arara | 4015

TSE Growth

Initiation

High-growth fintech company in a country lagging in the cashless space

Summary

• **Overview:** arara primarily serves retailers such as supermarkets and restaurant chains, offering *Dokuji Pay* (branded currency payment + marketing) and high-speed e-mail delivery software as a service. With its *Dokuji Pay* service, where clients are the issuers, the company has a certain level of distinction from its competitors in this niche field, and is solidifying its market position. Starting in March 2024, the company plans to integrate its digital signage-related business as well, aiming to quickly accelerate its retail marketing platform strategy to help retail stores strengthen their connection with consumers both inside and outside their stores. Taking advantage of this opportunity, the company plans to rename itself Paycloud Holdings and become a holding company.

• **Earnings:** The company has formulated a three-year medium-term management plan that ends in FY2025/8, targeting sales of ¥7.0 bn and EBITDA of ¥1.5 bn. In FY2024/8, the halfway point of the plan, the company expects annual transaction volume in its mainstay cashless service business to grow from ¥1.2 tn in FY2023/8 to ¥1.5 tn in FY2024/8. In addition, it plans to consolidate Cloudpoint (CP), which operates a digital signage-related business, in 2H, which it projects will bring sales to ¥6.9 bn and EBITDA to ¥650 mn. However, since the company has not yet determined the basis for calculating the goodwill cost of CP and the amount of amortization at this time, it is only disclosing a tentative operating profit forecast for FY2024/8.

• **Share price insights:** Since the company has not disclosed its forecast for ordinary profit, net profit, or EPS for FY2024/8, the EV/EBITDA multiple is the most effective way to evaluate the company's shares. Based on the company's EBITDA forecast for FY2025/8, its current Enterprise Value is only about 6x EBITDA, a level that probably does not reflect the company's earnings growth in FY2025/8 onward. However, once the company takes advantage of its name change to Paycloud Holdings, which better reflects its business activities, to refine its IR disclosure and rectify the information asymmetry in the process, the equity market may gain more conviction of the company's earnings growth story for FY2025/8 onward and evaluate it as a high-growth fintech company.

• **Risks:** Once a system failure occurs, which are common to all system companies, its payment services will not be operational at stores. On the other hand, the company's business model is basically an anonymous cashless service, so there is no risk of personal information leaks. One potential risk in terms of investment is the possibility of equity financing (stock dilution) as a method of raising funds in the event of major M&A deals in the future, but the company noted that it has no intention of raising capital at the current stock price level to raise its cost of capital.

Y mn, %	Sales	YoY	Operating profit	YoY	Ordinary profit	YoY	Net profit	YoY	EPS	DPS
2020/8 NC	**1,201**	*15.3*	**136**	*29.5*	**142**	*27.9*	**143**	*25.4*	**25.32**	**0.0**
2021/8 NC	**1,461**	*21.6*	**305**	*124.3*	**280**	*97.2*	**229**	*60.1*	**37.34**	**0.0**
2022/8 NC	**1,165**	*(20.3)*	**(160)**	*(152)*	**(1,506)**	*(638)*	**(1,834)**	*(901)*	**(252.06)**	**0.0**
2023/8 C	**4,476**	*284.1*	**163**	*N/A*	**133**	*N/A*	**114**	*N/A*	**10.65**	**0.0**
2024/08 CE	**6,900**	*54.2*	**200**	*22.7*	-	*N/A*	-	*N/A*	-	**0.0**

Source: Compiled by SIR from the company's financial statements.
Note1: The company has not disclosed projections for ordinary profit and profit attributable to owners of parent for FY24/8 as it positions net sales, adjusted EBITDA, and operating profit as key performance indicators in its management strategy. Furthermore, since it does not disclose profit attributable to owners of parent, it does not disclose EPS figures either. 2. The operating profit projection for FY24/8 may change as the amount of goodwill resulting from the business integration with Cloudpoint is yet to be determined.

Focus Point
arara's selling point is its evolution into a promising high-growth fintech company, taking advantage of its company name change that better reflects its business to transition to a holding company and separate management and execution, while also rectifying the information asymmetry that has likely contributed to the discount on its share price.

Key Indicators	
Share price (12/6)	569
YH (23/9/28)	967
YL (23/1/4)	283
10YH (15/11/24)	3,905
10YL (22/12/29)	273
Shrs out. (mn shrs)	11.855
Mkt cap (¥ bn)	6.745
Equity ratio	48.5%
FY23/8 P/B (act)	3.16x
FY24/8 P/E (CE)	—
FY23/8 ROE (act)	6.34%
FY24/8 DY (CE)	—

Stock Price Chart 52 Weeks

Source: Trading view

Kenichi Sugimoto, Analyst
research@sessapartners.co.jp

Company profile

■ Summary: Japan's top player in branded currency payment services

Currently, arara inc. provides high-speed e-mail delivery service and its subsidiary Valuedesign Inc. provides its *Dokuji Pay** (branded currency payment + marketing) service as a SaaS offering.

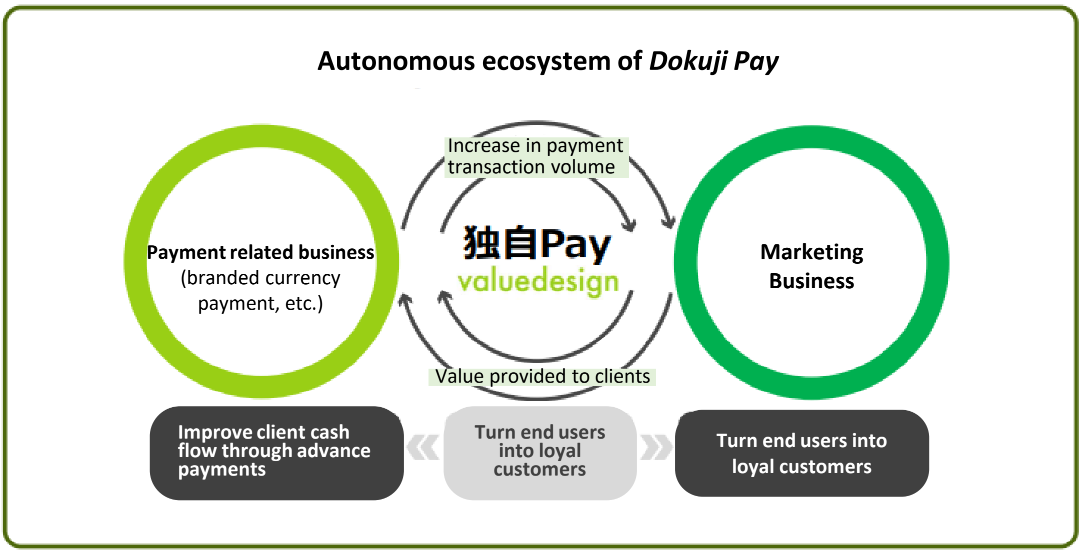
The company's mission is "Striving to make the world better and the people happier with new ideas and technologies," and by integrating its cashless service business into Valuedesign, which merged with the company in June 2022, the company has established and is further enhancing its position as a top player in Japan’s branded currency payment market.

