

August 20,2010

**(7552 TSE First Section)**  
**HAPPINET CORPORATION**

Broadening business portfolio as a comprehensive entertainment trading house

HAPPINET CORPORATION (hereinafter HAPPINET or the Company) is proactively engaged in what it terms “Happiness Networking,” a visionary concept which aims to inspire awe and dreams by providing new, creative forms of entertainment. HAPPINET is committed to achieving this goal as it reinforces and upgrades the foundations as a comprehensive entertainment trading house. Since March 2010, the Company has been following its fifth medium-term management plan, CAP (Change And Progress) 11, which seeks to achieve a dramatic transformation of its business structure over the next three years.

The following is a summary of Trias Corporation’s interview with Hiroyuki Ishimaru, Manager of HAPPINET’s Management Planning Team (which belongs to the Corporate Management Division’s Corporate Strategy Planning Department) and Mayumi Akimoto, who is also a member of the Management Planning Team.

**[Corporate History and Business Summary]**

HAPPINET was founded in February 1968 by Hiroshi Kawai, who presently serves as Chairman and CEO, as a toy wholesaler after leaving BANDAI Co., Ltd. The Company began offering computer game consoles such as PlayStation or SEGA SATURN from 1994, pioneering the retail of videogame units at toy store outlets. In 1999, the Company acquired Beam Entertainment Corporation from BANDAI at a time when the DVD market was rapidly expanding. At the time, the only offerings of video content were through the VHS format. In 2009, HAPPINET, then the fourth largest wholesaler of DVDs, acquired WINT CORPORATION, the second largest retailer of DVD and CD software, enabling the Company to enter the music CD retail business. HAPPINET had also bought SUNLINK CO., Ltd., the top maker of so-called “capsule” toys that children buy from vending machines (known locally as “gacha-gacha,” the toys are randomly chosen; a select few cost far more than what was paid, making them the “lucky hit”).

After acquiring SUNLINK, a wholly-owned subsidiary of BANDAI, and Apple Corporation, the second largest capsule toy maker, HAPPINET shot up in market share from No. 3 to No. 1, commanding a 60% share. Through such moves, HAPPINET today is involved in the following segments: 1) general toys; 2) audiovisual software; 3) videogames (game consoles and game software); amusement vending machines (such as capsule toys); and other businesses (such as trading cards).

[For further information, please consult Table 1: Summary of Net Sales by Segment for FY03/10 Actual and FY03/11 Forecast.]

**Table 1: Summary of Net Sales by Segment for FY03/10 Actual and FY03/11 Forecast**

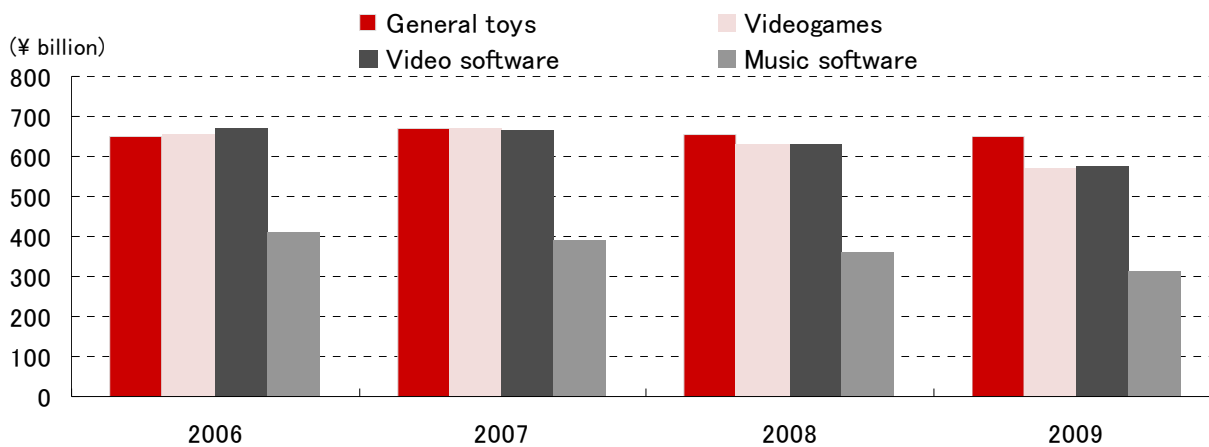
Consolidated (¥million)	FY3/09		FY3/10		FY3/11		
	Actual	Actual	Ratio	Y/Y Chg	Fcst.	Ratio	Y/Y Chg
Net Sales	166,778	194,246	100.0%	16.5%	200,000	100.0%	3.0%
Toy	54,482	57,749	29.7%	6.0%	58,000	29.0%	0.4%
Visual and Music	36,570	67,838	34.9%	85.5%	68,000	34.0%	0.2%
Video-Game	50,474	44,372	22.8%	-12.1%	50,000	25.0%	12.7%
Amusement	17,919	16,381	8.4%	-8.6%	17,000	8.5%	3.8%
Others	7,330	7,904	4.1%	7.8%	7,000	3.5%	-11.4%
Operating Income	2,137	2,327	100.0%	8.9%	2,600	0.0%	11.7%
Toy	894	1,633	70.2%	-	n.a.	n.a.	n.a.
Visual and Music	1,330	253	10.9%	-81.0%	n.a.	n.a.	n.a.
Video-Game	1,221	1,035	44.5%	-15.2%	n.a.	n.a.	n.a.
Amusement	△ 127	544	23.4%	-528.3%	n.a.	n.a.	n.a.
Others	101	232	10.0%	129.7%	n.a.	n.a.	n.a.
Eliminations & Corporate	△ 1,283	△ 1,371	-58.9%	-	n.a.	n.a.	n.a.
Operating Income Margin	1.3%	1.2%	n.a.	-0.1%	1.3%	n.a.	0.1%

