NEXT Co., Ltd. (TSE1, 2120)

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Launched overseas business operations by setting up a wholly-owned local subsidiary in Thailand

(August 10, 2011, Tokyo)

◆The first quarter of the year ending March 31, 2012 more or less in line with the plan

A brief look at our results for the consolidated first quarter of the year ending March 31, 2012 shows that, in the main service line "HOME'S Rental and Real Estate Trade" we changed the fee structure in January 2011, followed by the implementation of a website revamp initiative. Although some time will be required to achieve meaningful benefits from this initiative, we are also continuing our efforts on search engine optimization (SEO) and various devices such as smart phones. In light of such endeavors, we believe NEXT is now midway through an adjustment and upfront investment stage, with new businesses, "Lococom," "eQOL Skincare" and "MONEYMO," currently in a growth plateau stage.

Whereas in the first quarter under review, the Company recorded a decline in sales and profit from the same period a year ago, posting an operating loss, these results were more or less in line with our original projection. For the first quarter under review, consolidated sales stood at 2,357 million yen (a decline of 18.7% year on year) and consolidated operating loss totaled 5 million yen (compared with an operating profit of 690 million yen for the same period a year ago). Consolidated net loss for the quarter amounted to 11 million yen (compared with net income of 296 million yen for the same period a year ago). The average number of objects posted on our website continues to remain strong, standing at 2.83 million for the month of June 2011, followed by 2.91 million for July 2011, representing a return to the record high of March 2011. Such recovery was achieved as a result of the introduction of a pay-per-service fee structure.

In the "Rental and Real Estate Trade" business, the number of objects posted on our website grew significantly during the first quarter under review, following the fee structure change made earlier in the year. However, we failed to translate this development into actual sales from an early stage, resulting in quarterly sales declining 22.9% year on year. In the quarter under review, average sales per store stood at approximately 50,000 yen, a decline of 7.8% year on year, and the number of affiliated stores totaled 9,324, a decrease of 17.7%. Both these declines are attributable to the effects of the above-mentioned fee structure change.

In April 2011, we implemented a major revamp of the PC and mobile device versions of the local information website "Lococom". In addition, we released smart phone applications, resulting in total downloads exceeding the 100,000-mark within the following three months. However, we believe, some more time will be required before we can translate such efforts into actual sales. As for our overseas business initiative, concrete actions have already been initiated. With a view to launching our operations in Thailand, we are currently making preparations to set up a local subsidiary in the country. Separately, in the second quarter of the fiscal year ended March 31, 2011, we withdrew from the Guarantor Operating Business.

◆Achieved growth in terms of total website postings of new detached houses

In the first quarter under review, SG&A expenses grew 6.6% while personnel costs decreased from the same period a year ago in the absence of personnel costs for the Guarantor Operating Business totaling 93 million yen. The average consolidated number of employees stood at 585, including 23 new graduates. As for advertising costs, there was an increase in spending on listing advertising in the real estate information services business and on search engine optimization (SEO). In addition, in the first quarter under review, cost spending grew in local information services and new businesses. Allowances for uncollectible receivables and performance guarantees experienced a decrease of 56 million yen caused by the Company's withdrawal from the Guarantor Operating Business. Other SG&A expenses increased by 146 million yen in the quarter, due to the relocation of the head office. Cost items' shares of total sales rose across the board owing to decreased sales and head office relocation-related cost expansion.

As for sales by segment, in the first quarter under review, real estate information services sales declined 10.5% from the same period a year ago. Examining a breakdown of this segment, sales in "HOME'S Rental and Real Estate Trade" decreased 22.9% year on year due to seasonal factors and the effects of the Company' shift to the pay-per-inquiry-based fee structure. New condominium-related sales grew 24.3% year on year while new detached house-related sales rose 38.0% year on year. With regard to new condominium-related sales during the quarter, a special program page and other program products generated strong sales on the back of the growing number of new construction starts and condominium supplies. Meanwhile, new detached house-related sales continued to grow strongly, posting an increase of 16.3% year on year in the number of customers and a rise of 26.5% year on year in the number of objects posted on our website. As for the local information services, in April 2011 we migrated from the conventional advertising model to a pay-per-service-based fee model, based on counting the number of coupon uses. Although higher sales following the model change have been slow to emerge, customer-focused actions have been implemented smoothly.