In the mainstay cashless service business, clients (retail stores, etc.) use the company's services to become their own branded currency payment provider and reward point issuer, encouraging their consumers to use the service. Clients can carry out sales promotions, such as offering additional e-money or reward point campaigns based on the frequency of store visits and the amount of money spent. Major clients include supermarkets and restaurants, with annual transaction value topping ¥1.2 tn. The company receives a portion of the *Dokuji Pay* transaction value as a system usage fee. It does not disclose the rates of this fee, but notes that they are lower than the typical fees paid by credit card merchants to credit card companies (5% of the transaction amount for restaurants, 4% for retail stores, and about 1% for convenience stores). The company defines *Dokuji Pay* as a service that combines payment and marketing, and provides the sales promotion and marketing functions essential for encouraging regular customers to return to stores as a single package deal. The company itself is not directly involved in the issuance, operation, or settlement of the *Dokuji Pay* service. The payment providers and reward point issuers for *Dokuji Pay* are the company’s clients themselves.

In the solutions business, the company provides a high-speed e-mail delivery messaging service, a data security service featuring a personal information search solution, and an AR service. The messaging service includes an e-mail delivery service that automatically delivers large volumes of marketing e-mails for sales promotions and transaction e-mails such as notifications to companies and organizations with large numbers of members and users, reducing the risk of e-mail delivery delays and undelivered e-mails. Major clients include airlines, financial institutions, online shopping sites, and local public organizations.

*About *Dokuji Pay*

Client-specific payment service *Dokuji Pay* = branded currency payment + marketing



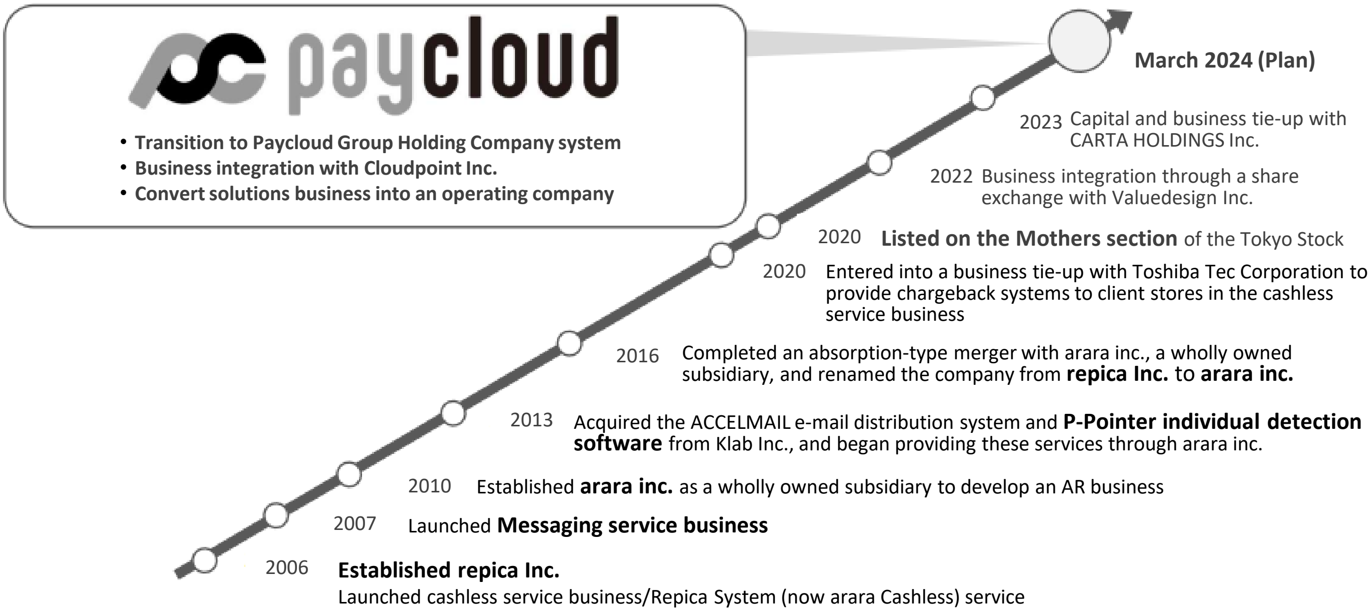
Source: Compiled by SIR from the company IR material.

■ **History and Future: Company name change and conversion to holding company planned for March 2024**

In 2006, Yosuke Iwai, the current representative director and vice chairman of the company, established repica as a cashless service business. In 2007, it launched a messaging service business and then changed its name to arara in 2016. In November 2020, the company listed on the Mothers section of the Tokyo Stock Exchange, and in June 2022, the company made Valuedesign, which was established in 2006 by Toru Onoe, the current president of the company, into its wholly owned subsidiary through a share exchange, integrating the cashless service businesses of the two companies and taking the top share of the branded currency payment market in Japan.

