NEXT Co., Ltd. (TSE1, 2120)

Takashi Inoue
President and CEO
NEXT Co., Ltd.

Income far exceeded our full-year forecast thanks to strong business performance

◆ Achieved differentiation from our competitors in the number of online property listings

The operating environment for the Japanese real estate industry has been showing improvement. In terms of the medium- to long-term industry outlook, we anticipate a last-minute surge in demand will occur prior to the planned consumption tax hikes with property buyers paying more attention to existing housing stock properties such as previously-owned and renovated properties than to newly-built ones. In such an environment, NEXT continued to review and revise its cost structure and strategies following on from the year ended March 31, 2012, and achieved a recovery in our operations in the first half of the year ending March 31, 2013 in line with our expectations.

For the 2nd quarter of the year ending March 31, 2013, NEXT achieved growth in sales and income due to the favorable performance of the real estate information services business. Consolidated sales for the quarter under review stood at 2,763 million yen, an increase of 12.2% year on year. Operating profit for the quarter amounted to 420 million yen, an increase of 63.3% year on year. Net income for the second quarter totaled 228 million yen, an increase of 166.5% year on year, exceeding our business forecast by a wide margin. The number of quarterly property listings averaged 3.93 million for September 2012, a robust growth of 660,000 year on year, pointing to the Company continuing to show differentiation from its competitors in the number of online property listings. The number of affiliated stores also grew to 9,808 as of September 30, 2012, a gain of 326 year on year.

During the quarter under review, SG&A expenses increased 5.9% year on year as advertising costs rose due to our aggressive branding promotion activities, offsetting the higher productivity-induced improvement in personnel costs. As for the proportion of costs to sales, the cost-of-sales and other SG&A-expenses ratio to sales for the quarter under review stood at 30.4%, down from 35.6% for the same quarter a year ago. The personnel-costs to sales ratio was 26.9% for the quarter, down from 30.1% for the same quarter a year ago. Meanwhile, although the advertising-costs to sales ratio increased to 27.4% for the quarter, compared with 23.9% for the same quarter a year ago, higher sales resulted in the operating profit margin recovering to 15.2% for the quarter under review, up from the 10.5% posted for the same quarter a year ago.

In terms of sales by service line, NEXT achieved year-on-year sales growth for all its service lines for the quarter under review, with the exception of the local information services business. The “HOME'S Rental & Real Estate Trade” business in the real estate information services business registered 1,491 million yen in sales for the quarter, a year-on-year increase of 85 million yen or 6.1% as the numbers of online property postings and affiliated stores grew as a result of the organizational realignment program implemented as part of our marketing initiative. Also contributing to the sales growth for the “HOME'S Rental & Real Estate Trade” business were the gains in site visitor count and in the number of inquiries that were attained, respectively, thanks to our aggressive branding promotion activities. The New Houses business posted 447 million yen in sales for the quarter, a year-on-year increase of 111 million yen or 33.2%. On a cumulative basis, sales for this business line totaled 875 million yen for the April-to-September 2012 period, an increase of 36.8% year on year, helping improve the Company's overall financial results. The Custom-Built House and Refurbishment business, albeit still small in scale, recorded 388 million yen in sales for the same six-month period on a cumulative basis, representing a year-on-year increase of 45.7%, as this business line continued to grow steadily.

As for profit and loss by segment, significant profit improvements were made by the local information services business and the “Others” business for the quarter under review. The local information services business posted 39 million yen in operating loss for the quarter compared with an operating loss of 214 million yen for the same quarter a year ago. The “Others” business recorded 53 million yen in operating loss for the quarter under review in comparison to an operating loss of 111 million yen for the same quarter a year ago. A marked decrease in operating losses for these business units was instrumental in NEXT achieving improved overall profitability. The real estate information services business for the quarter under review showed a decline in operating profit, which was attributable to the aggressive branding promotion initiative implemented by the Company during the quarter.

