Full-year FY03/22

Message from Koji Obuchi, President and CEO of CROOZ Group

(May 12, 2022)

I am Koji Obuchi, president and CEO of the CROOZ Group. Earlier today, on May 12, 2022, we announced our financial results for FY03/22. To give you a better understanding of our current situation, I would like to share my thoughts and impressions.

First of all, the financial results for this term appear to show sales dropping significantly—over half compared to the previous fiscal year. This is because of the impact of the Accounting Standard for Revenue Recognition, which must be adopted by all listed companies that employ Japanese accounting standards. As a result, from FY03/22, we have disclosed sales net of purchasing costs. This is a change in the method of reporting and has no impact on profit. We previously referred to transaction value as sales, so I had not mentioned transaction value specifically. When making year-on-year comparisons, please bear in mind that what we reported as sales through FY03/21 has been disclosed as transaction value as of Q1 FY03/22[1].

Looking now at overall consolidated group full-year results, consolidated transaction value was JPY32,278mn (-9.6% YoY), and consolidated operating profit was JPY1,238mn (-42.0% YoY). Consolidated transaction value for Q4 FY03/22 was approximately JPY7,223mn (-6.9% YoY), and consolidated operating profit was JPY487mn (+121.3% YoY).

I will touch on this in more detail later, but the main reasons for the YoY decrease in full-year consolidated operating profit were decreased operating profit in the mainstay SHOPLIST business as well as development and promotion costs for new games at Studio Z we incurred through Q3 this year.

Next, allow me to explain in detail the business results for each business segment.

First, let me review the E-commerce business, which consists of the SHOPLIST business as well as e-commerce-related businesses such as e-commerce contract development and operation agency services, which previously were part of the Other segment. The e-commerce-related businesses are still small compared to the SHOPLIST business, so I will focus mainly on the latter. The total transaction value of the SHOPLIST business in FY03/22 was JPY23,036mn (-15.3% YoY) and operating profit was JPY915mn (-52.9% YoY). In Q4 FY03/22, transaction value was JPY4,750mn (-18.1% YoY), and operating profit was JPY185mn (-53.8% YoY). Both transaction value and operating profit fell below the previous year's levels. Frankly, this was not the outcome that we had envisioned. It has been over a year since I returned to the company as president in July 2020 to focus on rebuilding the SHOPLIST business by reforming the business and organization through the Critical Project Program[2] and other measures. Reforming our business structure, including streamlining logistics costs and advertising promotions, enabled us to achieve double-digit growth in sales for the first time in eight quarters in FY03/21 and generate operating profit of nearly JPY2bn for the year—evidence that things were improving steadily. Meanwhile, some of the issues that have accumulated over time are firmly entrenched, and as such, time will be needed to resolve them and achieve a full-fledged recovery.

Now, let’s look at transaction value. It was down 15.3% YoY in the full year and 18.1% YoY in Q4. The main reasons for the drop include: (1) the tapering of one-time COVID-19 demand, (2) a decrease in the number of visitors via SEO, (3) fewer visits from advertising, and (4) a high stock-out rate of top-selling products.

As for the drop in the number of visitors via SEO, we have already resolved the impact of the bugs in the program. Google has recovered to essentially its highest level ever, while Yahoo has only recovered to about 68%. Yahoo’s recovery has not kept pace with that of Google because services offered by Yahoo affiliate companies are now displayed at the top of its search results page, and the most favorable SEO position is now further down the page than it was. Since this is beyond our ability to control, we will compensate for the lag in Yahoo's recovery by continuing with strengthening SEO measures for Google and implementing effective advertising promotion measures. Secondly, placing priority on advertising efficiency led to a decrease in the number of visitors via advertising. In response, we will continue to work to increase the number of visitors from ads on social networking sites such as YouTube and TikTok, conduct a special campaign only available to buyers via apps to bolster the number of visitors from apps with high purchase rates, and run TV commercials to increase recognition. We will also continue to improve and increase the number of visitors by implementing the PDCA cycle and conducting more effective advertising to attract users—F1 users, in particular, one of SHOPLIST's strengths. Further, to improve the stock-out rate of top-selling products, we will develop a system that uses past sales data to produce demand forecasts and ensure that inventory management is conducted appropriately. While we have not yet achieved the overall results we expect, there are signs of positive effects. For instance, until Q2, the decline in visitors from high-purchase-rate apps had been a factor in the decrease in transaction value, but we have seen an increase in the number of visitors via apps. Further, following the introduction of our demand forecasting system, we are seeing improvements in the stock-out rate of top-selling products and sell-through.

Next, I would like to talk about operating profit. Operating profit for FY03/22 was JPY915mn (-52.9% YoY), and JPY185mn (-53.8% YoY) in Q4. This is primarily attributable to a decrease in transaction value.

