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On **May 15, 2018**, SOURCENEXT Corporation announced earnings results for full-year FY03/18 and its dividend payment from retained earnings.

Quarterly performance (JPYmm)	FY03/16				FY03/17				FY03/18				FY03/18	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY	FY Est.
Sales	1,541	1,755	2,085	1,645	1,988	2,233	2,795	2,325	1,579	2,341	2,813	2,761		
YoY	10.7%	28.7%	12.9%	10.6%	29.1%	27.2%	34.0%	41.3%	-20.6%	4.8%	0.6%	18.8%		
Gross profit	1,069	1,311	1,516	1,159	1,452	1,532	1,758	1,568	989	1,579	1,933	1,779		
YoY	2.1%	26.3%	15.7%	9.2%	35.8%	16.8%	15.9%	35.3%	-31.9%	3.1%	10.0%	13.5%		
GPM	69.4%	74.7%	72.7%	70.5%	73.0%	68.6%	62.9%	67.4%	62.6%	67.4%	68.7%	64.4%		
SG&A expenses	820	839	1,017	917	1,008	1,057	1,295	1,177	1,172	1,637	1,009	1,295		
YoY	12.5%	12.0%	13.6%	17.2%	22.9%	26.0%	27.3%	28.4%	16.3%	54.8%	-22.1%	10.1%		
SG&A ratio	53.2%	47.8%	48.8%	55.7%	50.7%	47.3%	46.3%	50.6%	74.3%	69.9%	35.9%	46.9%		
Operating profit	279	459	492	215	486	380	476	231	63	376	398	402		
YoY	-21.3%	80.8%	18.6%	-22.9%	74.2%	-17.2%	-3.2%	7.3%	-87.1%	-1.2%	-16.4%	73.7%		
OPM	18.1%	26.1%	23.6%	13.1%	24.4%	17.0%	17.0%	9.9%	4.0%	16.0%	14.2%	14.5%		
Recurring profit	282	462	493	226	497	382	472	242	65	380	400	414		
YoY	-21.1%	78.0%	20.0%	-20.3%	76.5%	-17.4%	-4.4%	6.9%	-86.9%	-0.5%	-15.2%	70.9%		
RPM	18.3%	26.3%	23.7%	13.8%	25.0%	17.1%	16.9%	10.4%	4.1%	16.2%	14.2%	15.0%		
Net income	186	319	329	156	338	257	311	165	86	242	259	675		
YoY	-49.3%	-1.8%	18.5%	-35.8%	81.2%	-19.3%	-5.6%	5.3%	-74.5%	-6.1%	-16.8%	309.8%		
Net margin	12.1%	18.2%	15.8%	9.5%	17.0%	11.5%	11.1%	7.1%	5.5%	10.3%	9.2%	24.4%		
Cumulative	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY	FY Est.
Sales	1,541	3,296	5,381	7,025	1,988	4,221	7,016	9,341	1,579	3,920	6,733	9,495	100.5%	9,444
YoY	10.7%	19.6%	16.9%	15.4%	29.1%	28.1%	30.4%	33.0%	-20.6%	-7.1%	-4.0%	1.6%		
Gross profit	1,069	2,381	3,897	5,056	1,452	2,984	4,741	6,309	989	2,568	4,501	6,280		
YoY	2.1%	14.1%	14.8%	13.4%	35.8%	25.3%	21.7%	24.8%	-31.9%	-13.9%	-5.1%	-0.5%		
GPM	69.4%	72.2%	72.4%	72.0%	73.0%	70.7%	67.6%	67.5%	62.6%	65.5%	66.9%	66.1%		
SG&A expenses	820	1,659	2,676	3,593	1,008	2,065	3,360	4,537	1,172	2,371	3,818	5,114		
YoY	12.5%	12.3%	12.8%	13.9%	22.9%	24.5%	25.6%	26.3%	16.3%	14.8%	13.6%	12.7%		
SG&A ratio	53.2%	50.3%	49.7%	51.1%	50.7%	48.9%	47.9%	48.6%	74.3%	60.5%	56.7%	53.9%		
Operating profit	279	738	1,230	1,445	486	866	1,342	1,573	63	438	836	1,238	72.1%	1,717
YoY	-21.3%	21.3%	20.2%	11.0%	74.2%	17.3%	9.1%	8.8%	-87.1%	-49.4%	-37.7%	-21.3%		9.1%
OPM	18.1%	22.4%	22.9%	20.6%	24.4%	20.5%	19.1%	16.8%	4.0%	11.2%	12.4%	13.0%		18.2%
Recurring profit	282	744	1,237	1,464	497	879	1,351	1,593	65	445	845	1,259	73.2%	1,720
YoY	-21.1%	20.6%	20.4%	11.5%	76.5%	18.2%	9.2%	8.8%	-86.9%	-49.4%	-37.5%	-21.0%		8.0%
RPM	18.3%	22.6%	23.0%	20.8%	25.0%	20.8%	19.3%	17.1%	4.1%	11.4%	12.5%	13.3%		18.2%
Net income	186	505	835	991	338	595	906	1,071	86	328	586	1,261	105.5%	1,195
Net margin	-49.3%	-27.1%	-14.0%	-18.4%	81.2%	17.8%	8.6%	8.1%	-74.5%	-45.0%	-35.3%	17.8%		11.6%

Source: Shared Research based on company data

Figures may differ from company materials due to differences in rounding methods.

