efforts to incorporate in our information offerings of property information not listed by our existing affiliated stores, helped by the addition of new property information resulting from business launches of major real estate brokers' franchisees. Although the double-digit growth rate will be maintained, the growth rate for the number of properties posted is expected to slow down in the coming months since our initiative to raise the number of properties posted will be increasingly driven by our efforts to attain an increase in the number of affiliated stores.

(Tokyo, May 11, 2012)