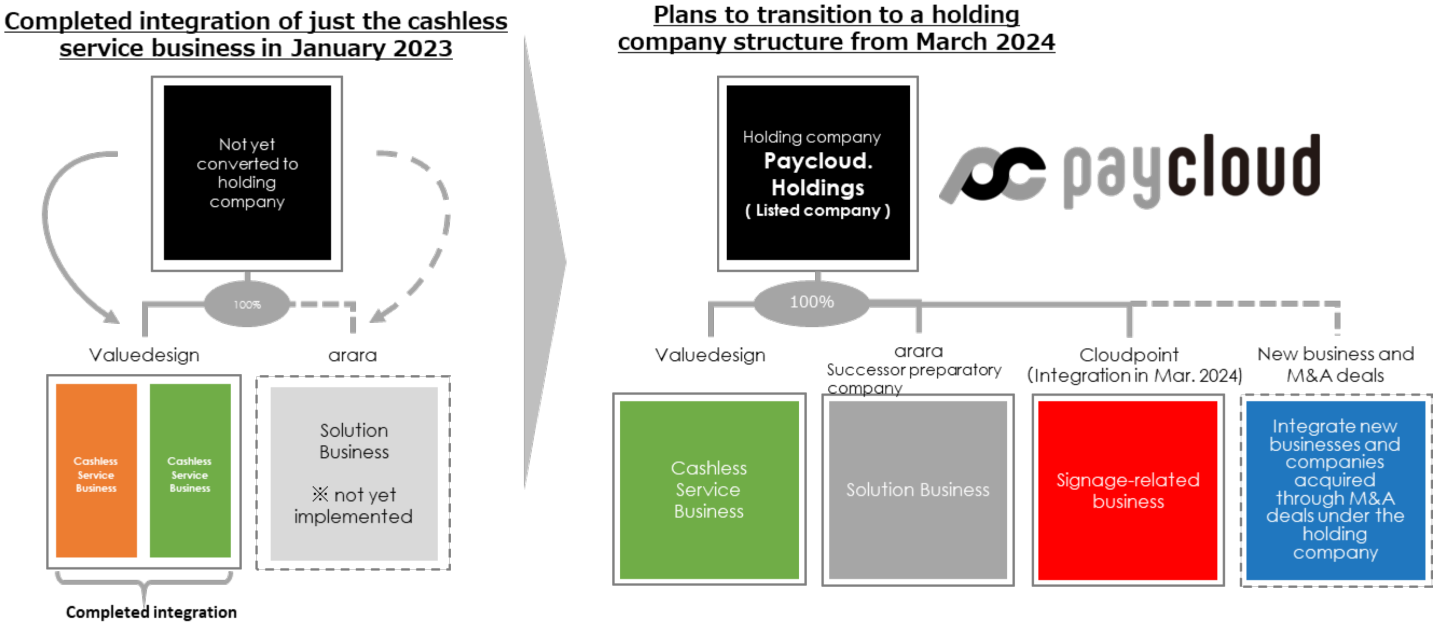
arara announced that it will strengthen its retail media and marketing-related business using digital signage by making Cloudpoint into a consolidated subsidiary in March 2024.

Taking this opportunity, the company plans to change its name to Paycloud Holdings and transition to a pure holding company structure. In addition to the three existing businesses of Valuedesign, which operates a cashless service business, arara, which operates a solutions business, and Cloudpoint, which operates a signage-related business, the holding company will also pursue new businesses through potential M&A deals and by creating businesses organically.



Source: Compiled by SIR from the company IR material.

Promoting separation of management and execution by converting to a holding company



Source: Compiled by SIR from the company IR material.

FY2023/8 segment information

(¥mn)	Cashless Service Business	Solution Business	Total	Adj.(*)	Grand total
Net sales	3,792	689	4,481	(5)	**4,476**
Operating Profit (OP)	620	226	846	(683)	**163**
OP Margin	16.4%	32.8%	18.9%		**3.6%**

Note*: Adjustments include corporate expenses not included in any segment, the majority of which are general and administrative expenses.
Source: The company IR material.

Business model

■ **Business model and business strategy:**

Following the business integration of Valuedesign, the company's business segments in FY2023/8, the first 12-month financial results disclosed, consisted of the cashless service business and the solutions business. The cashless service business is the growth driver of the company, accounting for about 85% of sales and 73% of unadjusted operating profit. The solutions business, on the other hand, has been relatively stable and highly profitable, with an unadjusted operating profit margin of about 33%.

■ **Business model of cashless service business**

Prior to the business integration, the former arara and Valuedesign were fiercely competing for market share as the two largest independent players in the cashless service business. However, the two companies agreed to further strengthen their market competitiveness and to enhance their Enterprise Value in the areas of payment and sales promotion by efficiently providing various cashless DX services to retailers and other clients by taking advantage of economies of scale. The business integration was completed in June 2022 through a share exchange in which 3.2 shares of arara common stock were allocated for each share of Valuedesign common stock.

Specifically, the company consolidated the cashless service businesses of the two companies into Valuedesign and unified the sales and client success functions in January 2023. This not only shared and expanded both companies' human resources for new client acquisition, sales agent network, and know-how for *Dokuji Pay* support, but also ended the fee discounting battle that had taken place as a result of the competition for market share between the two companies. In addition to the unification and consolidation of new client acquisition activities, the two companies have clearly strengthened their support for existing clients, developing measures to help clients attract more customers and expand sales by acquiring new users and boosting the payment ratio of their branded currency payment service.

In the cashless service business, the payment commission (system commission), which is a certain fee rate multiplied by the *Dokuji* Pay transaction value on the client side, is recorded as sales. Prior to the business integration, the fee rate was not only relatively low owing to the constant competition for clients, but also differed slightly from client to client. However, the fee rate for new clients has improved after the business integration. Accordingly, the company has noted that they need to expand transaction value in order to boost sales in the cashless service business, and that the growth driver for this is to pursue both new client acquisition while bolstering existing clients. In terms of pursuing both growth drivers, the management team has stated that it plans to expand its sales force headcount by 10% each year, taking on a manpower tactic that is in line with the recruiting and training activities outlined in the medium-term management plan. In addition, the company intends to revise system usage fees during FY2024/8, and plans to implement the price revisions gradually starting in November 2023.

■ **Advantages of introducing *Dokuji Pay***

The company’s *Dokuji Pay* is a prepaid system that enables customers to top-up cash onto a card or smartphone application before purchasing products, so that cash is received by the store as an advance payment at the time the card is loaded. As a result, client retail stores can (1) improve their cash flow and business conditions; (2) benefit from a lower fee rate of the *Dokuji Pay* service compared to credit card and general-purpose QR code payment services; (3) implement their own effective campaigns based on customer attributes and purchase histories using the sales promotion functionality provided as a standard feature of *Dokuji Pay*; (4) encourage customers to return to the store and become loyal customers by offering them various benefits and preferential services at the time of payment as the points granted to customers can only be used at their own stores; and as a result, (5) easily retain regular customers. Ultimately, the amount loaded (advance payment) will further increase as end users of client branded currency payment systems become loyal customers, and retailers will be able to achieve the same benefit as financing through bank loans and other means.

In contrast, with common payment methods such as credit card and QR code payments, the issuer is the credit card company or code payment company, which uses a portion of the several percent in fees collected from the merchant to provide rewards and benefits, so the rewards and benefits are less generous than those offered when using *Dokuji Pay*. Furthermore, on top of merchants not being able to run their own campaigns, the rewards do not necessarily encourage customers to return to the merchant's store. In this sense, *Dokuji Pay* can be seen as a product enabling retailers to take on their own initiatives to encourage repeat visits to their stores.