Sales by channel (quarterly) (JPYmm)	FY03/16				FY03/17				FY03/18			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Smartphones and telecom carriers	288	294	340	328	388	401	391	384	364	290	282	270
YoY	107.6%	57.4%	23.6%	-2.7%	34.7%	36.4%	15.0%	17.1%	-6.4%	-27.7%	-27.9%	-29.7%
SOURCENEXT online store	749	906	1,042	904	974	939	1,152	941	899	968	1,414	1,109
YoY	26.6%	59.2%	21.2%	16.5%	30.0%	3.6%	10.6%	4.1%	-7.7%	3.1%	22.7%	17.9%
Elec. mass retailers, third-party websites	436	512	663	368	572	826	1,159	870	185	921	928	1,172
YoY	-25.3%	-9.9%	-4.3%	4.8%	31.3%	61.3%	74.8%	136.4%	-67.6%	11.5%	-19.9%	34.7%
Other	66	43	39	46	52	69	92	109	130	161	183	217
Cumulative	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Smartphones and telecom carriers	288	582	922	1,250	388	789	1,180	1,564	364	654	936	1,206
YoY	107.6%	78.8%	53.7%	33.3%	34.7%	35.5%	27.9%	25.1%	-6.4%	-17.1%	-20.7%	-22.9%
SOURCENEXT online store	749	1,655	2,697	3,601	974	1,913	3,065	4,006	899	1,867	3,281	4,390
YoY	26.6%	42.6%	33.5%	28.8%	30.0%	15.5%	13.6%	11.3%	-7.7%	-2.4%	7.0%	9.6%
Elec. mass retailers, third-party websites	436	948	1,611	1,979	572	1,398	2,557	3,427	185	1,106	2,034	3,206
YoY	-25.3%	-17.7%	-12.7%	-10.0%	31.3%	47.4%	58.7%	73.1%	-67.6%	-20.9%	-20.5%	-6.4%
Other	66	109	148	194	52	121	213	322	130	291	474	691

Source: Shared Research based on company data

Figures may differ from company materials due to differences in rounding methods.

Overview

▷ Sales:	JPY9.5bn (+1.6% YoY)
▷ Operating profit :	JPY1.2bn (-21.3% YoY)
▷ Recurring profit:	JPY1.3bn (-21.0% YoY)
▷ Net income*:	JPY1.3bn (+17.8% YoY)

*Net income refers to net income attributable to parent company shareholders.

Progress

Compared with the company's full-year forecast, sales were 0.5% above plan, operating profit 27.9% below plan, recurring profit 26.8% below plan, and net income attributable to parent company shareholders 5.5% above plan.

Sales were in line with plan, but operating profit and recurring profit both finished below plan. The shortfall in earnings reflected a combination of a drop in sales through the company's smartphones/telecommunications carriers channel and expanded sales of POCKETALK and other models that carry lower margins versus software sales; this led to a larger-than-expected decline in the gross profit margin, which finished the year down 1.4pp at 66.1%. Earnings were further depressed by a 12.7% rise in SG&A expenses, which pushed the SG&A expense ratio up 5.3pp to 53.9% as personnel expenses were swelled by the addition of FUDEMAME Co. Ltd. as a wholly owned subsidiary, goodwill amortization (from acquisitions), and press conferences and other promotional measures taken to support sales of Rosetta Stone and POCKETALK that led to greater spending on advertising and promotion. At the net income level, a JPY570mn extraordinary gain from the sale of investment securities left earnings ahead of plan and at a new record high.

During FY03/18, the company acquired FUDEMAME Co., Ltd. in May 2017 and Rosetta Stone Japan in June 2017, making them consolidated subsidiaries. Among existing mainstay products, with the number of registered users of its Virus Security antivirus software approaching the 10mn milestone, the company boosted sales by launching a commemorative promotion. In December 2017, the company launched POCKETALK, an automatic interpreting device that represents its first IoT product. Thanks to the media buzz following the launch of POCKETALK, the company received inquiries from more than 1,000 companies. In anticipation of the surge in inbound tourist demand ahead of the Tokyo Summer Olympics in 2020, interest in the new multi-language interpreting device has been extremely high. A number of major companies have expressed an interest and decided to use POCKETALK, including JAL ABC, Inc., which runs airport home delivery and pocket Wi-Fi device rental services, Vision Inc., a Wi-Fi rental business, cosmetics giant Shiseido Japan, and Fujikyuu Travel, which is looking at ways to cope with tourists in rural areas.

