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On November 12, 2020, SOURCENEXT Corporation announced earnings results for 1H FY03/21.

Quarterly performance (JPYmm)	FY03/19				FY03/20				FY03/21				FY03/21	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of Est.	1H Est.
Sales	2,436	3,308	4,497	4,470	4,639	4,044	4,406	4,193	2,540	3,248			93.8%	6,174
YoY	54.3%	41.3%	59.9%	61.9%	90.5%	22.3%	-2.0%	-6.2%	-45.2%	-19.7%				-28.9%
Gross profit	1,355	2,126	2,896	2,725	2,815	2,535	2,691	2,338	1,478	1,983				
YoY	37.0%	34.7%	49.8%	53.1%	107.7%	19.2%	-7.1%	-14.2%	-47.5%	-21.8%				
GPM	55.6%	64.3%	64.4%	61.0%	60.7%	62.7%	61.1%	55.8%	58.2%	61.1%				
SG&A expenses	1,408	1,713	2,379	2,822	2,809	2,279	2,947	1,676	1,660	1,753				
YoY	20.1%	4.6%	135.8%	117.9%	99.5%	33.0%	23.9%	-40.6%	-40.9%	-23.1%				
SG&A ratio	57.8%	51.8%	52.9%	63.1%	60.6%	56.3%	66.9%	40.0%	65.3%	54.0%				
Operating profit	85	422	338	14	92	270	102	10	74	210			284.3%	100
YoY	35.8%	12.4%	-15.1%	-96.5%	7.8%	-36.0%	-69.9%	-26.9%	-19.3%	-22.3%				-72.4%
OPM	3.5%	12.8%	7.5%	0.3%	2.0%	6.7%	2.3%	0.2%	2.9%	6.5%				1.6%
Recurring profit	85	431	352	37	85	269	154	30	53	190			242.7%	100
YoY	30.6%	13.6%	-12.0%	-91.1%	0.1%	-37.7%	-56.2%	-19.7%	-37.7%	-29.4%				-71.7%
RPM	3.5%	13.0%	7.8%	0.8%	1.8%	6.6%	3.5%	0.7%	2.1%	5.8%				1.6%
Net income	49	350	226	-9	56	141	67	-40	7	118			181.1%	69
YoY	-42.8%	44.7%	-12.8%	-	13.1%	-59.6%	-70.1%	361.9%	-88.0%	-16.3%				-65.0%
Net margin	2.0%	10.6%	5.0%	-	1.2%	3.5%	1.5%	-	0.3%	3.6%				1.1%
Cumulative	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of Est.	FY Est.
Sales	2,436	5,743	10,241	14,711	4,639	8,683	13,089	17,282	2,540	5,788			36.2%	16,000
YoY	54.3%	46.5%	52.1%	54.9%	90.5%	51.2%	27.8%	17.5%	-45.2%	-33.3%				-7.4%
Gross profit	1,355	3,482	6,377	9,102	2,815	5,350	8,041	10,379	1,478	3,461				
YoY	37.0%	35.6%	41.7%	44.9%	107.7%	53.7%	26.1%	14.0%	-47.5%	-35.3%				
GPM	55.6%	60.6%	62.3%	61.9%	60.7%	61.6%	61.4%	60.1%	58.2%	59.8%				
SG&A expenses	1,408	3,121	5,500	8,322	2,809	5,088	7,571	9,711	1,660	3,412				
YoY	20.1%	31.6%	44.0%	62.7%	99.5%	63.0%	37.6%	16.7%	-40.9%	-32.9%				
SG&A ratio	57.8%	54.3%	53.7%	56.6%	60.6%	58.6%	57.8%	56.2%	65.3%	59.0%				
Operating profit	85	508	846	860	92	362	464	475	74	284			47.4%	600
YoY	35.8%	15.8%	1.1%	-30.5%	7.8%	-28.6%	-45.1%	-44.8%	-19.3%	-21.5%				26.4%
OPM	3.5%	8.8%	8.3%	5.8%	2.0%	4.2%	3.5%	2.7%	2.9%	4.9%				3.8%
Recurring profit	85	516	869	906	85	354	508	538	53	243			40.5%	600
YoY	30.6%	16.1%	2.8%	-28.1%	0.1%	-31.5%	-41.5%	-40.6%	-37.7%	-31.4%				11.6%
RPM	3.5%	9.0%	8.5%	6.2%	1.8%	4.1%	3.9%	3.1%	2.1%	4.2%				3.8%
Net income	49	399	624	616	56	197	264	225	7	125			30.0%	416
YoY	-42.8%	21.7%	6.5%	-51.2%	13.1%	-50.6%	-57.6%	-63.5%	-88.0%	-36.6%				84.9%
Net margin	2.0%	6.9%	6.1%	4.2%	1.2%	2.3%	2.0%	1.3%	0.3%	2.2%				2.6%