To illustrate *Dokuji Pay* being a product enabling retailers to take on their own initiatives to encourage repeat visits to their stores, let's take a hamburger store as an example. Suppose there is a burger store selling a hamburger for 300 yen, and the burger store also sells its *Dokuji Pay* card for 1,000 yen. The card is designed in a way where when a customer loads 1,000 yen into the card, it is worth 1,100 yen. When a customer purchases a ¥1,000 card using cash, common QR code payment methods such as PayPay or a credit card, the purchased card is worth ¥1,100, so the customer has three opportunities to purchase a ¥300 burger, with ¥200 still remaining, thus providing an incentive for a fourth visit to the store. From the burger store's point of view, this is a way of selling the *Dokuji Pay* mechanism as a different type of product that secures the fourth visit (selling price of ¥1,200) for ¥1,000. Since customers can load the money through other payment methods, *Dokuji Pay* does not necessarily compete with other cashless payment services, and can even complement them in some ways.

One of the points that distinguish the company from general payment service providers is that it has accumulated intangible assets such as promotional expertise in various industries, such as restaurants, apparel, and supermarkets, by working together with its clients. For example, in the case of a *Dokuji Pay* campaign for a supermarket, customers who load their card can be given a box of tissues to take home as a gift. This encourages others who come across the reload campaign to take an interest by motivating them to reload their cards by offering a tissue box. The accumulation of common expertise and knowledge is in understanding that the perfect signature gift for a program like this is a tissue box, which is too big to fit into a shopping bag and lets other people know that there is a campaign going on at the store.

■ Business model of the solutions business

The core of the solutions business is the messaging service, which accounts for about 75% of its sales. This is primarily an automated email delivery service for the mass and simultaneous delivery of transaction emails, such as promotional marketing emails and notifications, which has the advantage of reducing the risk of customer email delivery delays and undelivered emails. Marketing emails are emails aimed at attracting customers and creating loyal customers, which is highly complementary with the *Dokuji Pay* service. Transaction emails include automatic notification emails in response to customer actions such as reservations and registrations for products and services, and are used to distribute emails linked to core systems, such as execution notifications at securities firms. By facilitating the coordination between core systems and high-speed email delivery systems, which are paramount for customer service, the company has secured a critical position. Furthermore, by providing a safe, secure, and stable API, the company has ensured long-term client use (average client use of API is nearly 8 years).

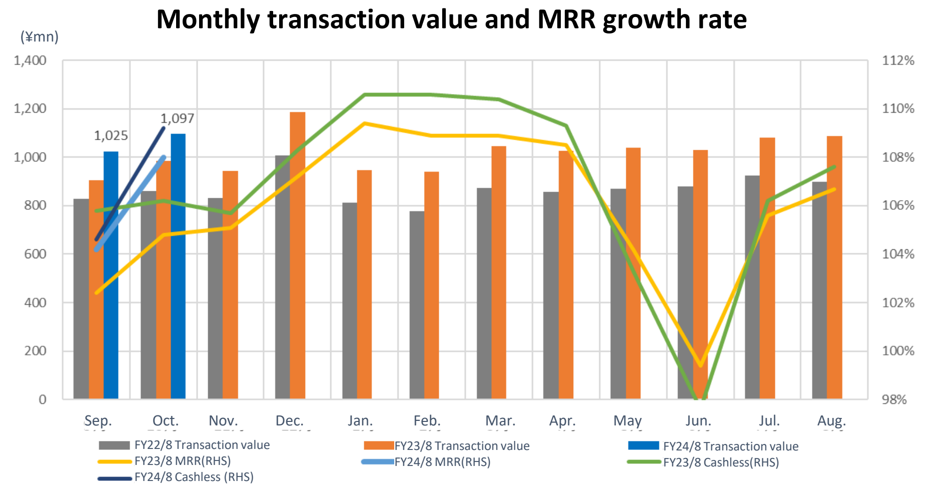
Service usage fees are the main source of sales in this business, and sales are calculated by multiplying the fixed monthly fee per client by the number of client companies. To boost sales, the company is focusing on acquiring and retaining new clients rather than raising the price per client. Its churn rate during FY2023/8 was low at 0.2%, and the company had an average of 254 clients in 4Q (vs. 220 clients at the end of FY22/8). The company's share of the Japanese email delivery market is estimated to be around 2%, and there is room for broad expansion as the company acquires new clients in the future.

According to interviews with the management team, the cost structure of this business mainly consists of fixed costs such as outsourcing expenses (server costs and outsourcing costs) and personnel expenses, so the marginal profit ratio is high, and sales beyond the break-even point easily ties directly into profit. As a result, the business is more profitable than the cashless service business, with an unadjusted operating profit margin of about 33% in FY23/8.

■ MRR growth rate and transaction value as KPIs

The company has been disclosing monthly recurring revenue (MRR) growth rate (YoY), transaction value (renamed from payment value owing to the launch of online reload service from September 2023), total accumulated ID count, and total store count as key performance indicators (KPIs) on a monthly basis starting from September 2022.

The company defines recurring revenue as the sum of payment fees in the cashless service business and system usage fees in the solutions business (cashless services, messaging services, and data security services), which are paid to the company on an ongoing basis based on the use of its services, and is directly related to the sales line in the company's income statement. For the cashless service business, which accounts for 85% of total sales, the company separately discloses the MRR growth rate for just the cashless service due to its importance. However, it should be noted that the MRR growth rate is the YoY growth rate of gross revenue including new contracts signed during the month, and differs from comparable store revenue growth rate, which excludes the impact of new stores. Accordingly, it goes without saying that as long as the company continues signing new contracts, MRR and transaction value will be positive YoY (over 100%). With that said, since the company began disclosing the figures, both transaction value and MRR have been growing YoY, and with the exception of May-June of the previous FY2023/8, the cashless service MRR growth rate has been higher than the overall MRR growth rate, which indicates that the company's business is steadily expanding.



Source: Compiled by SIR from the company IR material.