By sales channel

Smartphones and telecommunications carriers

Sales: JPY1.2bn (-22.9% YoY)

This channel focuses on apps offered and sold through the fixed-rate, all-you-can-use app subscription service offered by Japan's three leading telecommunications carriers. SOURCENEXT increased the number of applications offered through KDDI's au Smart Pass to 41 (versus 35 in FY03/17), with a focus on popular overseas apps. In particular, Wi-Fi security, provided via au Smart Pass Premium made a significant contribution to sales. The number of apps offered on SoftBank's App Pass was 28 (versus 27 the previous year). The company launched a number of new apps like SunSurveyor and Instant Livelog, but there was a steady increase in new titles from competitor companies, with the number of applications offered by the total service also increasing. Hence sales declined slightly. The number of apps offered through NTT DoCoMo's Sugotoku Contents service was 24 apps from five sites (versus 23 apps from five sites in FY03/17).

E-commerce (SOURCENEXT online store)

Sales: JPY4.4bn (+9.6% YoY)

The company operates the SOURCENEXT eSHOP as part of its own website. The eSHOP sells software and PC-related hardware.

Sales performance was strong. POCKETALK was a strong-seller, with the launch of the extended warranty for the device providing an additional boost to sales.

SOURCENEXT held a trade fair for its five core brands, FUDEOH and FUDEMAME, along with Rosetta Stone, the language learning software product, VEGAS, video editing software, and Paintshop, image editing software, to gain increased exposure for these brands. This was well-received.

At Rosetta Stone, the company promoted in-house developed products, working to expand sales with the introduction of a new intermediate and advanced versions "Business Edition" and "Private Edition."

With Microsoft terminating support for Office 2007, the company has focused on expanding sales of ThinkFree Office NEO, its latest Office 2016 compatible software product. It has also looked to upgrade popular products such as Pitari Shikaku, a graphics software product for correcting distortions caused by camera angles.

Electronics mass retailers and third-party websites

Sales: JPY3.2bn (-6.4% YoY)

This sales channel consists primarily of major electronics retailer chains and third-party websites that sell PC software and other products to individual users.

SOURCENEXT upgraded promotional materials accompanying the launch of new versions of Rosetta Stone, FUDEOH, FUDEMAME, and other software products, which led to a boost in distribution.

On the security software front, with the number of registered users of mainstay antivirus product Virus Security approaching the 10mn milestone, the company launched a commemorative promotion at electronics retailers nationwide.

In December 2017, POCKETALK went on sale in large-sized stores, accompanied by product displays and product demonstrations to help increase customer awareness of the product.

Other channels

Sales: JPY691mn (+101.5% YoY)

Sales through other channels consist primarily of revenues from site licenses for PC software and for unlimited use of smartphone apps, targeting corporations (such as discount smartphone and SIM businesses), educational institutions, and government agencies.

SOURCENEXT launched APPLI CHOU HOUDAI, a fixed-fee, all-you-can-use smartphone app service for Android apps, focused on major cellphone stores. The company also launched "Smartphone Answering Machine," a new app designed to serve as a next-generation answering machine. The company also began a rental service for POCKETALK aimed at business users in December 2017, and began promoting POCKETALK as a means of communicating with the many overseas tourists that are expected to visit Japan in the coming years, targeting business such as department stores, drug stores, airlines, railway operators, and operators of large shopping centers.

