

# Alpha-Win Company Research Report

## LOCKON CO., LTD.

(3690 TSE Mothers)

Issued: 2/19/2019

Research Dept., Alpha-Win Capital Inc.

<http://www.awincap.com/>

### ● Flash Report on Performance

#### ◆ A leading company in Internet advertising effect measurement systems

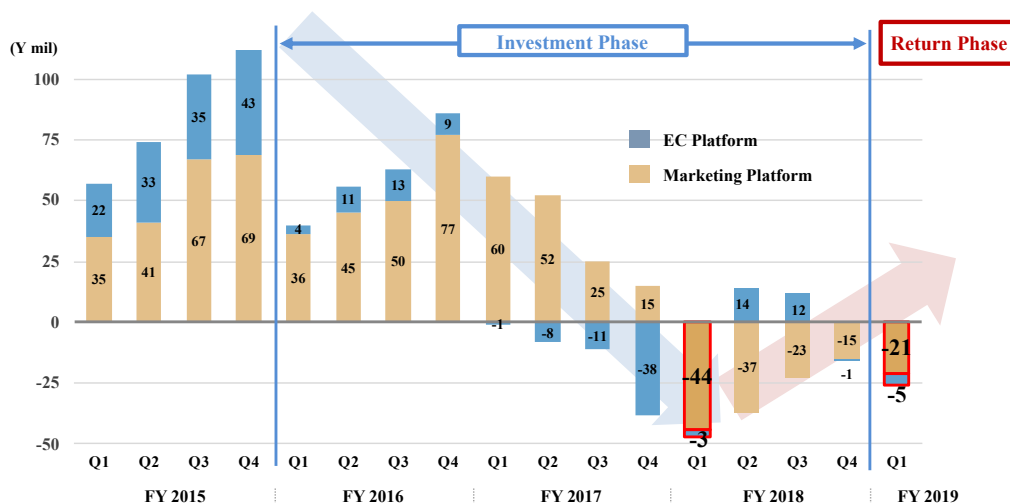
• LOCKON CO., LTD. (hereinafter referred to as the “Company”) is a leading company in a niche field; its main product is its proprietary Internet advertising effect measurement system (AD EBiS) provided via the Cloud to companies. Over the past few years, the Company has been conducting business restructuring and upfront investment, temporarily resulting in a net loss in FY 2018 (note that all fiscal years or FY in this Report end in September; e.g. FY 2018 ends in September 2018). However, thanks to the new subscription-based business model and its past investments that have begun to produce positive results, record-high sales and improvement from operating loss to operating profit are expected for this fiscal year. Going forward, while aiming to expand the sales of its core products, the Company also plans to develop the Internet Marketing Robot business on a global scale through alliances with other companies and by utilizing the accumulated information assets.

#### ◆ This fiscal year’s Q1 results: excellent fundamentals with improved operating loss and significant rise in sales

• The Company’s financial results for the first quarter (hereinafter “Q1”) of FY 2019 are as follows: Y519 million in sales (+20.0% YOY), -Y26 million in operating loss (last Q1: -47 million), -Y29 million in recurring loss (last Q1: -Y46 million), and -Y36 million in net loss (last Q1: -31 million). Sales were largely pushed up by the marketing platform business segment. Although there was a net loss, the profits are improving.

• Since FY 2016, the Company has been actively carrying out business restructuring and upfront investment. As a result, despite increasing sales, the cost burden has been pulling down profit to cause consecutive profit declines. On a quarterly basis, as shown in Figure 1, although an operating loss has been consecutively posted since Q4 of FY 2017, it had reached the bottom in Q1 of FY 2018 and has been improving since then.

【 Figure 1 】 Quarterly Change in Operating Profit or Loss (Unit: Y mil) (Ref: prepared by Alpha-Win Research Dept. based on the Company’s financial results summary and financial results briefing materials)



• Regarding the breakdown of Q1 sales by business segment, the marketing platform segment accounts for 89% of the total. Especially due to the growth of its core business AD EBiS and the acquired business AdRepo, the segment’s sales increased by about 30% YOY (Figure 2). AD EBiS’s number of active accounts increased by 174 (+12.5%) from 1,395 last Q1 to 1,569 this Q1. In addition, its average unit price also increased by Y11,160 (+14.8%) from Y75,461 to Y86,621 owing to the change in the pricing system (Figures 3 and 4). As a result, this segment’s profit improved, with the amount of loss becoming halved from -Y44 million last Q1 to -Y21 million this Q1 (Figure 2 described previously). Furthermore, in Q2 as well, the average unit price of new contracts seems

Performance Report

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to be maintained at greater than Y100,000 and the number of accounts seems to be increasing by about 20 per month.