On the other hand, total accumulated ID count is the number of issued IDs, consisting of two types: Reusable reloadable IDs and gift card-like IDs that are disposed of when fully used. It is also difficult to determine when to deactivate a reusable ID in cases where it has not been used for several months, and neither the company nor the contracted issuing company can accurately determine the number of IDs that are active or inactive. The total store count includes store IDs for stores that have been closed as they are managed by the client, and the company is unable to determine the total active store count. In this sense, the total ID count and total store count are the accumulated gross consumer and contracted store counts of clients that have previously installed the company's services, and do not take into account withdrawals or service discontinuations. As such, the importance of these figures among the KPIs comes below MRR and transaction value.

Based on the breakdown of arara's non-consolidated cost of sales and SG&A expenses in the FY22/8 annual securities report, fixed costs, consisting mainly of server costs, labor costs, and business outsourcing costs, account for nearly 80% of total expenses, resulting in a high marginal profit ratio (before amortization of goodwill) of approximately 70%. Therefore, unless the company makes a series of large investments that would result in a substantial increase in fixed costs, the company's profitability should improve dramatically as long as it continues to expand its business steadily as sales would come in well beyond the break-even point.

■ Summary of Cloudpoint's digital signage-related business

At the time of its FY2023/8 earnings result announcement on October 13, 2023, the company also announced a stock swap and business integration with Cloudpoint ("CP"), to take effect on March 1, 2024.

Founded in 1990 by Takashi Miura, CP is involved in digital signage, spatial design, and advertising, and plans and proposes sales promotions, spatial design, and cost reductions using video equipment in a variety of locations, including commercial facilities, retail stores, transportation facilities, outdoor advertising, and public facilities.

Digital signage is a generic term for a system that uses screens and other electronic display devices connected to a network to distribute information in a variety of locations, including for outdoor advertising, inside and outside of stores, public facilities, and transportation systems. Specific examples are as follows.

- KFC* and Baskin Robbins* stores installed digital signage for menu boards and POP displays, enabling them to deliver menu and other information as well as promotional content tailored to the time of the day.
- Metro Ad Agency* installed an ultra high-definition LED vision system on the second basement concourse of Shibuya Station, utilizing a total of 12 pillars and 24 screens for story-like images and life-size representations of people, characters, etc. using large vertical screens. It is used for various purposes including information dissemination, spatial design, advertising, and sales promotion.

KFC

Menu-board

Baskin-Robbins

Menu-board

Metro-ad

Pillar ads

Source: The company IR material.

CP provides digital signage services such as sales promotion advertisements on menu boards and fixed displays to 48,000 screens in approximately 20,000 locations nationwide, including restaurant chains, shopping centers, and convenience stores. CP's strength lies is its one-stop execution of all operations from installation to operation, including consulting and planning, equipment selection, system proposal, installation work, content creation, distribution and operation, equipment maintenance, and analysis. While there are companies in Japan that are strong in each of these eight business fields, no other company is able to comprehensively provide all services as a one-stop shop. By leveraging this strength, CP can resolve customers' labor shortages, improve operational efficiency, and promote in store DX.

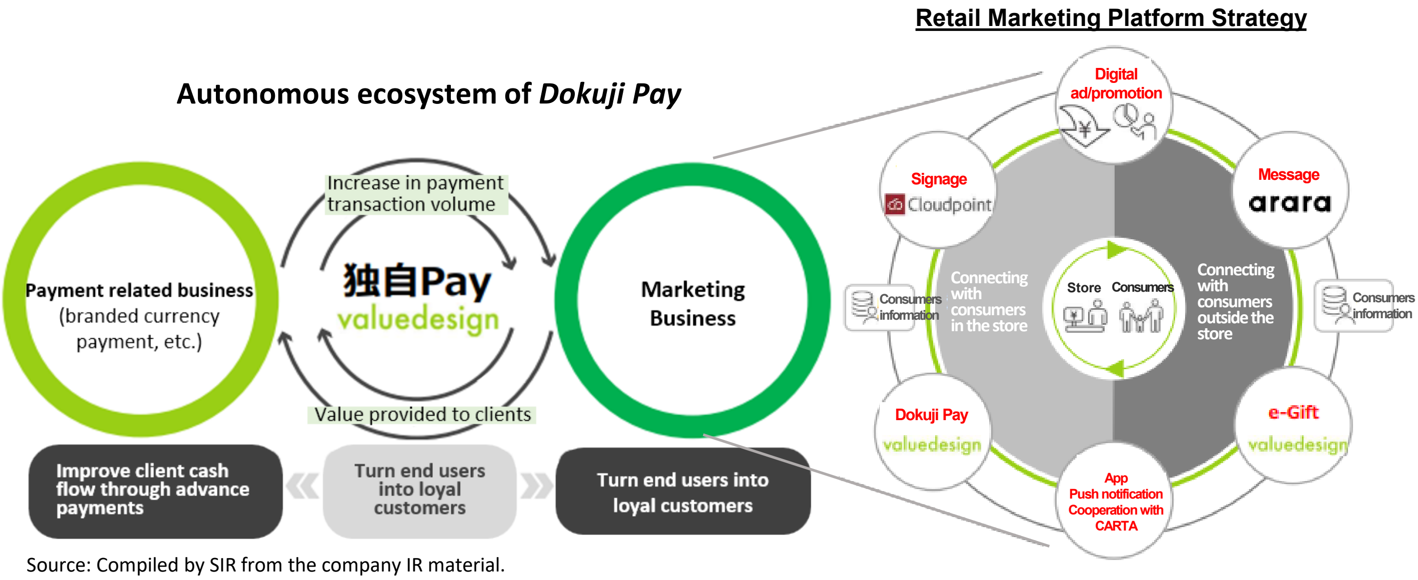
CP's digital signage-related business mainly generates spot lump-sum sales, such as from the sale of goods and initial sales of digital signage equipment and system installations, rather than recurring service usage fees and maintenance fees from contracted clients. Unlike the cashless service and solutions businesses, which generate recurring sales, sales in the digital signage-related business is likely to be more volatile.

Significance of Cloudpoint integration in terms of growth strategy

The main applications of digital signage fall into three categories: information dissemination, advertising and sales promotion, and spatial design. In the area of advertising and sales promotion and spatial design, the company expects to achieve synergies with Valuedesign, which boasts a client base of retail stores and restaurants.

To accelerate the *Dokuji Pay* eco-system, the service will serve as a touchpoint with consumers outside the store, providing coupons and special offers provided by stores and manufacturers through apps and other means, and promoting store visits with e-gifts. CP's digital signage was an indispensable piece of the retail marketing platform strategy, as consumers who visit stores are notified of great deals through digital signage on permanent displays in stores. Once they are motivated to make a purchase through a "last push" using the client branded currency payment service, clients can then launch receipt-based promotions that motivate consumers to return to their stores. CP, arara, and Valuedesign shared the same vision in this regard, which led to the business integration.