Full-year company forecasts

(JPYmn)	FY03/17			FY03/18			FY03/19		
	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Est.	2H Est.	FY Est.
Sales	4,221	5,120	9,341	3,920	5,574	9,495	6,418	10,389	16,807
YoY	28.1%	37.3%	33.0%	-7.1%	8.9%	1.6%	63.7%	86.4%	77.0%
Cost of sales	1,238	1,794	3,032	1,352	1,862	3,214			
Gross profit	2,984	3,325	6,309	2,568	3,712	6,280			
YoY	24.5%	25.1%	24.8%	-13.9%	11.6%	-0.5%			
GPM	70.7%	65.0%	67.5%	65.5%	66.6%	66.1%			
SG&A expenses	2,065	2,671	4,736	2,371	2,671	5,042			
SG&A ratio	48.9%	52.2%	50.7%	60.5%	47.9%	53.1%			
Operating profit	866	707	1,573	438	800	1,238	478	2,021	2,499
YoY	17.3%	0.0%	8.8%	-49.4%	13.1%	-21.3%	9.1%	152.7%	101.9%
OPM	20.5%	13.8%	16.8%	11.2%	14.3%	13.0%	7.4%	19.5%	14.9%
Recurring profit	879	714	1,593	445	814	1,259	480	2,022	2,502
YoY	18.2%	-0.8%	8.8%	-49.4%	14.0%	-21.0%	7.9%	148.5%	98.8%
RPM	20.8%	13.9%	17.1%	11.4%	14.6%	13.3%	7.5%	19.5%	14.9%
Net income	595	475	1,071	328	933	1,261	345	1,473	1,818
YoY	17.8%	-2.1%	8.1%	-45.0%	96.4%	17.8%	5.3%	57.8%	44.1%
Net margin	14.1%	9.3%	11.5%	8.4%	16.7%	13.3%	5.4%	14.2%	10.8%

Source: Shared Research based on company
 Figures may differ from company materials due to differences in rounding methods.

Outlook for FY03/19

For FY03/19, the company is forecasting consolidated sales of JPY16.8bn (+77.0% YoY), operating profit of JPY2.5bn (+101.9%), recurring profit of JPY2.5bn (+98.8%), and net income attributable to parent company shareholders of JPY1.8bn (+44.1%). The company expects to pay an annual dividend of JPY4.40 per share versus JPY3.05 in FY03/18.

Overview

The company is looking for sales of the new POCKETALK interpreting device to gain momentum as businesses make ready for the growing number of overseas tourists expected to visit Japan ahead of 2020 Tokyo Olympics. It is expanding sales through online stores and through major electronics retailer chains, has set up a POCKETALK rental service aimed at operators of lodging and tourist facilities, and is promoting POCKETALK online and through TV commercials. In addition to the domestic market, the company is also looking to expand the number of POCKETALK units available overseas.

With respect to IoT products, the company plans to leverage experience in software development, its large user base (now more than 16mn users), and its sales network (including its own eShop network as well as major electronics retail chains). The company also plans to expand sales and development of new products that incorporate proprietary features, such as IoT products that make use of AI.

In the PC software arena, in April 2018 the company launched its new *ZERO Series* of security software that has an unlimited subscription period and can be used on an unlimited number of devices. The latest version can also be used on multiple operating systems, including smartphones and Apple computers. ZERO Super Security also comes with a safety function for web cameras. The company plans to keep sales of its security software growing by expanding the range of compatible operating systems and adding new features. Along with sales through its own online stores and brick-and-mortar retailers, the company plans to increased sales and earnings by offering special promotional products that make use of a young celebrity.

With regard to Rosetta Stone, plans call for expanding sales by developing cloud-compatible products that will allow users to access the program via smartphones and tablet computers.

At the SG&A expense level, the company plans to step up spending on TV commercials and online promotions to support sales of POCKETALK, but is otherwise looking to reduce SG&A spending in other areas.

The company plans to continue investing in IT systems with the aim of both supporting future growth and reducing costs.

On **the same day**, the company made an announcement regarding the issuance of its ninth and tenth series of stock warrants (with provisions to set the exercise price/conditions for suspending the exercise).

Overview of the offerings

Allotment date	Any day between June 7, 2018 and June 11, 2018.
Number of stock warrants to be issued	61,200 warrants Ninth series: 51,200 warrants Tenth series: 10,000 warrants
Issuing price	Ninth series: JPY400 per warrant Tenth series: JPY70 per warrant In light of potential changes in the share price and various other considerations related to the offering, on a day between May 23, 2018 and May 25, 2018 designated by the Company's Board of Directors as the day to determine the final terms of these warrants, the issuing prices shall be determined via a calculation applying the same method used to calculate the above prices; if such calculation presents an amount exceeding the amount outlined above, the company will fix the issuing prices based on

	the results of the latter calculation.
Potential dilution	Potential dilution: 6,120,000 shares (100 shares per warrant) Ninth series: 5,120,000 shares Tenth series: 1,000,000 shares No upper limit on amount exercised
Capital raised (net of estimated expenses)	JPY 5,317,100,000
Subscription or allotment method (allotted party)	Allotted to SMBC Nikko Securities through third-party allotment

Use of proceeds from offering

Specific use of proceeds	Amount (JPYmn)	Expected timeframe of expenditure
New product development (Ninth series)	1,000	June 2018–June 2021
Advertising/promotional support for new product sales (Ninth series)	1,000	June 2018–June 2021
Working capital to support sales of new products (Ninth series)	2,000	June 2018–June 2021
M&A, IP acquisition, etc. (Ninth and Tenth series)	1,317	June 2018–June 2021
	5,317	

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