• Meanwhile, in the EC platform segment, sales are declining due to the transfer of the SOLUTION business to affiliated companies and the transfer of the DMP business between segments. However, since the segment's sales are already only about 11% of this Q1's total sales, the effect of its sales decline on the Company's overall performance is becoming smaller. The EC-CUBE business, which remains as part of the segment, has been continued by a consolidated subsidiary that is 100% owned by the Company and is growing steadily thanks to the new software version and the growth of the EC market. The segment's profit has remained about the same, at a net loss of -Y3 million last Q1 and -Y5 million this Q1 (Figure 2 described previously).

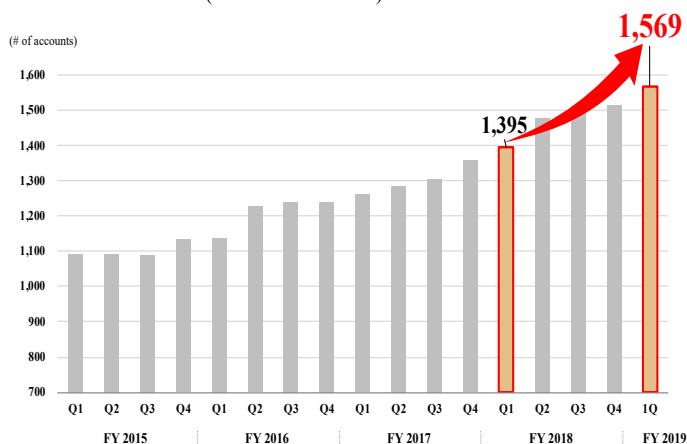
【 Figure 2 】 Change in Q1 Financial Results and the Company's Targets for This Fiscal Year (Unit: Y mil, %)

	FY 2018	FY 2019	YOY	YOY	FY 2019 Full-year
(Unit: Y mil)	Q1 (Oct-Dec)	Q1 (Oct-Dec)	Diff.	% Change	Company Target
Total Sales	433	520	87	20.0%	2250-2350
Marketing Platform	353	460	107	30.5%	
EC Platform	80	59	(21)	-26.0%	
Gross Profit	286	344	58	20.1%	
Gross Margin	66.1%	66.1%		0.0%	
SG&A Expenses	334	370	37	11.0%	
SG&A Expenses Ratio	77.1%	71.3%		-5.8%	
Operating Profit (by seg.)	(48)	(27)	21		0-50
Marketing Platform	(44)	(21)	23		
EC Platform	(3)	(5)	(2)		
Operating Margin	-11.0%	-5.1%		5.9%	0-2.2%
Marketing Platform	-12.5%	-4.6%		7.9%	
EC Platform	-4.2%	-9.2%		-5.0%	
Recurring Profit	(47)	(30)			Not disclosed
Net Profit	(32)	(36)			Not disclosed

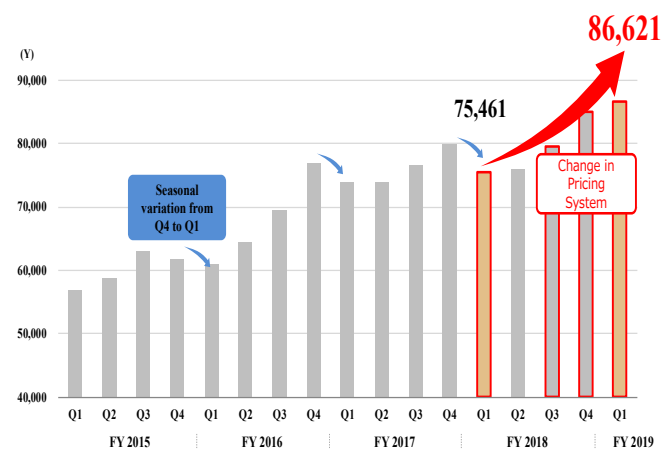
(Ref) Prepared by Alpha-Win Research Dept. based on or using excerpts from the Company's financial results summary and financial results briefing materials; same for the other figures.

