WELLNET CORPORATION (2428 JP)

FY25 EARNINGS GROWTH FORECAST MOSTLY REFLECTS PRICE HIKES.

FY24 (JUNE YEAR-END) RESULTS

Wellnet reported FY24 (June year-end) recurring profit [RP] of ¥1,223mil (+30.8% YoY) on sales of 10,132mil (+7.5% YoY). The results beat guidance for RP of ¥1,150mil (+22.9% YoY) while sales came in roughly in line with the original forecast for ¥10,160mil (+7.8% YoY).

Wellnet (2428 JP): Earnings Summary & Guidance

(¥mil)	FY23	FY24			
	FY	FY	YoY(%)	FY CE	FY vs FYCE (%)
Sales	9,424	10,132	7.5	10,160	-0.3
COGS	7,572	7,992	5.5	N/A	N/A
Gross Profit	1,851	2,140	15.6	N/A	N/A
GPM (%)	19.6	21.1	+1.5ppt	N/A	N/A
SG&A	912	917	0.5	N/A	N/A
SG&A / Sales (%)	9.7	9.1	-0.6ppt	N/A	N/A
OP	939	1,222	30.1	N/A	N/A
OPM (%)	10.0	12.1	+2.1ppt	N/A	N/A
RP	935	1,223	30.8	1,150	6.3
NP	635	836	31.7	790	5.8

Source: Nippon-IBR based on Wellnet's FY24 earnings material

FY24 revenues were boosted by (1) strong sales of high value-added services such as settlement + α SaaS to transportation companies and (2) easy comps: FY23 sales were weak due to lacklustre sales in Wellnet's core transportation-related settlement services due to COVID-related restrictions which lasted until May 2023. However, negative factors included (1) a -9.3% YoY declined in sales from the largest retail platformer customer Amazon Japan [AMZNJ], which comprises approx. 21.5% of Wellnet's total sales and (2) no increase in fees (charges per transaction) as commission rate negotiations did not take place during FY23.

The FY24 RP performance, however, came in ahead of guidance thanks to: (1) the high value-added services noted above (+103.4% YoY), (2) a peak out of depreciation costs for large-scale developments such as ALTAIR which sequentially started from FY16, and (3) an improved sales mix due to declines in revenue from cash settlements at convenience stores [CVSs] such as cash settlement transaction for AMZNJ as consumers are moving away from cash payments. As a result, both gross profit margin [GPM] and operating profit margin [OPM] improved by +1.5ppt YoY to 21.1% and +2.1ppt YoY to 12.1%, respectively.

Wellnet has been allocating its resources primarily focusing on 1) e-billing, which includes payment settlement service for AMZNJ, and 2) settlement + α SaaS such as the e-money smartphone app *Shiharai Hisho*, the e-ticketing app *Bus Mori!*, and other customised multi-payment SaaS during FY24.

Revenue from the firm's largest customer in FY24, AMZNJ, has been declining due to consumers using less cash at CVSs and switching to settlement via

EXECUTIVE SUMMARY

- Wellnet reported FY24 sales of ¥10,132mil (+7.5% YoY), largely in line with guidance of ¥10,160mil (+7.8% YoY). At the profit level, the firm produced FY24 RP of ¥1,223mil (+30.8% YoY), which was ahead of guidance (¥1,150mil +22.9% YoY).
- Overshot in RP and improved RPM resulted from (1) increase in sales of high value-added solutions, and (2) improved sales mix: revenue from AMZNJ fell as consumers move away from cash payment, as well as peak out of depreciation cost.
- One of the high value-added, "settlement + α" solutions, Surutto QRtto was launched in June 2024. So far, Wellnet will only receive a system management fee, hence will not have much of an impact to FY25 earnings.
- Wellnet is guiding for FY25 RP of ¥1,500mil (+22.6% YoY) on sales of ¥12,000mil (+18.4% YoY), which will likely be achieved by price hikes on multi-payment services.
- Wellnet does not have any particular growth investment for now, hence plans to maintain more than 50% dividend pay-out ratio.
- Furthermore, on 14 August, the firm announced share buyback of max 500,000 shares / ¥300mil in an aim to increase the level of shareholder returns and improve capital efficiency. The Company's 'Performance Target-Linked Third Warrant' is expected to fulfil the conditions for exercising the right, but any shortfall in the treasury shares to meet the required number of shares will be bought back in the market, rather than by the issue of new shares.

credit cards and deferred payments via Paidy app. In FY24, sales from AMZNJ fell -9.3% YoY to ¥2,173mil. The second largest client, Degica, is a multi-functional payment settlement solution provider for global e-commerce merchants based in Japan, whose sales to Wellnet totalled ¥1,261mil in FY24. Wellnet provides Degica with collection agency system which is a part of Degica's multi-functional payment settlement system – this partially offset the loss of sales from AMZNJ in FY24.