◆Interest-bearing debt maintained at the zero level

With regard to the consolidated balance sheets, NEXT maintained interest-bearing debt at the zero level as of September 30 2012. Net assets stood at 8,940 million yen as of September 30, 2012, representing an increase from March 31, 2012. Meanwhile, net assets per share as of September 30, 2012 amounted to 476.02 yen, an increase of 5.3% from March 31, 2012. As for the status of goodwill, the Company amortized the goodwill of the former Littel Co., Ltd., currently NEXT's recommendation engine research and development business unit, and of overseas subsidiary Next Property Media.

A look at the consolidated cash flow statement shows that cash flows from operating activities for the quarter under review stood at 978 million yen, an increase of 382 million yen year on year. The balance of cash and cash equivalents amounted to 4,112 million yen for the quarter. If time deposits of three months or more of approximately 2,000 million yen had been included, the total balance of cash and cash equivalents would have amounted to 6,114 million yen as of September 30, 2012.

Sales for the six months ended September 30, 2012 stood at 5,500 million yen compared with 4,820 million yen for the same period a year ago. Operating income for the six months ended September 30, 2012 amounted to 942 million yen in comparison to 251 million yen for the same period a year ago, and net income for the six months ended September 30, 2012 totaled 525 million yen compared with 74 million yen for the same period a year ago. The Company's actual financial results for the six months ended September 30, 2012 far exceeded its business forecast for the first half of FY 03/2013 released on August 7, 2012 with sales coming in above forecast by 2.4%, operating profit by 52.8% and net income by 62.2%, respectively. In terms of sales by service line, the real estate information services business registered 5,445 million yen in sales for the six months ended September 30, 2012, above forecast by 135 million yen. For the same six-month period, sales for the Rental & Real Estate Trade business exceeded forecast by 56 million yen, while sales for the New Houses business and the Custom-built House and Refurbishment business came in above forecast by 23 million yen and by 5 million yen, respectively, pointing to favorable growth registered by these businesses.

As for the highlights of the financial results for the second quarter of the year ending March 31, 2013, NEXT continued to show growing numbers of affiliated stores and online property postings. For September 2012, the number of properties posted online rose by 20.4% compared with the same month a year ago. The best way for NEXT to make the strongest impression on website users is to demonstrate the "HOME'S" website's appeal as the top Japanese real estate information site in the number of property listings. It is based on this conviction that we will continue to work hard to attain an increased number of online property postings in the coming months. A rising trend started for the number of affiliated stores with a 3.4% year-on-year gain posted for September 2012, supported by the Company's newly-developed system to provide close-at-hand follow-up support to targeted website users.

The second highlight for the quarter under review was that NEXT carried out, during the period, a large-scale branding promotion initiative across the country. Specifically, in order to raise the profile of the "HOME'S" site and promote its use, we ran TV commercials, in-train hanging advertisements and special campaigns as part of the branding promotion initiative designed to demonstrate the appeal of the "HOME'S" website as "the top Japanese real estate information site in the number of property listings." This resulted in the Company achieving an expanded number of inquiries during the quarter. We witnessed a rising number of positive social media responses expressing the fondness of the commercial and noting the strong impression it left on TV watchers. A website user questionnaire survey carried out by the Company allowed us to confirm that website users were being made aware of the appeal of the "HOME's" site as "the top Japanese real estate information site in the number of property listings." Since August 15, 2012, the day on which NEXT's branding promotion initiative was launched, we experienced a fast-growing level of sales for HOME'S Rental & Real Estate Trade business, which for September 2012 posted a 10.1% year-on-year growth.