### [Major Trends in Toy Distribution Market]

Toy companies in Japan were resurrected as an export industry at the direction of the Allied Occupation forces after World War II as a means to barter for such imported commodities as food. In the 1950s, toys became a major Japanese export, with TAMIYA INC. (in 1946), BANDAI (in 1950), TOMY (in 1953), TAKARA (in 1955) and EPOCH CO., LTD. (in 1958) eventually emerging as the largest players. The videogame industry was born in 1978, when Nintendo introduced its first computer game, which went on to create an enormous market. It quickly overtook the general toy market, as the latter had been hurt by Japan's inexorable decline in birthrate and absence of major hit products (see Chart 1). While the general toy market has regained a modest edge over the past several years, both markets have reached rough parity in terms of size.

Generally speaking, there are two major categories of manufacturers in Japan: the large blue-chip maker that offers a full lineup of products and the medium-sized maker, which specializes in select products. Both rely on wholesalers such as HAPPINET to distribute their offerings. Due to the plethora of products and manufacturers (the major toy makers once possessed their own wholesaling operations), wholesalers also serve to consolidate offerings and outlets. Wholesalers, in fact, supply a broad array of retailers, from department stores and GMS, to specialty chains and general toy stores. Today, Japan's wholesale toy market is worth some ¥300 billion, of which 40% belongs to HAPPINET and TOMY-affiliated wholesaler. Other players include large independent operators like KAWADA CO., LTD., as well as local and regional wholesalers. The average annual turnover for a major independent wholesaler is around ¥5-20 billion, while the median operator sells ¥2-3 billion a year.

**Chart 1: HAPPINET's Market Trends**



Source: General toys (The Japan Toy Association, FY), Videogames (Media Create Co., Ltd., CY),  
Video software (Japan Video Software Association, CY),  
Music software (Recording Industry Association of Japan, CY)

### [HAPPINET's Initiatives]

One salient characteristic of the Japanese toy industry is the vast number of players, both in terms of manufacturers and retailers, which are involved. Other prominent traits include the fact that toy manufacturing relies primarily on molding and that the majority of production is now being done abroad, mainly in China; in addition, it takes over three months from the placement of an order to the arrival of a product since the government—responding to growing public demand for safer products—mandates that every new toy pass strict safety standards, a time-consuming process which culminates in official certification, or the so-called ST Mark. Due to the long inspection lead time and ample surplus stock that wholesalers maintain to avoid any shortages, the toy distribution structure in Japan is saddled by inventory. To cope with this unique distribution structure, HAPPINET has adopted an Optimal Distribution System, which coordinates marketing support, logistics and logistical data, since more than a decade ago—a cumulative investment worth over ¥5 billion to date. The Optimal Distribution System can track products on a single-item basis, and incorporates an Electronic Ordering System (EOS) based on a proprietary POS system. The Company also customizes the system to meet the needs of its corporate customers and their respective specifications.

Meanwhile, the Company launched its HAPPINET East Japan Logistics Center in Ichikawa City, Chiba Prefecture, in October 2001. In February 2006, it added the No. 2 HAPPINET East Japan Logistic Center in Funabashi City of the same prefecture, as well as a HAPPINET West Japan Logistics Center in the Kansai area. Its East Japan Logistic Center features sophisticated distribution equipment, including high-speed piece sorters and digital picking systems. In addition to the advanced hardware, the center is constantly manned by 200-300 temporary workers who are crucial to ensuring quality and

speed for its logistical operations. HAPPINET has developed a proprietary system to manage this workforce and considers this “software” side of its overall logistics infrastructure as part of its competitive superiority versus rival companies.