【 Figure 3 】 Quarterly Change in the Number of Active Accounts for AD EBiS

(Unit: # of accounts)



【 Figure 4 】 Quarterly Change in AD EBiS's Average Unit Price (Unit: Y)



• Regarding profit, this Q1's gross margin was about 66.1%, which is about the same as last Q1. Meanwhile, although SG&A expenses increased by 11% YOY from Y334 million to Y370 million due to the increased number of employees, thanks to increased sales and cost control the SG&A expenses ratio improved by 5.8 points from 77.1% → 71.3% (in the order of last Q1 → this Q1; the same applies below). The increase in the sales of the marketing platform segment (+Y129 million YOY) offset the decreased sales of the EC platform segment (-Y42 million YOY), increased personnel expense (+Y30 million YOY), and increase in other various expenses. As a result, operating loss was improved by Y21 million from -Y47 million → -Y26 million. Since the disposal of fixed assets was recorded as extraordinary loss, net loss for the quarter slightly worsened from -Y32 million → -Y36 million.

• The balance sheet has not changed significantly as of the end of this Q1. While cash and deposits decreased due to the payment of acquisition costs and other factors (in the order of last Q1 → this Q1: Y1,194 million → Y875 million), goodwill was recorded as part of intangible fixed assets (in the same order: Y0 million → Y121

million). This goodwill comes from the acquisition of AdRepo and is planned to be amortized over eight years on a straight-line basis (approx. Y16 million per year). Although the Company has raised capital for future business development through long- and short-term loans (approx. Y500 million outstanding), it currently has ample liquidity and its equity ratio was 54.0% at the end of this Q1 such that there should be no issue for the time being.

### ◆ Disclosed full-year financial results forecast: expects a significant rise and a record-high in sales and improvement from operating loss to operating profit

- At the same time as the recent disclosure of Q1 financial results, the Company also disclosed its full-year forecast (range) for the current fiscal year. For the full fiscal year, the Company expects a significant rise in sales and an achievement of a positive operating profit; sales are forecasted to be Y2,250-2,350 million (24.7-30.2% YOY increase) and operating profit is expected to be Y0-50 million (last FY: -Y98 million). However, in considering the rapid changes of the Internet-related business, the Company has kept its forecasts for recurring profit and net profit undisclosed and its dividend undetermined. It also has not disclosed a forecast for the interim results.
- In terms of the breakdown of full-year sales by segment, the main marketing platform segment is expected to serve as the driver of the Company's overall sales growth since the actively pursued investments are expected to produce positive results and the AdRepo business acquired last fiscal year is expected to contribute to sales. On the other hand, for the other segment or the EC platform segment, although sales will be strong with the new version of EC-CUBE and the expansion of the EC market, the Company expects an overall decrease in sales due to business transfers, etc. (sales forecast by segment has not been disclosed).
- The Company plans to actively recruit mainly engineers and sales representatives; its plan is to increase the number of staff from 144 at the end of FY 2018 → 147 at the end of Q1 of FY 2019 (actual number as of December 2018) → approximately 170 at the end of FY 2019. However, the Company is also executing various measures toward creating a positive operating profit including suppressing the rate of increase in employees and cost below the rate of increase in sales.
- Progress in Q1 with respect to the Company's full-year financial results forecast for this fiscal year was 22.1-23.1% for sales (last Q1, 23.9%; NA for operating profit since a loss was posted for both periods). Monthly sales including January 2019 show that this fiscal year's cumulative sales are growing steadily (Figure 5).

【 Figure 5 】 Monthly Changes in Sales (Unit: Y thou, %)

FY 2019 Sales		2018 (Q1)			2019	Oct-Jan cumulative
		Oct	Nov	Dec	Jan	
Marketing Platform	Thou. Yen	149,201	150,478	160,409	158,319	618,407
	% YOY Change	126.9	130.9	133.7	132.9	131.1
EC Platform	Thou. Yen	21,839	18,683	18,936	25,060	84,518
	% YOY Change	78.3	67.6	76.5	96.8	79.6
Total	Thou. Yen	171,041	169,161	179,345	183,379	702,926
	% YOY Change	117.6	118.6	124.0	126.4	121.7

(Ref) Prepared by Alpha-Win Research Dept. based on the news release on the Company's website.