As for other significant expense items, logistics-costs-to-transaction-value fell 0.1% YoY to 14.2% in the full year and 0.5% YoY to 13.9% in 4Q. This was the result of proactive moves to streamline operations including a review of materials and improvement of packaging workflows. The reduction in logistics-costs-to-transaction-value amid falling transaction value is testimony to the solid progress on moves to cut costs.

In addition, our promotion-cost-to-transaction-value decreased by 0.3% from 8.8% in FY03/21 to 8.5% in FY03/22, and by 0.9% from 6.4% in Q4 FY03/21 to 5.5% in Q4 FY03/22. Also, due to the change in the accounting method for point reserves caused by the Accounting Standard for Revenue Recognition that went into effect from FY03/22, the amount previously recorded as sales promotion expenses is now deducted from sales. If not for this change, our promotion-cost-to-transaction-value for FY03/22 would have increased by 0.9% to 9.7% and 1.1% to 7.7% in Q4. This is partly due to the decline in transaction value, but also because we are aggressively investing in measures I alluded to earlier, such as YouTube advertising and live streaming through influencer casting. From FY03/23 onward, we will actively invest in restoring and further boosting transaction value. While that means promotional expenses will remain high for the time being, we will identify and enact more effective advertising and promotion measures while implementing the PDCA cycle.

Our FY03/22 outsourcing-cost-to-transaction-value rose by 0.4% from 2.1% to 2.5%, but fell by 0.5% to 3.0% in Q4 FY03/22 from 3.5% in Q4 FY03/21. Some of the key projects from FY03/21 required major system upgrades and new development, which resulted in significant engineering outsourcing costs. As of Q3, however, the figure has been trending downward as, for the most part, development was almost complete. We expect outsourcing costs to stabilize from FY03/23 onward, and we believe that they will settle at the level before Q2 FY03/21, around JPY100mn per quarter.

This concludes my review of FY03/22 results for the SHOPLIST business. As I have already mentioned, we must get transaction value back on track toward growth—this is priority number one. We have not yet recovered from the ongoing issue of the declining number of visitors, but we will recover from FY03/23 and put the business back on track for growth.

Let's move on to the Games business. Until FY03/21, the segment was named the Internet Content Business, but we have renamed it to reflect the actual business more accurately. FY03/22 sales amounted to JPY2,680mn (+19.2% YoY), and we recorded an operating loss of JPY379mn (compared with an operating profit of JPY149mn in FY03/21). Q4 sales amounted to JPY989mn (+80.5% YoY), and operating profit was JPY93mn (compared with an operating loss of JPY21mn in Q4 FY03/21). Development and promotion costs for the new game *SHAMAN KING Funbari Chronicle*, officially released on December 8, were considerable until Q3, resulting in a non-consolidated full-year loss for the segment. However, the segment turned to the black from Q4, as it no longer incurred development costs, and we expect it to post stable earnings from FY03/23 onward. As for the latest situation, in February 2022, the game captured the number four position in the top-selling app rankings (game segment) on the iPhone App Store, and has remained in the top 20 releases in the monthly rankings subsequently, as numerous users continue to enjoy the game. Going forward, we will strive to make our game content as attractive as possible to existing users, including *SHAMAN KING fans*, as well as new users, so everyone can derive more enjoyment.

Let's turn our attention now to the Online Advertising and Media Business. This segment is the result of having integrated the Advertising Agency and Media businesses—which were disclosed separately until FY03/21—into a single reportable segment. Since the Advertising Agency and Media businesses were closely related in many areas, we decided to manage them as one business segment.

FY03/22 transaction value totaled JPY3,369mn (-3.1% YoY), and operating profit increased significantly, to JPY671mn (+39.7% YoY). In Q4 FY03/22, transaction value was JPY754mn (+10.3% YoY), and operating profit was JPY181mn (+20.6% YoY). This is due to the previously announced Rank King and other new media and advertising agency businesses—mainly in the financial sector—performing well. The business is starting to show stable earnings. Furthermore, the profit margin is high, and we forecast substantial growth, so we will continue working to expand earnings.

In the Investment business, we converted a portion of the fund equity managed by our consolidated subsidiary Sevenwoods Investment, Inc. to cash. This resulted in the company's stake in the fund decreasing, and the fund no longer being a consolidated subsidiary. From Q4 FY03/22, the Investment business ceased to be a reportable segment. Going forward, it will continue to be a net investment as previously, and the profit and loss resulting from the investment will no longer affect the company's operating profit and loss.

This concludes my review of the results for each segment. In the SHOPLIST business, transaction value continues to fall, and it will be some time before we see improvement. There are, however, still measures we can take to reverse the decline in the number of visitors and the stock-out rate of top-selling products. The Games business has released a new game and no longer incurs development costs, so we intend to generate steady revenue from this business going forward. The Online Advertising and Media business continues to perform well and is generating profit, so we don't see any reason to be pessimistic for the group overall, and think there is plenty of scope for growth going forward.