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

Sales by channel (quarterly) (JPYmm)	FY03/19				FY03/20				FY03/21			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
SOURCENEXT online store	-	-	-	-	-	-	-	-	1,314	1,350		
YoY	-	-	-	-	-	-	-	-	6.4%	-		
Electronic mass retailers	-	-	-	-	-	-	-	-	555	1,214		
YoY	-	-	-	-	-	-	-	-	-79.3%	-		
Corporate sales	-	-	-	-	-	-	-	-	630	618		
YoY	-	-	-	-	-	-	-	-	-7.1%	-		
Other	-	-	-	-	-	-	-	-	38	67		
YoY	-	-	-	-	-	-	-	-	-11.0%	-		
[Previous categories]												
Smartphones and telecom carriers	238	222	185	183	158	150	152	145	-	-	-	-
YoY	-34.6%	-23.4%	-34.4%	-32.2%	-33.6%	-32.4%	-17.8%	-20.8%	-	-	-	-
SOURCENEXT online store	1,046	1,269	1,648	2,336	1,997	1,630	1,826	1,602	-	-	-	-
YoY	16.4%	31.1%	16.5%	110.6%	90.9%	28.4%	10.8%	-31.4%	-	-	-	-
Elec. mass retailers, third-party websites	817	1,573	2,344	1,369	1,918	1,687	1,707	1,711	-	-	-	-
YoY	341.6%	70.8%	152.6%	16.8%	134.8%	7.2%	-27.2%	25.0%	-	-	-	-
Other	333	243	321	582	564	578	721	735	-	-	-	-
Cumulative	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
SOURCENEXT online store	-	-	-	-	-	-	-	-	1,314	2,664		
YoY	-	-	-	-	-	-	-	-	6.4%	0		
Electronic mass retailers	-	-	-	-	-	-	-	-	555	1,769		
YoY	-	-	-	-	-	-	-	-	-79.3%	-1		
Corporate sales	-	-	-	-	-	-	-	-	630	1,248		
YoY	-	-	-	-	-	-	-	-	-7.1%	-0		
Other	-	-	-	-	-	-	-	-	38	105		
YoY	-	-	-	-	-	-	-	-	-11.0%	-0		
[Previous categories]												
Smartphones and telecom carriers	238	460	645	828	158	308	460	605	-	-	-	-
YoY	-34.6%	-29.7%	-31.1%	-31.3%	-33.6%	-33.0%	-28.7%	-26.9%	-	-	-	-
SOURCENEXT online store	1,046	2,315	3,963	6,299	1,997	3,627	5,453	7,055	-	-	-	-
YoY	16.4%	24.0%	20.8%	43.5%	90.9%	56.7%	37.6%	12.0%	-	-	-	-
Elec. mass retailers, third-party websites	817	2,390	4,734	6,103	1,918	3,605	5,312	7,023	-	-	-	-
YoY	341.6%	116.1%	132.7%	90.4%	134.8%	50.8%	12.2%	15.1%	-	-	-	-
Other	333	576	897	1,479	564	1,142	1,863	2,598	-	-	-	-

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

1H FY03/21 results (out November 12, 2020)