(Note) Values shown are preliminary data before an audit by an auditor and may be revised in the future.

### ◆ Financial results forecast for this fiscal year and for the medium term (by Alpha-Win Research Dept.)

- Based on the current situation, we have not changed our previous forecast for both sales and profits. The sales range of Y2,250-2,350 million (assuming a YOY sales growth of 24.7-30.2%) disclosed by the Company is about Y100-200 million greater than our forecast. While the Company's plan seems to include the expectation that M&A and other factors during the fiscal year will raise the sales growth rate, on top of the approximately +21.7% YOY in cumulative sales growth rate during this fiscal year's October to January, we have kept a somewhat conservative forecast for sales. Since AD EBIS's number of accounts is increasing by about 20 companies per month and its average unit price for new customers is maintained at over Y100,000, the sales of the existing businesses are expected to continue to be strong.
- We have decided to keep our original forecast because the Q1 results show that operating profit is so far mostly in line with our forecast, our estimated full-year operating profit is within the Company's expected range, and it seems that the Company will continue cost control to achieve its target. Also, it is worth noting that in recent years the Company has been disclosing its full-year forecast when reasonable estimation becomes possible and therefore its

forecast has been highly accurate, as indicated by its track record (see Figure 27 on page 27 of the first report).

- In our financial results forecast, we have not included any particular expectation for non-operating profit or loss or extraordinary gain or loss at this point. However, we believe that if gains or losses from the sales, retirement, or reevaluation of assets or contingent liabilities arise, the fiscal year may result in a net loss.
- Over the medium to long term, we expect that sales will increase by about 20-30% per year since the Internet Marketing Robot business, which the Company is focusing on, has a high growth potential. We expect that the Company will maintain net profit in the future and may also be able achieve a double-digit profit growth over the medium to long term, although these would depend on the success of cost control (progress with upfront investment, recruitment, etc.).

### ◆ Stock Price

- With improvements in the stock market's overall trend, the Company's stock price made a rebound after hitting the bottom in late December of 2018. Especially since the disclosure of Q1 results, the stock price has been rising along with the trading volume, largely outperforming indexes such as the TOPIX and the TSE Mothers Index. This rise seems to reflect the announcement of a share buyback and the expectation for operating loss to turn into profit for the full-year results. Regarding the planned share buyback, the maximum number of shares is 110 thousand shares (equivalent to 1.7% of outstanding shares) and the maximum value is Y100 million. The buyback is planned to be conducted on the market during February 7 to April 26. As for the purpose of this buyback, the Company aims to improve asset efficiency and shareholder value and plans to use the repurchased shares for stock compensation for its officers and employees and for M&As in the future. The planned number of shares to be repurchased is equivalent to approximately 9.1 days' worth of the average daily trading volume during the most recent three months (approx.) up to February 6, the date when the share buyback was announced. Additionally, the Company issued 19,900 new shares (approx. Y22.6 million, which is equivalent to 0.3% of outstanding shares or 1.7 days' worth of the trading volume for the same period as above) with February 18 as the payment date and allocated them as transfer-restricted stock compensation to its officers and employees, including directors, for the purpose of creating incentives and sharing shareholder value.
- Although the stock valuation is high based on the financial results forecast for the current and next fiscal year, we believe that it may be starting to reflect the expectation for the Company to achieve and maintain net profit and return to a profit-growing phase. Going forward, we expect that the stock price will reflect the regularly disclosed monthly sales and quarterly profit, AD EBiS's average unit price and number of active accounts which are important indicators (KPIs) directly linked with financial performance, and revenue over the medium term.