Sales to Main Clients

(¥mil)	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
Amazon	3,525	3,278	3,166	3,388	3,406	2,984	2,594	2,397	2,173
Yahoo Japan	578	1,447	1,593	1,579	1,116	888	751	560	N/A
DEGICA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1,261
Total Sales	10,529	10,260	9,783	10,032	9,379	8,842	8,950	9,424	10,132
% AMZNJ	33.5	32.0	32.4	33.8	36.3	33.8	29.0	25.4	21.5
%YJ	5.5	14.1	16.3	15.7	11.9	10.0	8.4	5.9	N/A
%DEGICA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	12.4
OPM (%)	19.5	10.7	6.9	5.0	8.7	6.4	8.2	9.9	12.1

Source: Nippon-IBR based on Wellnet's YUHO and FY24 Tanshin

Although the decline in sales from the giant shopping platformer led to an improved OPM, Wellnet sees it as a risk because a huge proportion of sales could disappear as consumers' payment patterns change over time. That said, the firm also sees it an opportunity to develop a new business in its SaaS offerings to transportation operators, such as for payment and authentication solutions.

Wellnet has been investing in the development of its settlement + α services since 2016 and started offering solutions to support the digital transformation of transport operators. The firm's latest service – Surutto QRtto – provides a digital ticketing system using QR codes in collaboration with Surutto KANSAI, an IC ticket service organisation made up of 61 railway and bus operators in the Kansai region, was launched in June 2024. With this system, users purchase tickets from a dedicated website, and when boarding the train, the QR code is used to display the ticket on their smartphone via Wellnet's server.

The system targets tickets that are not currently IC chip compatible, as well as standard tickets. Moreover, despite the firm not actively advertising this service, usage by inbound tourists has been steadily increasing. Wellnet generates revenue from monthly management fees for the app system and per-user settlement and authentication fees in the Surutto QRtto service. However, revenue from such operational fees will not be enough to offset the likely decline in cash payment settlement revenues from AMZNJ.

The key growth determinant will likely be down to whether Wellnet can gain mandates for payment solutions from each of participating transportation operators. This would generate recurring revenue flow based on transaction volumes. Contributions from potential payment settlement mandates are not included in Wellnet's FY25 earnings forecast or medium-term management plan which will be in its final year in FY25.

On the BS, cash and cash equivalent includes deposit for fee collection services. As of the end of FY24, net cash totalled ¥4,677mil (+31.5% YoY).

Cash and Deposit and Current Liability breakdown

(¥mil)	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
Total Cash and Deposits	14,458	15,848	10,564	12,915	8,690	10,504	13,129	14,070	16,657
Receiving Agency Deposits	9,566	11,381	6,959	9,394	6,340	8,350	10,171	10,514	11,980
NET Cash and Deposits	4,892	4,467	3,605	3,521	2,350	2,154	2,959	3,556	4,677
Total Current Asset	19,416	20,753	14,481	15,138	14,504	14,034	16,864	18,756	21,746
NET Total Current Asset	**9,850**	**9,372**	**7,522**	**5,744**	**8,164**	**5,684**	**6,693**	**8,242**	**9,766**
Total Current Liability	12,398	13,513	8,726	11,325	12,867	11,960	14,206	15,106	16,918
Receiving Agency Deposits	9,566	11,381	6,959	9,394	6,340	8,350	10,171	10,514	11,980
NET Current Liability	**2,832**	**2,132**	**1,767**	**1,932**	**6,527**	**3,611**	**4,035**	**4,592**	**4,938**
Working Capital	**7,018**	**7,240**	**5,755**	**3,813**	**1,637**	**2,074**	**2,658**	**3,650**	**4,828**

Source: Nippon-IBR based on Wellnet's YUHO and Tanshin

FY25 OUTLOOK AND MEDIUM-TERM PLAN (FY23~FY25)

FY25 is the final year of the three-year medium-term plan. Wellnet guides for FY25 recurring profit [RP] of ¥1,500mil (+22.6% YoY vs 3-year CAGR +25.8%) on sales of ¥12,000mill (+18.4% YoY vs 3-year CAGR +10.3%), which are the target figures for the final year (FY25) of the plan.

