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On **November 8, 2018**, SOURCENEXT Corporation. announced earnings results for 1H FY03/19.

Quarterly performance (JPYmm)	FY03/17				FY03/18				FY03/19				FY03/19	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of 1H	1H Est.
Sales	1,988	2,233	2,795	2,325	1,579	2,341	2,813	2,761	2,436	3,308			89.5%	6,418
YoY	29.1%	27.2%	34.0%	41.3%	-20.6%	4.8%	0.6%	18.8%	54.3%	41.3%				63.7%
Gross profit	1,452	1,532	1,758	1,568	989	1,579	1,933	1,779	1,355	2,126				
YoY	35.8%	16.8%	15.9%	35.3%	-31.9%	3.1%	10.0%	13.5%	37.0%	34.7%				
GPM	73.0%	68.6%	62.9%	67.4%	62.6%	67.4%	68.7%	64.4%	55.6%	64.3%				
SG&A expenses	1,008	1,057	1,295	1,177	1,172	1,637	1,009	1,295	1,408	1,713				
YoY	22.9%	26.0%	27.3%	28.4%	16.3%	54.8%	-22.1%	10.1%	20.1%	4.6%				
SG&A ratio	50.7%	47.3%	46.3%	50.6%	74.3%	69.9%	35.9%	46.9%	57.8%	51.8%				
Operating profit	486	380	476	231	63	376	398	402	85	422			106.2%	478
YoY	74.2%	-17.2%	-3.2%	7.3%	-87.1%	-1.2%	-16.4%	73.7%	35.8%	12.4%				9.1%
OPM	24.4%	17.0%	17.0%	9.9%	4.0%	16.0%	14.2%	14.5%	3.5%	12.8%				7.4%
Recurring profit	497	382	472	242	65	380	400	414	85	431			107.6%	480
YoY	76.5%	-17.4%	-4.4%	6.9%	-86.9%	-0.5%	-15.2%	70.9%	30.6%	13.6%				7.9%
RPM	25.0%	17.1%	16.9%	10.4%	4.1%	16.2%	14.2%	15.0%	3.5%	13.0%				7.5%
Net income	338	257	311	165	86	242	259	675	49	350			115.6%	345
YoY	81.2%	-19.3%	-5.6%	5.3%	-74.5%	-6.1%	-16.8%	309.8%	-42.8%	44.7%				5.3%
Net margin	17.0%	11.5%	11.1%	7.1%	5.5%	10.3%	9.2%	24.4%	2.0%	10.6%				5.4%
Cumulative	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY	FY Est.
Sales	1,988	4,221	7,016	9,341	1,579	3,920	6,733	9,495	2,436	5,743			34.2%	16,807
YoY	29.1%	28.1%	30.4%	33.0%	-20.6%	-7.1%	-4.0%	1.6%	54.3%	46.5%				77.0%
Gross profit	1,452	2,984	4,741	6,309	989	2,568	4,501	6,280	1,355	3,482				
YoY	35.8%	25.3%	21.7%	24.8%	-31.9%	-13.9%	-5.1%	-0.5%	37.0%	35.6%				
GPM	73.0%	70.7%	67.6%	67.5%	62.6%	65.5%	66.9%	66.1%	55.6%	60.6%				
SG&A expenses	1,008	2,065	3,360	4,537	1,172	2,371	3,818	5,114	1,408	3,121				
YoY	22.9%	24.5%	25.6%	26.3%	16.3%	14.8%	13.6%	12.7%	20.1%	31.6%				
SG&A ratio	50.7%	48.9%	47.9%	48.6%	74.3%	60.5%	56.7%	53.9%	57.8%	54.3%				
Operating profit	486	866	1,342	1,573	63	438	836	1,238	85	508			20.3%	2,499
YoY	74.2%	17.3%	9.1%	8.8%	-87.1%	-49.4%	-37.7%	-21.3%	35.8%	15.8%				101.9%
OPM	24.4%	20.5%	19.1%	16.8%	4.0%	11.2%	12.4%	13.0%	3.5%	8.8%				14.9%
Recurring profit	497	879	1,351	1,593	65	445	845	1,259	85	516			20.6%	2,502
YoY	76.5%	18.2%	9.2%	8.8%	-86.9%	-49.4%	-37.5%	-21.0%	30.6%	16.1%				98.8%
RPM	25.0%	20.8%	19.3%	17.1%	4.1%	11.4%	12.5%	13.3%	3.5%	9.0%				14.9%
Net income	338	595	906	1,071	86	328	586	1,261	49	399			21.9%	1,818
Net margin	81.2%	17.8%	8.6%	8.1%	-74.5%	-45.0%	-35.3%	17.8%	-42.8%	21.7%				44.1%