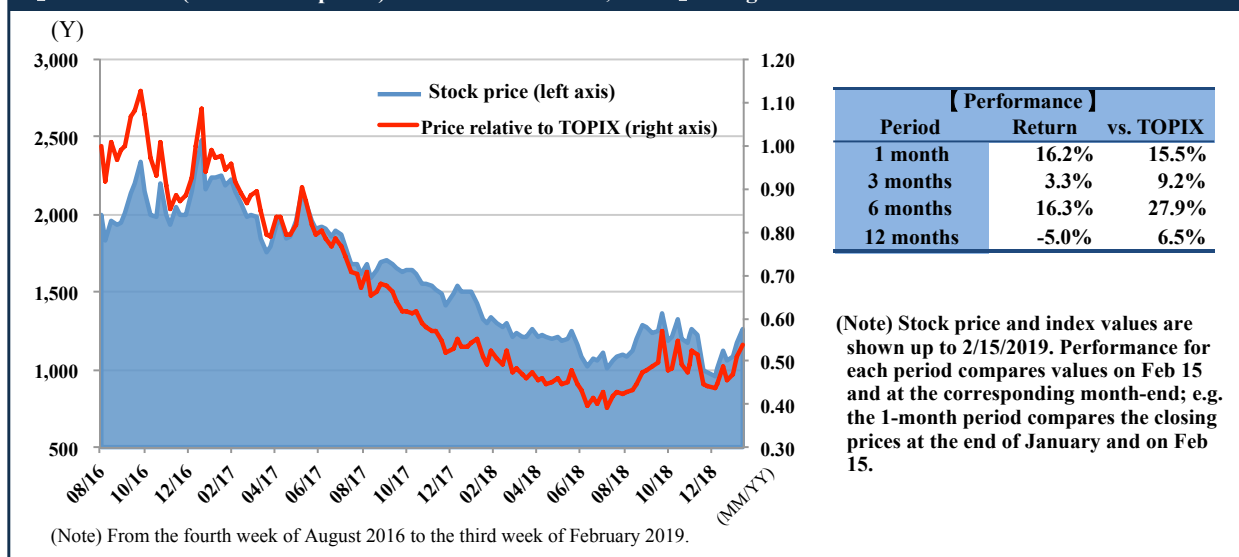
[ 3690 LOCKON CO., LTD. Sector: Information & Communication ] Figure A												
FY	Sales (Y mil)	YOY (%)	O.P. (Y mil)	YOY (%)	R.P. (Y mil)	YOY (%)	N.P. (Y mil)	YOY (%)	EPS (Y)	BPS (Y)	Dividend (Y)	
2016	1,612	12.2	247	-29.2	250	-28.9	168	-26.9	26.79	189.08	5.0	
2017	1,719	6.6	92	-62.6	106	-57.5	72	-56.8	11.56	195.60	5.0	
2018	1,804	5.0	-98	-	-115	-	-88	-	-14.02	184.97	0.0	
2019	CE	2,250-2,350	24.7-30.2	0-50	To profit	Not disclosed at this point					ND	
2019	E	2,150	19.2	30	To profit	10	To profit	10	To profit	1.60	170.60	0.0
2020	E	2,600	20.9	120	300.0	100	900.0	96	860.0	15.34	185.94	0.0
2021	E	3,000	15.4	250	108.3	230	130.0	155	61.5	24.77	210.71	0.0
2018	Q1	432	2.8	-47	-	-46	-	-31	-	-5.05	-	-
2019	Q1	519	20.0	-26	-	-29	-	-36	-	-5.72	-	-

(Note) CE = the Company's estimate; E = Alpha-Win Research Dept.'s estimate. Estimated EPS and BPS values reflect the change in the number of shares due to the issuing of new shares and the share buyback. "ND" stands for not determined. "To profit" indicates a change from loss to profit.

[ Stock Price and Valuation Indicators: 3690 LOCKON CO., LTD. ] Figure B						
Item	2/15/2019	Item	P/E	P/B	Dividend Yield	Dividend Payout Ratio
Stock Price (Y)	1,264	Last FY (actual)	-	6.8	0.0%	0.0%
Shares Outstanding (thou.)	6,372	This FY (est.)	791.0	7.4	0.0%	0.0%
Market Capitalization (Y mil)	8,054	Next FY (est.)	82.4	6.8	0.0%	0.0%
Dilutive Shares (thou.)	0	Equity Ratio at Last FY-End	54.5%	Last FY's ROE	-	-

(Note) Estimates were made by Alpha-Win Research Dept.; estimated P/E and P/B values reflect the change in the number of shares due to the issuing of new shares and the share buyback.

【 Stock Chart (end-of-week prices): 3690 LOCKON CO., LTD. 】 Figure C



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