◆Leaving the conservative FY 03/2013 business forecast unchanged

NEXT will leave unchanged the conservative business forecast for the year ending March 31, 2013 until the effects of its branding promotion initiative and of the site renovation-based SEO (Search Engine Optimization) are identified. The Company renovated the "HOME'S" real estate trade site on October 1, 2012 and its real estate rental site on November 1, 2012. Yet it is generally believed in the internet service industry that a major site renovation implemented can potentially cause the site's SEO effects to decrease by 20% to 30% for a certain period of time (two to three months). Although positive effects have been continuing to be generated recently, we need to monitor the situation for a period of at least two to three months to identify the effects of the renovation in question. If the SEO effects are found to have weakened, NEXT will spend additional advertising costs for the purpose of supporting its financial results. While the additional advertising cost spending for the third quarter of the year ending March 31, 2012 has already been factored into the Company's business forecast for the year, we may not need to spend such additional costs, depending on the status of the SEO effects. We have factored in the costs for the branding promotion initiative slated for the coming annual peak season, the fourth quarter of the year ending March 31, 2013, yet we have not factored the potential sales expansion effect into our business forecast.

Sales for the year ending March 31, 2013 are forecast at 10,332 million yen, an amount exceeding the sales for the six months ended September 30, 2012 (53.2% of the full-year sales forecast) by 4,832 million yen. Personnel costs for the full-year are projected at 3,068 million yen, 49.4% of which were expended in the six months ended September 30, 2012. Advertising costs amounted to 1,386 million yen for the six-month period, and they are anticipated to total 3,129 million yen for the year ending March 31, 2013 under our projection. The Company spent 44.3% of this amount for the six-month period, and has added to the amount of costs to be used in the event of an emergency during the six months ending March 31, 2013. Operating profit for the full-year is forecast at 535 million yen, an amount already exceeded by the operating profit for the six months ended September 30, 2012, an amount representing 176% of the full-year forecast. We decided, however, to leave unchanged our business forecast for the year ending March 31, 2013 in view of the possibility of sales not rising as expected despite the cost spending for the second half of the year. It should be by the end of January 2013 that we will be able to identify the effects of the portal site renovation discussed earlier.

In terms of sales by service line, all types of services of the real estate information services business continued to show strong sales for the six months ended September 2013, exceeding in the period 50% of the sales that are forecast for the year ending March 31, 2013.

◆The first full overhaul of the “HOME'S” website in 10 years

Among our initiatives planned for the second half of the year ending March 31, 2013 in the real estate information services business are the full overhaul of the “HOME'S” website for the Rental & Real Estate Trade business and the holding of the HOME'S EXPO, an event aimed at helping NEXT step up the relationship with affiliated stores. We will continue to organize large-scale branding promotion programs in the coming years. Meanwhile, as for the overseas operations, the Company launched in Indonesia a real estate information website designed for local website users. Moreover, we launched in Thailand another real estate information website intended to cater for the needs of Japanese expatriates living in the country.

The above-mentioned website revamp constituted the first total overhaul of the “HOME'S” website in 10 years that covered areas ranging from base infrastructure to application layer. This overhaul was designed to enable the SEO effect to be maximized through site integration and to allow the website's user reach to be enhanced through an introduction of cross-search function, a function that allows the website visitor to search for properties across all categories. In addition, the overhaul was aimed at raising NEXT's brand profile through a design unification process and at improving the matching rate by enhancing website usability.

For an online service firm, it is a challenging step to implement a full overhaul of a 10-year old large-scale system in order to transform it into a platform equipped to serve next generation needs. Although this overhaul process involved certain levels of change-related risks, developments so far have been favorable.

The last fiscal year's HOME'S EXPO was held in Tokyo alone. Given the positive review received from guests then, NEXT will organize the event this fiscal year in Tokyo and Osaka. Attended by over 300 guests, the HOME'S EXPO held in Osaka on November 6 proved to be a successful event. In Part 2 of the program, with the aim of helping affiliated stores using the "HOME'S" website better and more fruitfully, NEXT's Director and Executive Officer gave seminars on our service development, branding promotion initiative, website renovation objective and future strategy, and shared ideas on the strategy with the affiliated stores.