At the end of the latest fiscal year, a portion of our net investments was deemed to be unrecoverable, so we booked a loss of valuation on investment securities of approximately JPY700mn as an extraordinary loss. Net investment entails investing in a start-up company with the aim of receiving capital gains by selling our stake when the company is involved in M&A or IPO several years later. It generally takes five to seven years to start earning returns on an investment. If we look at the probability of success in businesses and start-ups, not all investees succeed, and an accounting loss on such investments is sometimes recognized. A few investments are very successful, and the returns obtained from this portion of our portfolio enable us to earn returns significantly above the entire invested amount. Due to the nature of net investment, costs are sometimes incurred upfront in the form of losses. We believe we have reached the stage where we think similar large impairment losses are unlikely, and expect to start to earn returns on our investments. We do not see any particular problems with progress. Several of our investees have prospects of stock market listing within a few years in their sights, and we expect they will generate significant profits several years hence.

The SHOPLIST business is now poised to produce steady profits. As I've said previously, though, we must reinvest those profits toward increasing transaction value. The issue is that we have not done this. This fiscal year, we started moving forward with investments to grow transaction value, including bolstering investment in advertising promotion. This may contribute to suppressing YoY profits in the short term. We have not changed our objective, however, which is to boost both sales and profits through increased transaction value, though the timeline to achieve this may vary to a certain degree. We will continue our efforts in the coming fiscal year and beyond.

Our goal was to restore the transaction value growth rate to the FY03/21 level by end-FY03/22. As of Q4, however, the transaction value growth rate was still lower than in Q4 FY03/21, and we feel that it will still take some time to fully recover. It is taking longer than we originally anticipated, which is disappointing, but we will work hard to achieve this goal. Areas that need urgent action to restore the transaction value growth rate are 1) a declining number of visitors, and 2) the stock-out rate of top-selling products. To reverse the decrease in the number of visitors, we will continue with measures related to fortifying advertising promotion, focusing on social networking sites. And we intend to optimize the stock-out rate of our top-selling products by analyzing the sales performance data since the launch of the service in 2012 to enhance the range of products that users want to purchase. We are developing a system that produces demand forecasts on the SKU level and ensures that inventory management is being conducted appropriately. We are seeing improvements in the stock-out rate of popular products and sell-through—signs that our initiatives are making solid progress. Moreover, improving the stock-out rate leads to a higher purchase rate, leading to increased visitors and higher advertising promotion efficiency. We are continuing to review the logic behind the priority of product display on the SHOPLIST site, and this is starting to positively impact transaction value. While the exposure prioritization logic has not changed fundamentally in the past few years, the number of brands and products we handle has grown considerably in recent years, resulting in products that would normally sell being buried and not getting the necessary exposure. Our expectation is that properly revising the website’s display logic will enable us to secure more orders even without an increase in the number of visitors. This project is now well underway; unfortunately, the decrease in visitors prevents us from seeing the effects of this change. Assuming the same number of visitors, though, the potential does exist to improve transaction value by 10% or more compared to the time preceding the launch of the project.

In 2022, Korean cosmetic brands favored by females in their teens and early 20s, brands new to Japanese fashion shopping sites, and brands popular with women in their 20s selling mainly handbags and jewelry, plan to open stores. We are providing ongoing fresh marketing proposals to new customers opening stores on our SHOPLIST OUTLET (opened in June 2021), and are doing our best to tap into stores that sell luxury brands and cosmetics handled by department stores at a discount.

By FY03/21, we were able to lay the foundation for cost reduction, operational streamlining, and organizational structure improvement. In FY03/22, we began devoting most of our resources—and I, over 90% of my attention—to critical projects oriented toward significantly increasing our transaction value. We have not yet satisfied our initial expectations in terms of progress, primarily due to the greater-than-expected decrease in visitors. Going forward, we will take simple measures to include offering products that appeal to SHOPLIST visitors and meet their needs, lowering the stock-out rate of top-selling products, and building the inventory of those products to sufficient levels. These measures will help restore the transaction value and, once again, put the business on track toward growth.

May 12, 2022
Koji Obuchi

*1 From fiscal years beginning on or after April 1, 2021, all listed companies that employ Japanese accounting standards are required to adopt the Accounting Standard for Revenue Recognition. This will require SHOPLIST, Online Advertising and Media, and other businesses to disclose sales net of purchase costs from April 2021 onward. As a result, FY03/22 sales will appear to be lower, but this is only a change in reporting and will not have any impact on profit. We previously referred to transaction value as sales, so I did not mention it specifically. From FY03/22, however, we are referring to sales, sales growth rate, and operating profit margin as transaction value, transaction value growth rate, and operating-profit-to-transaction-value ratio, respectively, in our disclosures. You may safely assume that transaction values disclosed from FY03/22 onward are equivalent to figures that until FY03/21 were reported as sales.

*2 Critical Project Programs are those directly supervised by the president. The project owners are granted the same authority as the president. They dig deep into the background of and reasons for issues, apply various factual data to the creation of solutions, and rebuild SHOPLIST.