It is generally believed that the toy industry offers tens of thousands of products, and HAPPINET itself handled 15,000 items in the past. At the same time, the Company’s domain market—which extends from toys to audiovisual entertainment software like videogames and music CDs—covers some 35,000 outlets. HAPPINET sells to 100% of all such outlets, worth some 80-90% of their total sales. Despite the sheer complexity of the industry’s rapidly expanding distribution structure, the Company’s Optimal Distribution System has achieved a delivery failure rate of nearly zero percent, relieving stores of the need for itemized inspection of shipped products.

### **[Goals of the Fifth Medium-Term Management Plan, CAP 11]**

The three-year CAP 11, the Company’s fifth Medium-Term Management Plan, was initiated from FY03/10. In the past, HAPPINET has been focused on a business expansion strategy, but under CAP 11, it is now engaged in fortifying its profit base in order to reinforce and upgrade its foundations as a comprehensive entertainment trading house. The Company has also adopted three Group-wide objectives: 1) Improve its profit structure; 2) upgrade its logistical infrastructure even further; and 3) establish a business unit to develop and sell original products. The Group’s target for FY03/12—the third and final year of the current management plan—is ¥230 billion in net sales and ¥3.5 billion in ordinary income.

HAPPINET took stronger steps to reduce inventory from FY03/10, especially unnecessary stock, as part of its goal of upgrading its ability to project market demand more accurately. From April 2009, for example, it integrated separate lines of procurement to existing clients into a single system, which resulted in a considerable cost, time and manpower savings. It pared the number of products it was handling to 10,000 items, which still met 99% of the Company’s client orders, and reduced another 5,000 items by switching to a system that ships orders directly from the manufacturer. HAPPINET also tackled the issue of ample surplus stock—a signal trait of the Japanese toy industry—by lowering the optimal level of inventory to meet the harsher realities among retailers since the Lehman Bros. collapse. The cost of disposing wasted inventory totaled some ¥900 million per year, and by thoroughly revamping its inventory, the Company believes it will contribute to improved operating income.

In FY03/11—Year Two of the management plan—HAPPINET is focusing on a thorough operational application of its new inventory control system. It is also creating a profit structure to enhance the profitability of retail outlets, primarily by adopting reforms to back-office functions.

For example, the Company is testing a sales support system at the GMS level that provides each outlet with marketing proposals based on product lineup and inventory of that specific store. As for developing original products, a special development team is leading the way to sell HAPPINET's offerings on an exclusive basis.

It should be noted that with the acquisition of WINT as a consolidated subsidiary last year, HAPPINET's business line encompasses the entire range of packaged entertainment software. The Company is currently in the process of developing a new business model known as 3PL—or 3rd Party Logistics—in which HAPPINET is contracted as an outsourced distribution agency by a client-company to handle its entire logistical operation. Because the retail industry is turning toward complex-type shops, providers of audiovisual content are finding it increasingly difficult to meet the logistical challenges of the retailing transformation and are looking for agents to service such needs. The Company thus aims to capture this emerging intermediate distribution market and expand its share.

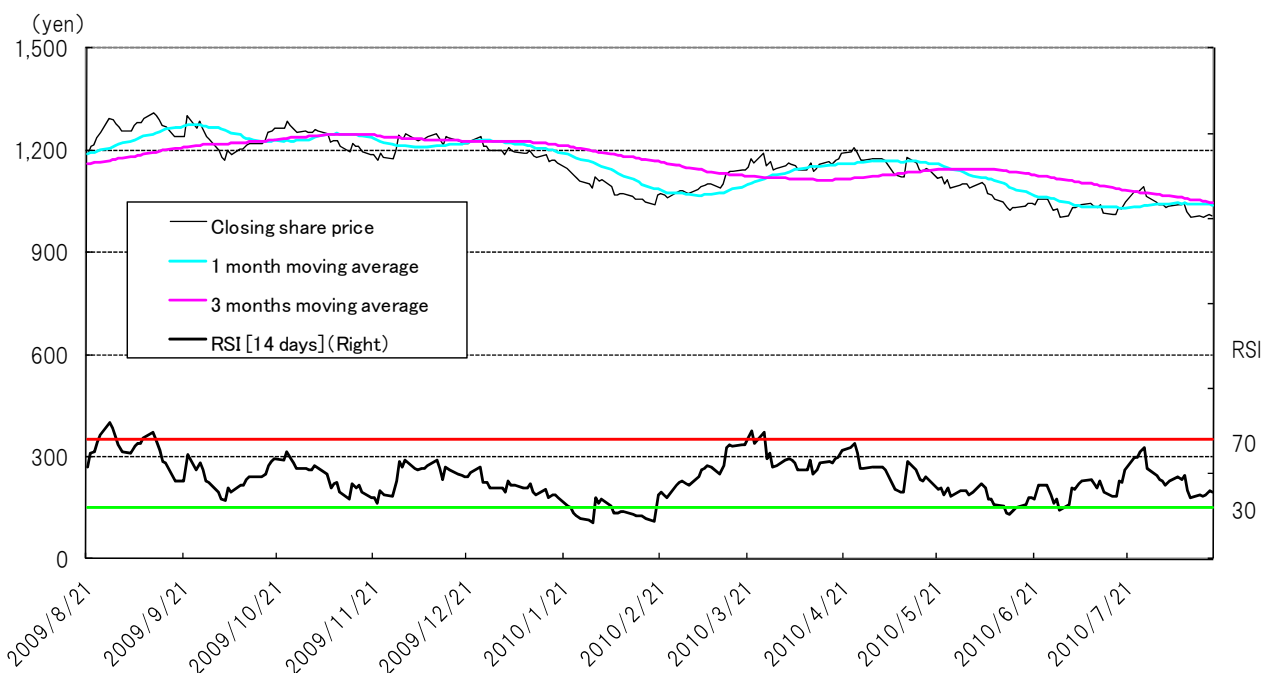
In order to meet these new challenges, HAPPINET will be adding more logistical muscle that will enable it to command an even greater share of the gradually contracting distribution market. Moreover, by maximizing its low-cost operation based on a distribution system created by the Company itself, management is targeting to increase ordinary income margin to at least 1.5% per year as the next step. With that as a foundation, HAPPINET intends to achieve sales of 10 billion yen for its original product development business, which will incorporate risk controls as well. ■■■