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

Sales by channel (quarterly) (JPYmm)	FY03/17				FY03/18				FY03/19			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Smartphones and telecom carriers	388	401	391	384	364	290	282	270	238	222		
YoY	34.7%	36.4%	15.0%	17.1%	-6.4%	-27.7%	-27.9%	-29.7%	-34.6%	-23.4%		
SOURCENEXT online store	974	939	1,152	941	899	968	1,414	1,109	1,046	1,269		
YoY	30.0%	3.6%	10.6%	4.1%	-7.7%	3.1%	22.7%	17.9%	16.4%	31.1%		
Elec. mass retailers, third-party websites	572	826	1,159	870	185	921	928	1,172	817	1,573		
YoY	31.3%	61.3%	74.8%	136.4%	-67.6%	11.5%	-19.9%	34.7%	341.6%	70.8%		
Other	52	69	92	109	130	161	183	217	333	243		
Cumulative	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Smartphones and telecom carriers	388	789	1,180	1,564	364	654	936	1,206	238	460		
YoY	34.7%	35.5%	27.9%	25.1%	-6.4%	-17.1%	-20.7%	-22.9%	-34.6%	-29.7%		
SOURCENEXT online store	974	1,913	3,065	4,006	899	1,867	3,281	4,390	1,046	2,315		
YoY	30.0%	15.5%	13.6%	11.3%	-7.7%	-2.4%	7.0%	9.6%	16.4%	24.0%		
Elec. mass retailers, third-party websites	572	1,398	2,557	3,427	185	1,106	2,034	3,206	817	2,390		
YoY	31.3%	47.4%	58.7%	73.1%	-67.6%	-20.9%	-20.5%	-6.4%	341.6%	116.1%		
Other	52	121	213	322	130	291	474	691	333	576		

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

1H FY03/19 results

Overview

- ▷ Sales: JPY5.7bn (+46.5% YoY)
- ▷ Operating profit: JPY508mn (+15.8% YoY)
- ▷ Recurring profit: JPY516mn (+16.1% YoY)
- ▷ Net income*: JPY399mn (+21.7% YoY)

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

Net income attributable to parent company shareholders was bolstered by a JPY111mn gain on the sale of investment securities, which was more than enough to offset the increase in corporate taxes in Q2, when the company no longer had the tax loss carryforwards from subsidiaries to defer taxes as it did in 1H FY03/18.

Compared with the company's forecast for 1H, sales came in 10.5% below plan, operating profit came 6.2% above plan, recurring profit 7.6% above plan, and net income 15.6% above plan.

In September 2018, the company rolled out POCKETALK W, a pocket-sized language interpreting device that is the successor model to the original POCKETALK. SOURCENEXT took over the lead in developing the new model, making significant improvements to the original design. Now compatible with 4G networks and even easier to use, the new POCKETALK W has already drawn a lot of attention from the market.

The launch of POCKETALK W led to a sharp jump in sales YoY, but sales came short of expectations for a number of reasons. Not only was the product launch delayed (from August to September), sales were further dampened by a series of major typhoons that hit the Japanese mainland and delayed receipt of shipments of the new model coming in by airfreight. This left the company with far fewer units on hand in September than it had planned, and unable to take delivery of the units it had expected to stock and sell in the month of September. The shortfall in sales notwithstanding, earnings came in higher than expected because the company was able to reduce CoGS ratio by shifting development to in-house, and at the SG&A expense level, spent less than originally planned on advertising and promotion by adjusting the promotion period (during which it ran TV, magazine, and transit ads) to match the timing of deliveries of the new models. As a result, the company made no changes to its forecast for the full year.

Compared with the company's forecast for the full year, 1H sales reached 34.2% of the target (1H FY03/18 sales reached 41.3% of full-year FY03/18 results), operating profit 20.3% (35.4%), recurring profit 20.6% (35.3%), and net income 21.9% (26.0%).

The closure of some major airports due to typhoons and earthquakes led to a 5.3% YoY decline in the number of overseas tourists visiting Japan (to 2.2mn) in the month of September (according to statistics released by the Japan National Tourism Organization in October). However, the number of tourists visiting Japan from Southeast Asia, the US, Australia, and Europe (excluding the UK) continued to rise during 1H despite some flights being cancelled thanks to the favorable environment of the Japanese tourism market against the backdrop of the upcoming 2020 Tokyo Olympic Games, recent global situation, and diversified travel destinations.

Under such circumstances, the company worked to acquire new users for smartphone apps, PC software, and IoT products, and enlarge its market.