An example of the evolution of the business model through this integration and consolidation of CP effective March 2024 is the idea of possessing the point of monetization from a marketing perspective, and being able to provide all of the solutions that enable stores of cashless service client companies to seamlessly connect with consumers. To give a concrete example, the company will use LINE Mini Apps developed by Digiclue, a subsidiary of CARTA HOLDINGS Inc., which the company entered into a capital and business tie-up with in March 2023, to stimulate consumer purchase interest and encourage store visits by providing information on store advertisements and campaigns (e.g., coupons). Digital signage advertisements operated by CP will be placed at the storefronts to provide information about the day's events and other information to stimulate consumer purchase interest when they visit the store. Consumers can use coupons posted on the LINE Mini App and pay for other purchases with the branded currency payment service available on their LINE My Card. In this way, the company will be able to repeatedly provide a total marketing solution that promotes store revisits for regular customers with *Dokuji Pay* accounts and improve cash flow and business efficiency, by bringing potential customers (consumers) outside of the store inside, visually stimulating their purchase interest, and providing points they can use the next time they visit the store by paying with the *Dokuji Pay* system.



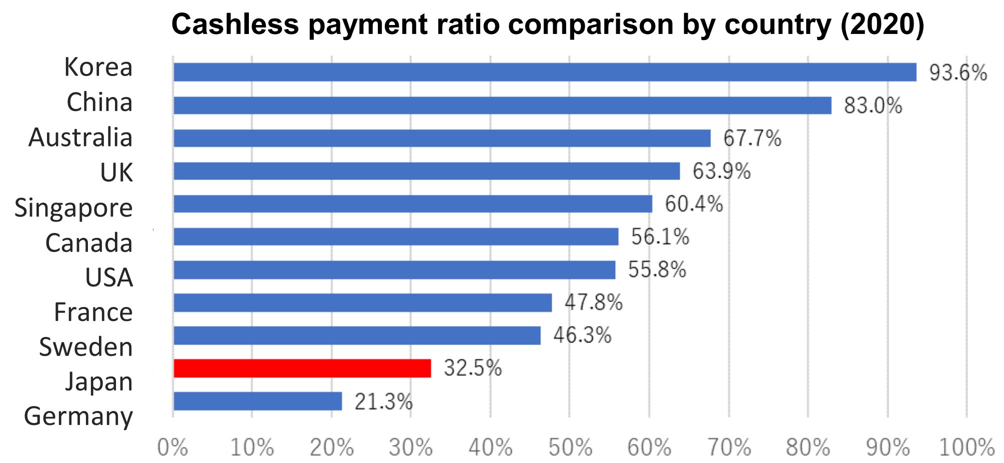
Source: Compiled by SIR from the company IR material.

Business opportunities and risks

■ Major growth potential offered by a country lagging in the cashless space

According to materials prepared by the Study Group on the Future Direction of Cashless Payment under the Cashless Payment Promotion Office, Commerce and Service Industry Policy Group, Ministry of Economy, Trade and Industry in March 2023, Japan's cashless transaction value in 2021 amounted to ¥95 tn, with the cashless ratio at 32.5% of private-sector final consumption expenditure. In 2022, the Ministry of Economy, Trade and Industry (METI) reported that the cashless payment ratio was 36.0% (¥111 tn), of which credit cards accounted for 30.4% (¥93.8 tn), debit cards 1.0% (¥3.2 tn), electronic money 2.0% (¥6.1 tn), and code payments 2.6% (¥7.9 tn). Compared to other countries, Japan lags in the cashless space and has a lot of room to expand.

The Cashless Vision formulated by the Study Group in April 2018 clearly stated the direction of cashless policy promotion, stating, "Toward the Osaka-Kansai Expo (2025), we pledge to realize a high cashless payment ratio and achieve the 40% cashless payment ratio target set in the 'Future Investment Strategy 2017' as a 'Payment Method Reform Declaration' ahead of schedule. Furthermore, in the future, we will aim for 80%, the highest level in the world."



Source: Compiled by SIR based on materials from the Study Group on the Future Direction of Cashless Payment published in March 2023 by the Cashless Payment Promotion Office, Commerce and Service Industry Policy Group, Ministry of Economy, Trade and Industry.

Based on data from Yano Research Institute Ltd.'s "2022 Edition: Actual Conditions and Future Forecast of the Japan Cashless Payment Market," the company estimates the prepaid serviceable available market (SAM) to be ¥23 tn, of which it estimates the serviceable obtainable market (SOM) for *Dokuji Pay* to be ¥5.2 tn. Based on this data, it formulates its growth strategy for the cashless service business.

Taking on a variety of business opportunities while cementing its niche position

Players in the broadly defined cashless service market include a significant number of general-purpose cashless providers, such as credit, debit, QR/barcode payment, and general-purpose e-money services from the transportation and distribution sectors. As mentioned earlier, *Dokuji Pay* does not necessarily compete with general-purpose cashless payment services, and can even complement them in some ways.

On the other hand, there are only a few operators that provide SaaS-type systems to retail stores similar to *Dokuji Pay*. One of these is the cashless service offered by the CGC Group (a cooperative chain of small and medium-sized supermarkets nationwide), and about 100 of the 208 CGC member stores (4,436 total stores) have already introduced this service. However, the company noted that since CGC only offers this service to CGC member stores, it does not compete with CGC for the approximately 800 supermarkets nationwide that are not CGC member stores. Less than half of supermarkets have installed the *Dokuji Pay* system and there is room for further growth. The company has approximately 250 supermarket clients, or about 25% of all supermarket companies. There is also a system company competing with the company in restaurant chain sector (family restaurants, Japanese and Chinese restaurants, fast food, etc.). This company has not moved into the small in restaurant chain sector, thus creating a certain degree of segregation. Accordingly, it is fair to say that the company has cemented a solid position in this niche business area.

The company is also actively working with local governments. If there is an existing supermarket client in the municipality, it is easier for the company to bring the local government on board as a new client. The current local pay program for local governments is subsidized by the Japanese national government and is therefore seasonal. The company is now proposing a scheme to local governments that does not rely on national government subsidies with the aim of offering the service year-round. This is something it is working on with NTT DOCOMO, called the iD scheme, and this could be another business opportunity going forward.