In the first quarter under review, operating profit declined year on year in all segments with local information services recording an operating profit decline of 124 million yen from the same period a year ago as a result of increased staffing and the implementation of various promotional programs, with efforts aimed at achieving higher sales in the second half of the fiscal year ending March 31, 2012. "Others" posted a rise in cost spending on the launch of "MONEYMO" and "eQOL Skincare.

The balance sheets for the first quarter under review show that net assets per share decreased 1.5% from March 31, 2011 as a consequence of a post-peak season sales slowdown. In relation to goodwill amortization, the residual value of Willnic Co., Ltd. and Littel Co., Ltd. amounted to 750 million and around 200 million yen, respectively. Regarding cash flows, the balance of cash and cash equivalents as of June 30, 2011 stood at 4,586 million yen, a decline of 121 million yen compared with March 31, 2011.

◆Promoting use of the coupon of "Lococom," the local information website

As for the Company's actual performance against its earnings forecast, sales for the first quarter under review reached a level equivalent to 47.5% of the fiscal year 2011 first half forecast of 4,966. Looking at costs, personnel costs were in line with projection. While advertising costs and operating expenses in the quarter fell short of projection by approximately 30 million yen and approximately 37 million yen, respectively, due to spending postponement, these costs and expenses will be spent in the second quarter onward.

The trend of sales by service shows that real estate information services sales for the first quarter under review reached a level equivalent to 48.5% of the fiscal year 2011 first half forecast. Looking at the main components, HOME'S Rental and Real Estate Trade business sales amounted to 47.5% of the first half forecast with the number of objects continuing to do well. Thus the Company will seek to achieve an increased number of inquiries by revamping the website and implementing

SEO-related initiatives. New condominium service quarterly sales were more or less in line with projections, standing at a level equivalent to 45.7% of the fiscal year 2011 first half forecast. New detached house service sales amounted to 54.2% of the first half forecast with option products and the growing number of objects continuing to support those sales. Quarterly sales under review for custom-built houses and refurbishment services stood at a level equivalent to 52.2% of the first half forecast.

Local information services quarterly sales amounted to 7.5% of the first half forecast. The level of the first quarter sales had originally been projected to be low. Given that local information services sales were assumed to reach high levels from the second quarter onward, the Company will need to achieve an increase in the number of coupon users starting from the second quarter. “Others” sales reached a level equivalent to 20% of the first half forecast, falling short of projection despite the rising “MONEYMO” website customer traffic and the growing number of customer insurance consultations. The underperformance against forecast is partly due to the high level of the original projection.

As the top priority initiative for the year ending March 31, 2012, in the real estate information services business we are focusing our efforts on enhancing sales by maintaining an industry top-class number of properties posted and maximizing the number of inquiries. In the quarter under review, the number of properties posted on our website continued to do well. As for the number of inquiries, although the number of unique users was in line with expectations, the percentage of users actually proceeding to place an inquiry fell short of projections. Still, various metrics have been showing an improvement on the back of our fine-tuning efforts, which should allow us to achieve increased sales in future.

In the local information services business, we set out our goal to increase the number of coupon users and attain single-month profitability. Examining the actual results during the quarter under review, the number of application downloads remained healthy while the number of coupon users was still unsatisfactory. In connection with the efforts to achieve single-month profitability, we must address the challenge of attracting greater website user traffic and further promoting the use of coupons, given that the number of affiliated stores has been growing faster than expected.

Looking at NEXT’s overseas business development, in April 2011 we launched multilingual services on the “HOME’S” website (Chinese and English), which has since started to attract inquiries from overseas locations. In Thailand, the Company is currently preparing to establish a local subsidiary while an initiative to set up operations in China and ASEAN nations is now under consideration. As for the status of new businesses, “MONEYMO” business sales are expected to be driven mainly by pay-per-service fee revenue, based on the number of life insurance consultations and the number of written product information requests. Meanwhile, website content collaboration with other industry players continues to make good progress, recording high levels of sales steadily in the four-month period since the collaboration launch. The “eQOL Skincare” business has been smoothly achieving a growing number of registered users, although our original sales projection was not aggressive.