As part of its branding promotion activities, the Company on September 15, 2012 launched part 1 of its public transport-based advertising campaign, in which we made a "prior announcement" of our plan to renovate the "HOME'S" website on November 1. Part 2 of the campaign was launched on November 3, which comprised a branding promotion program designed for us to demonstrate, as a means of highlighting our differentiation from competitors, the appeal of the "HOME's" website as "Japan's top real estate information website in terms of the number of property postings and of user-friendliness." Furthermore, starting from this coming January, the seasonal peak month for rental properties, we will actively run additional public transport-based advertising as well as other campaigns and TV commercials.

Among the highlights of our overseas business operations was the October 1 launch in Thailand of our rental property information services targeting Japanese persons who relocate to Bangkok for business purposes. From now on, we will work hard to enhance our paid online information service program designed for local Thai website users, a program launched in the year ended March 31, 2012. As for the Chinese market, too, the promotion of our paid online information service program will be pursued as our priority initiative for the coming years given that the number of our online Shanghai and Beijing property postings has already grown to some 1.5 million. In Indonesia, since August 30 NEXT has been running its Indonesian language-based real estate information service website designed for local Indonesian website users. With this initiative being in its infancy stage, we will strive to achieve an increased number of online property postings in the country. Meanwhile, in Jakarta we have been providing real estate information services targeting Japanese expatriates residing in the country.

In China in the quarter under review, NEXT acquired additional shares in Next Property Media Holdings ("NPM") Limited, previously 39% owned by the Company, to make it its consolidated subsidiary, a move aimed at allowing us to improve our decision-making speed and pursue our operations in China in earnest. As a result of this share acquisition, NEXT now holds above 90% of shares in NPM. However, this will not have any effect on our income statement for the year ending March 31, 2013 since the consolidation of NPM as subsidiary will start from April 1, 2013.
(Tokyo, November 12, 2012)

* For the presentation material used for this meeting, please go to the following URL:
http://www.next-group.jp/en/ir/presentation_20121108.pdf

◆ Q&As ◆

Q1. What are Japanese real estate companies doing now in relation to the expected last-minute surge in demand arising from the planned consumption tax hikes? And what action will be taken by such companies from the next fiscal year onwards?

A1. With regard to large-scale condominium development projects, there is nothing real estate companies can do in relation to the expected demand surge as the condominium land acquisition process takes as long as three to five years. As for small-scale condominium development projects, there are signs that real estate companies are preparing to step up their land acquisition activities in the coming months. Meanwhile, in the area of detached houses, a category with even shorter construction lead times, aggressive investment activities seem to be proceeding in terms of custom-built houses, house refurbishment and built-for-sale detached houses.

Probably, it should be after the completion of the planned 5% to 10% two-stage consumption tax program that we will begin to see previously-owned property renovation begin to attract strong interest from real estate market participants.

In real estate transactions, land sale proceeds are exempted from consumption tax. As for the proceeds from the sale of previously-owned buildings, they are subject to consumption tax if the seller is a business operator, but not so if the seller is an individual person. Given that sellers of the bulk of previously-owned buildings traded in the market are individuals, we would likely see the expansion of the previously-owned building renovation market with a growing number of individuals buying existing properties for getting renovation projects done according to their preference.

We note that the Ministry of Land, Infrastructure, Transport and Tourism intends to work hard towards the goal of doubling the size of the Japanese previously-owned property transaction market. This initiative, assisted by government policies and the planned consumption tax hikes, will probably lead to rising consumer demand for previously-owned properties. It is for this reason that we are watching the property renovation market with interest.

Q2. Did your perception of risk change in the run-up to or after your website renovation?

A2. We spent two years bringing the website renovation program to a close. During the course of this project, we devised a number of fail-safe plans to address various kinds of risks. Still, the website renovation program was completed successfully without requiring us to actively implement the prepared fail-safe plans. Therefore, unless our website's SEO effect ends up eroding, sales should reach or, perhaps, exceed the target level.