Q2 saw the rollout of the company's new POCKETALK W model in September. The successor to the original POCKETALK, the new model features significant improvements. Unlike the original model, SOURCENEXT took the lead in developing POCKETALK W, making a number of major improvements including the addition of a larger touchscreen and a new translation engine. POCKETALK W is also compatible with 4G networks and is easier to use. With the launch of the product, the company ran television and radio ads, advertised in magazines, and used transit ads to increase exposure and raise product recognition. Through these efforts, the company was able to significantly increase not only sales to individual users but also sales to businesses

and organizations including railway operators, retailers, restaurants, and local government agencies involved in promoting tourism. These efforts notwithstanding, sales during Q2 were lower than expected. The company attributed the shortfall to a number of factors, starting with the delay of the product launch from August to September. Sales were further dampened by a series of large typhoons that hit the Japanese mainland in September, delaying deliveries of shipments of the new model coming in by airfreight. This left the company with far fewer units on hand in September than it had planned as it was unable to take delivery on the units it had expected to stock and sell in September.

1H consolidated gross profit of JPY3.5bn rose 35.6% YoY. The change in the company's product sales mix pushed its gross profit margin down 4.9pp YoY to 60.6%. The SG&A-expense-to-sales ratio was down, however, falling 6.2pp YoY to 54.3% as strong top-line growth easily offset the increase in SG&A spending, which rose 31.6% YoY to JPY3.1bn on increases in advertising and promotional spending to support the launch of POCKETALK W, personnel expenses due to an increase in personnel, shipping costs at the company's online store, and spending on contract labor to handle upgrades to the company's IT system.

Meanwhile, at existing businesses, the company pushed ahead with sales promotion initiatives for its mainstay postcard software ahead of the New Year's greetings card season at the end of the year.

By sales channel

Smartphones and telecommunications carriers

Sales: JPY460mn (-29.7% YoY)

This channel focuses on apps offered and sold through the fixed-rate, all-you-can-use app subscription services offered by Japan's three leading telecommunications carriers. SOURCENEXT increased the number of applications offered through KDDI's au Smart Pass to 35 (versus 39 in 1H FY03/18), with a focus on popular overseas apps. The number of apps offered on SoftBank's App Pass was 32 (versus 27 in 1H FY03/18). 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 1H FY03/18). In an effort to expand the user base for its apps, SOURCENEXT added features to its most popular apps that would allow them to connect and added a number of regular features. However, that was not enough to offset the slowdown in growth of subscribers to the fixed-fee, unlimited app usage services offered by telecommunications carriers and the resulting decline in the share of revenue paid to content providers like SOURCENEXT.

E-commerce (SOURCENEXT online store)

Sales: JPY2.3bn (+24.0% YoY)

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

The company set up a new, dedicated brand website just to handle sales of POCKETALK® W. In addition to the device itself, the company also expanded its lineup of POCKETALK W accessories (such as protective cases) and started selling these accessories through Amazon. Sales were also aided by its popular trade-on discount offer for people trading in the original POCKETALK model to purchase the new POCKETALK W model.

In other areas, the company reported steady growth in registered users following the launch of new versions of its postcard creation software for the New Year's greetings card season and B's Recorder.

Electronics mass retailers and third-party websites

Sales: JPY2.4bn (+116.0% 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.

Along with the launch of POCKETALK® W in September, the company did an expansive rollout through major electronics retailers nationwide supported by extensive sales promotion efforts. At the individual store level, the company set up special display corners where would-be customers could test the product; the displays also had video messages and cardboard cutouts featuring well-known entertainment personalities. In other product areas, the company began rolling out the latest versions of its postcard creation software and pushing ahead with sales promotions ahead of strong demand expected at the end of the year.

Other channels

Sales: JPY576mn (+97.9% YoY)

Sales through other channels consist primarily of POCKETALK sales and rentals to businesses, PC software, and unlimited-use smartphone app services.

The all-you-can-use smartphone app service for Android apps for low-price smartphone and SIM providers and Smart Answering Machine app released in FY03/18 (with which one can read answering machine messages as text), contributed to profit by increasing mobile phone and smartphone users.

The company has progressed steadily with its offering of POCKETALK rental services for businesses, in particular to transportation companies (airports and railway stations), and businesses that deal with foreigners or foreign visitors to Japan (such as retail or temporary staffing companies). The company also established a special website for retail stores, and created sales promotion tools to quickly get guidelines and other materials to individual business owners, local government agencies, and group companies. The company also rolled out a rental operator interpreting service as an optional service available with POCKETALK.

Meanwhile, on the existing product front, the company also saw growing contributions to sales and earnings from its ongoing efforts to expand sales of its Smart Rusuden app, a readable voicemail service which users pay for on a month-by-month basis that is sold through vendors of affordable smartphones and SIM cards.

This note is the most recent addition to the [full report](#).

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