The firm reckons that the growth drivers for FY25 are: (1) increase in sales of high value-added “settlement +α” solutions, and (2) hikes in commission fees that the firm charges to the users (consumers). On the other hand, there are some cost elements that will see increase in FY25, such as (1) rising HR costs (pay rises and an increase in personnel), and (2) an increase in settlement commission fees – payments that Wellnet makes to CVSs under a service agreement.

Although Wellnet aims to shift its business model gradually from depending on multi-payment services to higher value-added services, the vast majority of its earnings will still come from this business, therefore, maintaining margins will be key to earnings.

The gross profit is generated from two key components: (1) fees received from businesses using Wellnet’s payment settlement services (revenue), and (2) the fee the firm pays for fee collection service providers, such as CVSs – where consumers can either use the on-site Kiosk or pay cash at the till to settle their bills (COGS).

CVSs such as Lawson (delisted as of 24 July 2024 and currently co-owned by KDDI [9433 JP] and Mitsubishi Corporation [8058 JP]), Seven Eleven Japan (CVS arm of Seven & I Holdings [3382 JP]) and FamilyMart (delisted in November 2020 and became 100% subsidiary of Itochu Corp [8001 JP]) collect payments, which then will be collected by Wellnet through its payment infrastructure.

Management reckons that CVSs will raise their charges for fee collection in FY25 to reflect rising labour costs. Wellnet plans to pass on such cost increases to the fee it charges to businesses (which will then likely pass those higher costs onto consumers), with the aim of supporting the profit margin of its multi-payment services.

Any further upside to FY25 profit will solely come from payment solutions mandates with transportation service operators that participate in Surutto KANSAI consortium.

Results and Medium-term Plan Target (FY22~25)

(¥mil / June yr-end)	FY22	FY23	FY24	FY25	3-yr CAGR (%)
	Results	Results	Results	Target	
Sales	8,950	9,424	10,132	12.000	10.3
Recurring Profit (RP)	754	935	1,223	1,500	25.8
RPM (%)	8.4	9.9	12.1	11.0	N/A
Net Profit (NP)	532	635	836	1,000	23.4
Adjusted EPS (¥)	28.25	33.68	44.29	52.91	23.3
DPS (¥)	14.13	16.84	22.15	26.46	23.3
Dividend Pay-out Ratio (%)	50.0	50.0	50.0	50.0	N/A

Source: Nippon-IBR based on Wellnet's medium-term presentation material

CAPITAL ALLOCATION POLICY

As of FY24, the firm has approx. ¥8,272mil in shareholder equity, of which required working capital is approx. ¥3,000mil. Management is of the view that the major investments for growth made since FY17 has now peaked and with the launch of its Surutto QRtto services, the firm expects to see a return on investment from FY25 onwards.

Although the need to hire engineers will remain high as (1) the project scales up and (2) given the firm will continue to invest on security for its server that will have access to consumers' personal data, Wellnet is yet to disclose the amount of investment needed. As the firm expands its services to "settlement + α", it will require technologies that are not developed in-house and may result in having to co-develop or acquire with/from another company. So far, Wellnet has not identified any urgent need for development or investment for now.

Wellnet's dividend pay-out ratio remains at 50% – the firm changed it from 100% to 50% in FY17 to allocate resources to develop digital transformation solutions such as *Shiharai Hisho* and ALTAIR, primarily targeting at e-money and digitalisation demand from transportation operators. In FY25, the firm plans to pay cash dividend of ¥26.46/share (+19.5% YoY), or 50% of net profit [NP].

Furthermore, on 14 August, the firm announced share buyback of max 500,000 shares / ¥300mil in an aim to increase the level of shareholder returns and improve capital efficiency. The Company's 'Performance Target-Linked Third Warrant' is expected to fulfil the conditions for exercising the right, but any shortfall in the treasury shares to meet the required number of shares will be bought back in the market, rather than by the issue of new shares.

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