Although we previously made our business forecast conservatively in consideration of many kinds of risks that were thought to exist, I think we have successfully cleared the hurdle. So we are looking at the current situation positively.

Q3. Do you need a little more time before identifying the impact of the website renovation on its SEO?

A3. We need three months or so to know the impact of the website renovation. Believing that the SEO effect will diminish by 20% for a period of three months, we have set aside funds as the additional costs for the three-month period. However, even after the passage of one month since the completion on October 1st of the renovation of our real estate trade website, its SEO effect has not diminished as much as expected, pointing to the marginal level of the renovation's adverse impact. Therefore, we don't need to spend much of the anticipated additional costs for the one-month period.

Q4. Is there any possibility that the marginal level of the renovation's adverse impact on the site's SEO effect will continue after the one-month period?

A4. It all depends on the algorism of search engines such as Google, so we will not be able to identify the situation until three months have passed.

Q5. Page 20 of your presentation material shows that the difference between the actual advertising costs spent for the fiscal 2012 first half and the costs budgeted in your full-year forecast amounted to approx. 1,700 million yen. Am I right in thinking that the difference between the first half costs and the second half costs represents your additional advertising cost spending?

A5. The difference includes the costs for our listing advertisement aimed at supporting our website's SEO effect as well as the costs for our branding promotion activities slated for the annual peak season.

Q6. Even after the passage of one month since your real estate trade website's renovation, there has occurred almost no erosion of the site's SEO effect. Still, you are not yet sure if the situation will be fine in the second and third month after the renovation. Is it because you expect an algorism change will be made by Google?

A6. That is not the case. It is not that we anticipate a major algorism update will be implemented by Google. It is just that we have factored in the highest level of risk because we are not sure what will happen. Currently, we are continuing to monitor the status of our website's SEO effect on a daily basis, and if any erosion of the SEO effect occurs in future, we will run a listing advertisement campaign as a means to support the SEO effect. Having said that, there has been no need for the Company to do so up until now.

Q7. Am I right in thinking that no problem is likely to occur as things are fine after the passage of one month since your real estate trade website's renovation and that perhaps no additional costs would be incurred in the second and third months?

A7. Although there is no guarantee, we feel that no additional costs would need to be spent.

Q8. Have you factored into your business forecast the anticipated sales decline resulting from the post-website renovation SEO effect erosion? Or, do you think additional costs will be incurred

without any sales decrease?

A8. The latter is correct since we added to our cost budget with the aim of compensating, by listing advertisement, for sales with regard to a temporary SEO effect erosion that may potentially occur. This is expected to bring about some sales support effect.

Q9. My question concerns the figures for the rental and real estate trade business shown on Page 21. Subtracting the first half sales of 2,900 million yen from the full-year forecast gives 2,700 million yen as your anticipated approximate sales for the second half. What will cause the second half sales to decline from the first half level?

A9. This sales assumption was made on a conservative basis. I suppose most people think that full-year sales will reasonably be double the 2,900 million yen first half sales or more. That idea should be correct.

Q10. Regarding the branding promotion costs and the cost-benefit factor for sales for the next fiscal year onwards, if we assume that a certain degree of branding promotion will be achieved on the back of this fiscal year's cost spending, will the cost level remain unchanged from this fiscal year while sales will grow? Am I right in believing that is the case?

A10. You are right in thinking so. Although the branding promotion initiatives implemented in the past failed to show a clear cost-benefit impact as a sales boost factor, the initiatives carried out in the January-to-March period and the August-to-September period onwards this year seem to have been generating a reasonable impact. Therefore, we intend to continue spending branding promotion costs in earnest next year and onwards. Our branding promotion program has been undertaken on a country-wide basis so far, but its focus has been on major urban areas such as the Tokyo metropolitan area, the Kansai area and the Chubu area. In this sense, we wish to pay greater attention to other regions when implementing our branding promotion initiative in the future.

Q11. In terms of the "HOME'S" website, touted as the country's top real estate information website in terms of the number of property listings, what is the status of the property transaction close rate?