- ▷ In 1H FY03/21, the company reported consolidated sales of JPY5.8bn (-33.3% YoY), operating profit of JPY284mn (-21.5% YoY), recurring profit of JPY243mn (-31.4% YoY), and net income attributable to owners of the parent of JPY125mn (-36.6% YoY).
- ▷ Progress versus the 1H FY03/21 company forecast put sales at 93.8%, operating profit 284.3%, recurring profit 242.7%, and net income 181.1%. Sales fell slightly short of plan but each profit line was substantially above plan for the following reasons.
- ▷ Inbound demand declined sharply due to the spread of COVID-19, causing sales to fall slightly short of the 1H forecast.
- ▷ The company implemented effective measures to reduce SG&A expenses. It curbed promotion expenses by limiting large promotions in consideration of the smaller number of people visiting stores and reduced advertising expenses by focusing its online advertising on effective media as inbound demand shrank. As a result, each profit line ended up well above plan.
- ▷ Full-year FY03/21 forecast was unchanged. The company will promptly disclose any matters that impact its earnings going forward.
- ▷ Progress versus full-year FY03/21 company forecast put sales at 36.2% (1H FY03/20 sales were at 50.2% of full-year FY03/20 results), operating profit 47.4% (76.3%), recurring profit 40.5% (65.8%), and net income 30.0% (87.6%).
- ▷ Sales down 33.3% YoY: The decrease in sales reflected a 4.4% increase in sales through the company's own e-commerce site (SOURCENEXT online store), a 62.2% decrease in sales through electronics mass retailers, a 6.9% decline in corporate sales, and 3.1% decline in other. Demand for the company's POCKETALK® AI translation device declined on lower in-store sales due to restrictions on going out and retailers halting operations amid the COVID-19 pandemic and lower sales to travelers overseas. Meanwhile, sales of software and hardware used in teleworking were firm.
- ▷ Operating profit down 21.5% YoY: The gross profit margin declined 1.8pp YoY to 59.8%. The company increased provisions for losses due to product returns. Adjusted for product return provisions/reversals, the GPM was up 1.1pp YoY to 63.9%. In light of the slump in sales, the company constrained SG&A expenses to mitigate the impact on profits, and cut them by JPY1.7bn (-32.9%) YoY. The company curtailed advertising expenses by not airing TV commercials for POCKETALK® after running them in 2019 and not featuring it in TV shopping promotions. Furthermore, it was able to cut call center outsourcing fees incurred in running TV shopping campaigns and other promotion expenses associated with rolling out the product in stores. Still, the fall in sales outstripped the benefits, and the SG&A expense ratio rose 0.4pp YoY to 59.0%. The OPM increased 0.7pp YoY to 4.9%.

External environment

The October report from the Japan Electronics and Information Technology Industries Association showed PC shipments down 1.8% YoY in the April–September 2020 period.

1H FY03/21 initiatives

The SOURCENEXT group worked to acquire new users for IoT products, smartphone apps, and PC software, and to enlarge its market.

POCKETALK®

- ▷ Demand for the company's POCKETALK® AI translation device declined on lower in-store sales due to restrictions on going out and retailers halting operations due to COVID-19 and lower sales to overseas travelers.
- ▷ The company thus touted POCKETALK® as a language learning tool by adding Chinese to the language lesson feature in addition to the existing feature which enables English conversation practice with an AI partner.

- ▷ In light of this, the company worked to grow sales of POCKETALK® by developing B2B sales channels with medical institutions and factories, manufacturing facilities, and public institutions that employ non-Japanese workers, in addition to the company's online store.
- ▷ In July 2020, it added the POCKETALK® S Plus to its POCKETALK® S series, having developed the new model in response to user feedback asking for a larger screen that can display more characters at a larger font size. The translation function and other functionality are the same as in the existing models in the series, but the screen is bigger and the battery has more capacity.
- ▷ The company launched the POCKETALK® mimi in August 2020. This product uses AI-based voice recognition to instantly transcribe spoken language to text at the touch of a button, allowing smooth communication with people with age-related hearing loss or other hearing impairment. The company developed it after learning that people with hearing impairments were setting their POCKETALK® to "translate" from Japanese to Japanese. It sells the device through electronics mass retailers nationwide, and also at eyeglasses stores that stock hearing aids.