**[Reference] HAPPINET CORPORATION (Securities Code: 7552)**
**Key Financial Data and Business Results (Consolidated)**

Key Stock Indicators (Consolidated)			Key Financial Data (Consolidated)		
No. of Shares Issued	Mar.2010	12,025,000	Total Assets (¥million)	Mar.2010	49,050
No. of Treasury Stock	Mar.2010	823,385	Shareholders' Equity (¥million)	Mar.2010	18,961
Market Value (¥million)	20-Aug-10	12,133	Interest-Bearing Debt (¥million)	Mar.2010	2,490
BPS (¥)	Mar.2010	1,692.8	Equity Ratio (%)	Mar.2010	39.4
ROE (%) ※1	Mar.2010	6.3	Ratio of Interest-Bearing Debt (%) ※5	Mar.2010	13.1
ROA (%) ※2	Mar.2010	2.3	Free Cash Flows (¥million) ※6	Mar.2010	5,841
PER (times)	Mar.2011 fcst	8.1	※1 ROE=Current Net Income÷Averaged Shareholders' Equity of beginning of term and term end		
PCFR (times) ※3	Mar.2010	6.1	※2 ROA=Current Net Income÷Averaged Total Assets of beginning of term and term end		
PBR (times)	Mar.2010	0.6	※3 PCFR=Market Value÷(Current Net Income+Depreciation)		
Share Price (¥)	20-Aug-10	1,009	※4 Average Daily Volume=Average Daily Volume for previous 12months		
Unit Share (shares)	20-Aug-10	100	※5 Ratio=Interest-Bearing Debts÷Shareholders' Equity		
Average Daily Volume (shares) ※4	20-Aug-10	6,336	※6 Free Cash Flows=Operating CF+Investment CF		

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend per Share (¥)
FY03/07	160,606	2,153	2,554	1,616	134.54	30.0
FY03/08	168,958	1,451	1,569	△ 1,490	△ 124.11	40.0
FY03/09	166,778	2,137	2,322	1,135	97.64	30.0
FY03/10	194,246	2,327	2,513	1,179	104.60	30.0
Q2 (cumulative) FY03/11 fcst.	90,000	950	1,100	600	53.56	15.0
FY03/11 fcst.	200,000	2,600	2,800	1,400	124.98	15.0

Note: FY3/11 forecasts announced on May 12, 2010

**Share Price Charts and RSI**


Source: Prepared by Trias Corp. with Bloomberg L.P. data.

Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices.

In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.

$RSI = \text{averaged share price appreciation for } N \text{ days} \div (\text{averaged share price appreciation for } N \text{ days} + \text{averaged share price decline for } N \text{ days}) \times 100$

This Memo is for reference purposes only and is not intended as a solicitation for investment. The contents contained herein are prepared based on reliable information that already exists in the public domain. The Company, however, does not guarantee complete accuracy. Any opinion or information contained in the Memo is relevant as of the day of the Information Meeting and/or Company Visit, although the views and/or facts may be altered without prior notification. Final investment decisions shall be made by investors themselves based solely on their own judgment and responsibility.