◆Launching operations in Thailand and China within the current fiscal year

As part of efforts on services relating to smart phones and other smart devices, NEXT launched the provision of “Lococom” applications in April 2011. As for “HOME’S” applications, “HOME’S Nursing Care” was introduced in May 2011, followed in June 2011 by the launch of “Newly-posted Properties Navigation” designed for new condominiums. Rental property search services have achieved improved usability through a website revamp, which involved the development of an additional function of synchronizing rental property search and Google Maps. Separately, following a version upgrade for Android applications, we are now working on the launch of games in an effort to increase the number of fans. Going forward, the Company will launch the provision of “HOME’S Fortune Telling Rental Room Search” and “HOME’S Moving Estimates” services. In relation to the “Lococom” website, we will also launch a website optimized for smart devices, and start to provide Android applications.

As a “Lococom” promotion initiative, NEXT launched the provision of applications at the time of the full website revamp, holding an event in Shibuya in May 2011. In addition, in July 2011 the Company launched the “Tokyo 23-Wards Check-in Battle” competition. Separately, we began to take part in the “Odaiba Gasshukoku” event hosted by Fuji TV as a booth-operating participant, issuing free-of-charge “Purikura” use coupons with the aim of achieving a total of 10,000 people having used the coupon at least once. Under the current plan, the Company will implement a campaign in collaboration with Lawson in September and October 2011, thereby seeking to attain a total of 100,000 coupon users.

With respect to the future business development, NEXT aims to become a global company in database (DB) and communication concierge services (CCS). We intend to enhance our database and provide all types of website users with optimal information, ranging from residential property information, to local information and financial information, through various kinds of devices. In the medium term, the Company will seek to attain increased productivity, with the aim of achieving an operating profit ratio of 25%, and ensuring the return of profits to shareholders through continued dividend payments and profit growth. In the “HOME’S” business, we aim to become the top industry player in terms of the breadth of property information coverage and the number of inquiries, coupled with efforts to secure new sales drivers and develop overseas business operations.

Under its overseas business strategy, NEXT will seek to provide real estate information services with a focus on Asia, the region likely to experience significant economic growth as well as a dramatic penetration of the Internet. It is our wish to make available, as we do in Japan, a structure under which the user can search for information in various languages on the basis of a single database containing, as a comprehensive service platform, all kinds of property information including information on new property, previously-owned property, rental property, and resort property.

In Thailand, we will set up a wholly-owned local subsidiary with a view to launching operations in December 2011. Moreover, the Company aims to launch operations in China in the form of joint venture (less than 50% equity participation by NEXT) by the end of the fiscal year ending March 31, 2012. As for other countries, we are continuing negotiations, mainly with potential business partners based in East Asian and South East Asian countries.

Our local subsidiary in Thailand will gather real estate information in collaboration with the local company AREA (Agency For Real Estate Affairs Co. Ltd.). Looking at the current state of competitors in the country, the market is clustered with numerous small-sized real estate information website operators offering essentially charge-free structures (banner advertising), the information update frequency of which is limited, and providing a sub-optimal level of information. Thus, we intend to build a solid footing for our business operations in Thailand by offering improved services in light of such industry players’ weaknesses. The Bangkok real estate market sells some 100,000 units a year, of which 52% or so is accounted for by condominiums. While we note that in 2010 the country’s online real estate advertising market was worth approximately 235 million yen on the basis of advertising spending, the coming years are expected to see substantial growth in that market.

Q&As

1. Please tell us about the business model and sales structure you will adopt for setting up operations in Thailand. Also, please let us know whether such model and structure will be feasible in the Thai market.

Under our plan, for the Thai market, we will adopt the same business model as that used for “HOME’S” in Japan. As for the fee structure, we are still considering whether to employ a pay-per-posting-based fee structure or apply the posting-charge-free and pay-per-inquiry-based fee structure. The adoption of the advertising business models currently dominant in Thailand is not among our options.

The Thai market remains underdeveloped, leaving significant room for creating an ideal market in the coming years. Provided the website operator regularly and properly updates a large quantity of property information posted on the website, it should not matter which fee structure is chosen. The fee levels in the Thai market would be lower compared with those in Japan.

2. **My question concerns "Lococom." When your firm changed its business model, did the existing affiliated stores actually withdraw from membership initially before rejoining? How did the migration take place?**

Our previous business model was based on revenue that consisted largely of advertising revenue from fewer than 100 affiliated member stores providing paid services. Therefore, we visited individual store operators one by one to provide information and guidance, which resulted in most of them continuing to operate as our affiliated stores.