With the acquisition of the license for iD e-money provided by NTT DOCOMO, the company now has the environment enabling the use of Valuedesign's *Dokuji Pay* service in more than 2 million iD member stores nationwide. For *Dokuji Pay* issuers, this will not only improve convenience for *Dokuji Pay* users (consumers), but will also boost fee income and usage data collection. The new business opportunity for the company also means that it will be able to expand iD services to local currencies such as those used by local governments, which the company has not been able to capture to date.

International expansion of cashless service may also be a promising business opportunity in the future

The company also provides cashless services in overseas markets. In the Indian market, it offers digital gift services, and in the Thai market, it focuses on CRM and loyalty point services.

In the Indian market, the company is working with EazyDiner, a leading local restaurant reservation service provider, to expand its digital gift distributor business, which can be used at over 12,000 partner restaurants. Most recently, the company signed an agreement with Amazon and began handling Amazon Pay eGift Cards. The company is now poised to reach approximately 500 mn consumers in major cities in India.

The company noted that it does not disclose the amount or scale of overseas revenues because they are still minor and immaterial in terms of the company's overall size.

■ Potential business risks

The most significant business risk for the company would be a system failure. Once systems go down, stores will not be able to use its payment services. However, this is a risk common to all system operators and is not unique to the company. The company implements system redundancies to avoid this, but it keeps the system decentralized because if it were to manage balances entirely on a single system, all clients would experience downtime in the event of a system failure.

Since the company's database generally does not hold customer information related to personal information, the risk of personal information leaks in the company's cashless service is basically nonexistent given its business model, which is basically a white-labeled cashless service. On the other hand, in the solutions business, clients occasionally upload personal information to the server temporarily.

The emergence of new competitors is also unlikely to be a major factor. In terms of barriers to entry, it is not as simple as switching to another card company simply because they have a system, since expertise in campaigns and promotions for cashless services plays an important role. While the major players target the general-purpose payment business, the company's forte is in the B2B market for individual stores, which is a niche market. Accordingly, new entrants into this area are quite rare.

On the other hand, should technological innovation advance faster than expected along with rapid changes in business practices and consumer purchasing behavior, the company's dependence on SaaS offerings may slow its response, and the risk of a major revision to its growth strategy is not entirely unrealistic over the long term. While this is not a short-term risk, if it does materialize, the one that comes to mind today is the Buy Now Pay Later (BNPL) scheme, which is a popular payment method for online shopping in the US in particular, where even non-credit card holders can pay later in installments with no installment fees, with the merchant covering the payment settlement fees. This service is gaining popularity in Europe and the US, especially among young people, including Generation Z, as it enables installment payments even for expensive items. In terms of BNPL-related companies, US-based Affirm is publicly listed, while Australia's AfterPay (subsidiary of US-based Block) and Sweden's Klarna (unlisted) have been growing their business. In Japan, Paidy, a subsidiary of US-based PayPal, already offers a deferred payment service for online stores, but is not yet profitable according to its FY22/12 earnings announcement. However, since BNPL's business domain currently focuses on online shopping and not physical retail, the benefits of introducing BNPL to the company's physical retail store clients using the *Dokuji Pay* service are minimal. As such, the business model of BNPL services are opposite to that of the company's, and it is unlikely that there will be any direct competition. However, it remains to be seen what will happen if Generation Z, which will become the core of the company's end-users, becomes accustomed to paying later and begins to dislike prepayments. Ultimately, it is likely, that the payment service that the end-users believe offers the best value from among the various payment methods will win out the competition.

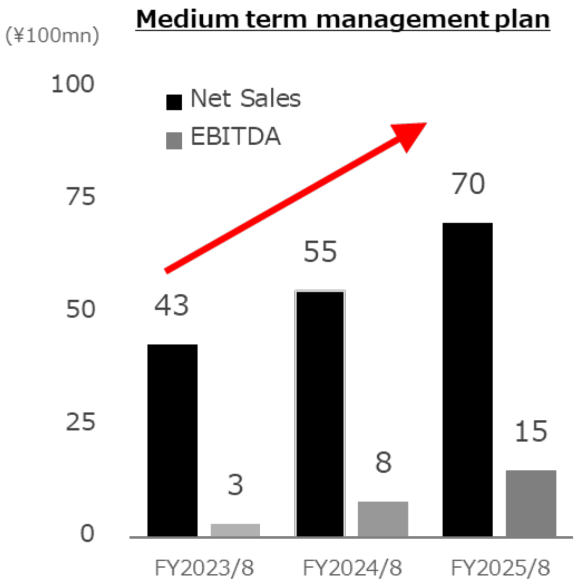
Medium-term Management Plan

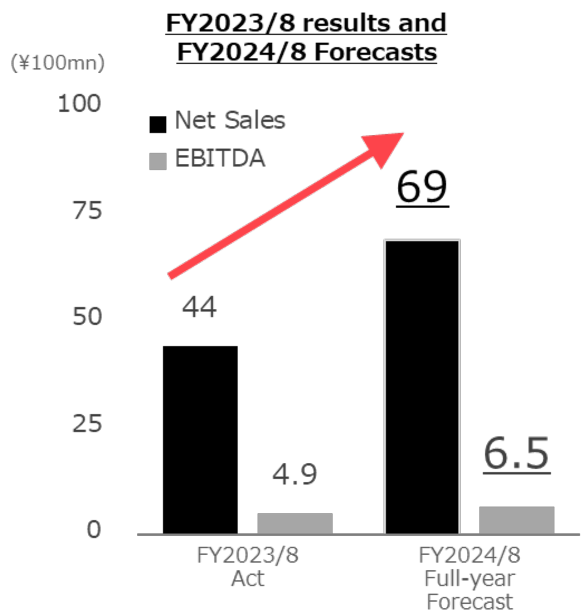
EBITDA = sum of operating profit and depreciation and amortization [including amortization related to intangible assets]

■ FY2025/8 earnings targets: Net sales of ¥7.0 bn, EBITDA of ¥1.5 bn

In March 2022, the company formulated a three-year medium-term management plan ending in FY2025/8. The plan's main objectives are to boost profitability by focusing management resources and streamlining operations through the integration of arara and Valuedesign, and to expand profits by leveraging *Dokuji Pay's* leading market share in Japan.