Telework-related products

- ▷ Following the Japanese government's recommendation that companies use teleworking wherever possible, SOURCENEXT put together plans to quickly roll out a range of related software products, services, and also hardware products. In March 2020, the company's website added a new page dubbed Telework Collection that details its various product offerings related to teleworking, including the Krisp Pro noise-cancelling app from V-Cube Inc. In July, the company began selling the Meeting Owl webcam for use in meetings.
- ▷ Developed in the US by Owl Labs, Meeting Owl automatically recognizes and focuses on the person speaking using AI technology, helping to create the illusion that users are speaking with one another in person. SOURCENEXT has exclusive sales rights in Japan, and has used comedian Akihiro Kakuta (of comic trio Tokyo 03) in a new commercial to introduce the product to the public. With the help of ads on television and in taxis, unit sales topped 3,000 in just three months.
- ▷ There has been an increase in people using computers at home for work or online study. This helped drive sales of existing products such as security software (Super Security ZERO) and the Dropbox online storage service which can be linked in with the Zoom web conferencing system.

Results by sales channel

Results by sales channel are as shown following. From Q1, the company changed its sales channel classifications. Corporate sales, which were previously classified as Other, have been reallocated to the Smartphones and telecommunications carriers business, which has been renamed Corporate sales. YoY comparisons use figures for the new classifications.

E-commerce (SOURCENEXT online store)

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

- ▷ Sales: JPY2.7bn (+4.4% YoY)
- ▷ The new POCKETALK® S Plus is larger than the conventional POCKETALK® S, and the eSHOP provides a clear explanation of new functions, including the easy of viewing enabled by the larger screen and the longer battery life made possible by greater battery capacity.
- ▷ The company launched the AI-based transcription device POCKETALK® mimi, and also began providing a rental service. Since the rental service minimizes the expense of initial adoption, it is used not only by individuals, but also by medical institutions and sign language clubs.

- ▷ In telework-related products, the company opened a dedicated website for the Meeting Owl webcam where users ranging from individuals to companies can view commercial videos and written descriptions to learn about the device's 360° field of view and its auto-focus and other functions, see examples of how the device has been adopted, and apply for trial use.
- ▷ In existing products, the company sold three brands of software for creating New Year greeting cards: FUEMAME, FUEOH, and Atena Shokunin. Sales of upgrade versions have also been robust.
- ▷ In other telework-related products, sales have been growing for security software (Super Security ZERO), B's Recorder for recording web conferences and webinars, the Dropbox online storage service, and IKINARI PDF Ver. 7 COMPLETE (for creating, converting, and editing files in PDF format).
- ▷ Due to the increasing number of people working from home, the Telework Collection bundled notebook computers with wireless earphones and XSplit VCam, in a web conference package aimed at users joining online conferences for the first time.
- ▷ It also sold a laptop table that automatically adjusts the height of a notebook computer platform, smartphone stands, wireless LAN repeaters, and other items that make the desktop environment for those working at home more comfortable.

Electronics mass retailers

This sales channel consists primarily of major nationwide electronics retailer chains that sell IoT products, PC software, and other products to individual users.

- ▷ Sales: JPY1.8bn (-62.2% YoY)
- ▷ In-store sales of POCKETALK® S declined due to restrictions on going out and retailers temporarily closing stores due to the COVID-19 outbreak, but in Q2 the company launched new products including POCKETALK® S Plus and the Doraemon Edition POCKETALK® S.
- ▷ It sold the AI-based transcription device POCKETALK® mimi through electronics mass retailers, but also worked to develop new sales channels, including eyeglasses stores that stock hearing aids.
- ▷ In addition, it expanded sales of the Meeting Owl webcam and three brands of software for creating New Year greeting cards.
- ▷ Among existing products, sales of security software such as Virus Security ZERO and Super Security ZERO grew on increased demand from teleworkers and students learning online, and the TOKU-UCHI touch typing learning software also grew sales.
- ▷ Despite gains on multiple fronts, the company was still unable to surpass the level of sales achieved in 1H FY03/20, when there was extraordinary last-minute demand for POCKETALK® and PC software ahead of the consumption tax hike in October 2019.