3. **Following the migration to a pay-per-inquiry-based fee structure, meaningful sales generation has been slow in coming. Could you discuss any metric showing visible improvement or any instance of meaningful achievement, if any?**

The visit-to-conversion rate (CVR) is not easy for outsiders to identify as we continue to implement continuous website fine-turning, which has allowed us to achieve certain benefits resulting from, specifically, the introduction of a structure designed to change screen images dynamically while analyzing visiting users' behavior through multivariate analysis. Among other website fine-tuning that has achieved certain results is the step to better highlight some buttons on the website for improved usability.

There has also been a net gain in the number of users thanks to the growing smart phone market, characterized recently by the increasing penetration of Android-based devices after a period of dominance by iPhone. This makes us anticipate a further increase in the number of new website user acquisitions from among Android-based device users from the second half of fiscal 2011 onward.

As we anticipate that feature phone users will gradually decline from now on, we will step up our efforts on smart devices.

4. **Do you expect the CVR to reach your projected level some time during the second half of the current fiscal year?**

We aim to achieve the targeted conversion rate level in the second half of the current fiscal year. By taking various measures, we will seek to raise our conversion rate to the internal target level prior to the start of the second half, followed by an implementation of promotional activities targeting better brand recognition, which should facilitate the overall progress of our initiatives.

5. **I suspect that the declining number of affiliated stores is caused by their low satisfaction levels regarding the pay-per-inquiry-based fee structure and the current level of the number of website users. What are the views expressed by such affiliated stores and how have you responded to them?**

Both positive and negative views have been voiced by those affiliated stores. One comment given by those expressing negative views was that the migration to the pay-per-inquiry-based fee structure had resulted in added trouble in making an exclusion request. Presumably, such trouble represents a 5 to 10 percent or so additional workload on the part of the affiliated stores. Under the pay-per-inquiry-based fee structure, the customer is charged with a fee based on each instance of inquiry placement, and no fee is chargeable for non-inquiries, which represents something of a beneficiary-pays-it-all format. It is up to the customer to decide whether or not to go to the trouble of posting the inquiry.

On the other hand, we have also received positive comments on the pay-per-inquiry-based fee structure, which has allowed affiliated store sales staff to service their customers more efficiently. Total transparency concerning the actual cost incurred per inquiry has resulted in such staff working with a better sense of business efficiency, thinking how best to help the customer and what types of property to post on the website for obtaining an inquiry, according to the affiliated stores.

The number of newly-joined affiliated member stores and that of membership withdrawals are cancelling each other out. The fact that we continue to have new sign-ups, however, is proof that our business model is gaining understanding in the business community.

6. Don't you think that unless your affiliated stores continue to grow like before it will be hard to achieve increased sales, even with an improved CVR?

We prioritize the number of properties posted on our website over the number of affiliated stores because achieving an increased number of properties, along with a growing number of inquiries, will generate more sales. Doubling the number of affiliated stores will have the effect of merely expanding our revenue of per-store basic monthly membership fee (10,000 yen per month) by the increased number of stores. Thus, we prioritize expansion of the number of properties and inquiries over the number of affiliated stores.

7. Am I right in thinking that, in the Rental and Real Estate Trade, the basic fee income is mainly based on the per-store payment of 10,000 yen times the number of the affiliated stores and that "Others" income consists of inquiry-based-fee income?

Option-based fee income accounts for 20 to 30% of the total.

8. What is the current status of the rental property segment within the Chinese rental property market? Also, could you discuss the potential size of the country's future rental property market, and what is the potential size of your addressable market?

In the absence of any statistical data of reasonable accuracy, I am unable to discuss the size of China's rental property market. According to industry sources, the annual supply of new properties in the nation's market stands at 6 to 10 million. I hear that the number of transactions on previously-owned properties has recently come to exceed that of new property transactions in major cities, but China's rental property market has yet to experience any growth explosion. Thus, as in Japan, the country's real estate market growth will eventually spread from the new property segment to the previously-owned property segment, and then to the rental property segment in coming years.

Given that New York Stock Exchange-listed major Chinese property portal operators such as Soufun, Sohu and Sina are mainly focused on new condominium information services, we believe that potential opportunities remain for us to enter the previously-owned property and rental property market segments in China and expand business there. Previously, we succeeded in growing our business mainly in the previously-owned property and rental property market segments in Japan, in contrast to Recruit which excelled in the new property market segment. Likewise, we wish to attain growth in the previously-owned property and rental property market segments in China by exploiting our knowhow in such market segments.

According to our sources, a Japanese real estate industry player has yet to enter the Chinese market using such business model.