A11. The rate of the "HOME'S" website-driven transaction close is not an important metric for analyzing NEXT's business performance, and cannot be kept track of. Although we continue to obtain numerical data based on answers given to our questionnaire, it is not disclosed.

Q12. How much contribution do your overseas sales make to NEXT's overall sales?

A12. The Company's overseas sales are still small because it is only one year since the launch of the overseas operations.

Q13. NEXT did not revise up its full-year business forecast after the close of the first half of the current fiscal year. Was it because there was some cause of concern for the second half of the year?

A13. We made our business forecast for the second half of the year conservatively for the following two reasons: 1) There was a possibility that the website renovation-caused SEO effect erosion would prove to be greater than expected; 2) We were unable to properly forecast to what extent our sales would be boosted by the branding promotion initiative planned to be implemented in the annual peak season in the second half of the current fiscal year.

Q14. Could you tell us about the changing competitive position in the past and now of the "HOME'S" website against rival website "SUUMO," a highly prominent website, as well as about your perception of the competitor site?

A14. The "SUUMO" website is our most formidable rival among different players operating in the industry. We think the "SUUMO" website's strength lies in the fact that its operator firm is a provider of a full range of services, both virtual and real, including online information, free paper and consultation counter services.

Having been ahead of NEXT in sales, the "SUUMO" operator firm has been continuing to spend an advertising budget greater in value than that of NEXT, thereby spending sizable costs on branding promotion initiative and TV CM in the process.

As for NEXT, the Company has historically been operating as an online-dedicated player, and is not equipped with corporate resources great enough for us to expand the scope of our advertising activities significantly. For this reason, we will continue to operate as an online-centric player in the coming years.

Having said that, it is also true that the "HOME'S" website is now neck-and-neck with, or just ahead of, the "SUUMO" website in the number of UUs (Unique Users), something made possible, under the above-mentioned circumstances, by our continued efforts to demonstrate to website users the "HOME'S" website's strength of being the country's top real estate information website in the number of property postings.

Being unable to afford a major spending program has allowed us to pursue insight- and idea-driven branding promotion efforts, in my view.

Although our "HOME'S" website is ranked top in terms of site user-friendliness, we have a policy of basically not outsourcing our operations with all our site development personnel (engineers and creators, among others) being regular employees. It is based on this policy that our personnel are working extremely hard to examine what site feature is user-friendly to website users searching for residential properties.

This must be another strength of NEXT. Although trailing the "SUUMO" website in sales and advertising budget, our "HOME'S" website is superior to the rival in terms of major metrics (the number of property listings, website visitor count and usability).

Q15. How does the "HOME'S" website compare with the "SUUMO" website in the number of property listings?

A15. Currently, the "HOME'S" website's property listings total approximately 4 million compared with about an estimated 1.6 million property listings of the "SUUMO" website.

Q16. If the impact of the anticipated SEO effect erosion proves to be almost zero, what will be the approximate amount of NEXT's minimum advertising costs for this fiscal year?

A16. The difference between last fiscal year's advertising costs of 2,700 million yen and this fiscal year's of 3,100 million yen represents our investment spending for branding promotion and SEO, which are absorbing about half of this spending, respectively. Although we intend to implement our branding promotion initiative in earnest, the absence of the adverse impact of the potential SEO effect erosion will mean that the related costs allocated will be saved.

Q17. Am I correct in thinking that operating expenses and other selling, general and administrative expenses for the full-year will be more or less at the levels shown in the presentation material?

A17. Other selling, general and administrative expenses would not differ much from the levels shown. As for operating expenses, they are skewed towards the second half of the year under our budget, meaning we may be able to curb operating expenses. If the number of affiliated stores continues to rise strongly, causing sales to increase further, that may potentially enable NEXT to rein in marketing promotion expenses included in operating expenses given that our branding promotion operations are partly outsourced to a full-commission marketing agent.