Corporate sales

In this channel, the company provides sales and rental of POCKETALK® for companies as well as all-you-can-use computer software and smartphone app services.

- ▷ Sales: JPY1.2bn (-6.9% YoY)
- ▷ New sales orders of POCKETALK® for companies declined sharply due to lower numbers of international travelers. Although existing contracts are ongoing, sales fell YoY.
- ▷ After the company broadcast commercials for Meeting Owl for use in telework, there was a rapid upsurge in inquiries and applications for trial use from universities and various organizations, and from companies in a range of industries including manufacturing and finance.
- ▷ The company provides content which it sells for use in major telecommunications carriers' fixed-rate, all-you-can-use app subscription services. It provided Power amp through SoftBank's App Pass. This led to sales growth for some carriers due to increasing membership and advertising campaigns. In existing products, usage of Smart Rusuden app, a readable voicemail service, and APPLI CHOU HOUDAI, which users pay for on a monthly basis, remained solid. These services are sold by vendors of inexpensive smartphones and SIM cards.

- ▷ In other products, computer software licensed to companies saw demand for security software increase YoY due to teleworking. However, sales overall were down YoY with the disappearance of the PC-related demand seen a year earlier in connection with the planned end of Microsoft's Windows 7 support.

Other channels

Sales through other channels include POCKETALK® sales overseas.

- ▷ Sales: JPY105mn (-3.1% YoY)
- ▷ Sales of POCKETALK® have been growing overseas, primarily via Amazon in the US and Europe. The global spread of COVID-19 during Q1 saw sales decline, but the level of sales nearly recovered to pre-pandemic levels by end-Q2. Sales of POCKETALK® via Amazon in the US have been robust, in part because the donation of 850 POCKETALK® units to medical institutions via Sourcenext Inc. was well received and the company was selected as one of "50 US Businesses That Stood Out During the Pandemic" by Newsweek magazine.
- ▷ In other regions, the company focused its promotional activities on Asia, and on Thailand in particular. It also opened a pop-up store in Malaysia, which generated strong sales especially to Japanese people stationed there.

Full-year company forecast

(JPYmn)	FY03/19			FY03/20			FY03/21		
	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Act.	2H Est.	FY Est.
Sales	5,743	8,968	14,711	8,683	8,599	17,282	5,788	10,212	16,000
YoY	46.5%	60.9%	54.9%	51.2%	-4.1%	17.5%	-33.3%	18.8%	-7.4%
Cost of sales	2,262	3,267	5,529	3,333	3,570	6,903	2,327		
Gross profit	3,482	5,700	9,182	5,350	5,029	10,379	3,461		
YoY	35.6%	50.7%	44.6%	53.6%	-11.8%	13.0%	-35.3%		
GPM	60.6%	63.6%	62.4%	61.6%	58.5%	60.1%	59.8%		
SG&A expenses	3,121	5,201	8,322	5,088	4,623	9,711	3,412		
SG&A ratio	54.3%	58.0%	56.6%	58.6%	53.8%	56.2%	59.0%		
Operating profit	508	352	860	362	112	475	284	316	600
YoY	15.9%	-56.0%	-30.5%	-28.7%	-68.1%	-44.8%	-21.5%	181.1%	26.4%
OPM	8.8%	3.9%	5.8%	4.2%	1.3%	2.7%	4.9%	3.1%	3.8%
Recurring profit	516	390	906	354	184	538	243	357	600
YoY	16.0%	-52.1%	-28.1%	-31.5%	-52.8%	-40.6%	-31.4%	94.3%	11.6%
RPM	9.0%	4.3%	6.2%	4.1%	2.1%	3.1%	4.2%	3.5%	3.8%
Net income	399	217	616	197	28	225	125	291	416
YoY	21.8%	-76.8%	-51.2%	-50.6%	-87.2%	-63.5%	-36.6%	945.8%	84.9%
Net margin	6.9%	2.4%	4.2%	2.3%	0.3%	1.3%	2.2%	2.9%	2.6%

Source: Shared Research based on company data

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

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

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