For FY2025/8, the company is targeting sales of ¥7.0 bn, as well as EBITDA of ¥1.5 bn, which it sees as a key performance indicator in its management strategy. The company explains that this earnings target assumes not only organic growth of existing businesses, but also a certain amount of revenue contribution from potential M&A deals. In addition, the company also added that the earnings targets are not calculated from the bottom up based on KPIs (such as total ID count and store count), but rather represent a rough earnings level as a stepping stone in the medium- to long-term growth phase. The reason the company does not disclose operating profit targets is because it positions M&A opportunities as one of its growth drivers and cannot forecast the goodwill that will be recorded in connection with the acquisition of Valuedesign. As such, it believes that operating profit after amortization of goodwill does not necessarily accurately reflect the company's actual earnings.





Source: Compiled by SIR from the company IR material. Note: The full-year FY2024/8 earnings forecast includes Cloudpoint's earnings forecast figures added together from March 1 (2H), the scheduled effective date of the business integration.

Results summary

■ FY2023/8 results exceeded initial projections

In FY2023/8, the first year of the medium-term management plan, the company reported net sales of ¥4,476 mn, EBITDA of ¥497 mn, operating profit of ¥163 mn, ordinary profit of ¥133 mn, and profit attributable to owners of parent of ¥114 mn, exceeding both the medium-term targets of ¥4,300 mn in sales and ¥300 mn in EBITDA (also exceeding the FY2023/8 forecast of ¥100 mn in operating losses disclosed on the FY2022/8 earnings summary report).

The main reason behind actual EBITDA coming in above the company's FY2023/8 forecast is the higher-than-expected sales growth, such as from reaching ¥1.22 tn in *Dokuji Pay* transaction value versus the original plan of ¥1.2 tn. In addition, the company had originally targeted a cost reduction of over ¥100 mn, but it managed to stop the price war for new clients between arara and Valuedesign in a healthy way, promoting the management integration in a sound manner and pursuing new clients together, which helped yield integration benefits that surpassed the cost reduction target.

The company also improved its financial position. It refinanced ¥1.4 bn of borrowings from Mizuho Bank through a syndicated loan arranged by Mizuho Bank (totaling ¥1.0 bn, with equal principal repayments of ¥200 mn annually over the next 5 years), which improved the short-term and long-term balance of interest-bearing debt, thereby improving the financial condition of the company, particularly its current ratio.

Full-year earnings forecast

■ FY2024/8 earnings forecast: Net sales of ¥6.9 bn, EBITDA of ¥0.65 bn

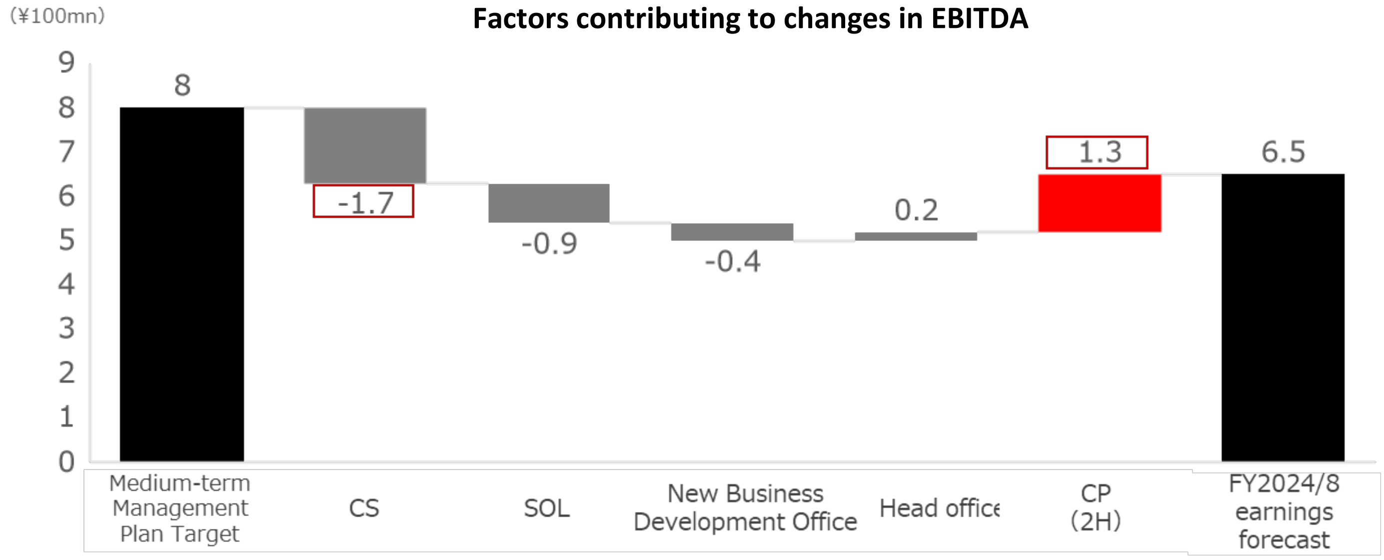
The company plans to include Cloudpoint's earnings in its consolidated financial results from March 2024 (i.e., 2H FY2024/8). As a result, the company projects net sales of ¥6,900 mn and EBITDA of ¥650 mn for FY2024/8, which is just shy of targets for the final year of the medium-term plan of ¥7,000 mn for net sales and ¥800 mn for EBITDA, respectively. The company has not made any changes to its original medium-term management plan for FY2025/8, and plans to drive its business forward to achieve its targets.

EBITDA estimates appear to have been revised downward from the ¥800 mn figure projected when the medium-term management plan was formulated. According to the company's explanation, the breakdown is as follows: (1) In the cashless service business operated by Valuedesign, the delivery of a major project originally scheduled to be recorded in FY2024/8 was brought forward to FY2023/8, and the earnings of the cashless service business will likely level off, accounting for part of the ¥170 mn drag in EBITDA; (2) Weaker-than-expected growth in the solutions business led to a downward revision of ¥90 mn; (3) Upfront investments in new business development led to a downward revision of ¥40 mn; (4) Reduction of head office expenses came in above projections, leading to an upward revision of ¥20 mn; and (5) The company expects the consolidation of Cloudpoint (CP)'s earnings from 2H to boost EBITDA by ¥130 mn for the six-month period. As a result, the company revised its EBITDA forecast lower by ¥150 mn compared to the initial plan.

The company plans to expand its sales force by 10% annually as part of its medium-term management plan. As the company's promotion projects for existing clients increase, it will need to assign support staff to these clients and stores, and sales-related personnel resources are often allocated to existing clients rather than to new client acquisition.

For FY2024/8, the company plans to make system investments of about ¥160 mn in the cashless service business and about ¥30 mn in the solutions business, along with about ¥3 mn in marketing expenses for updating its corporate website, for a total of about ¥190 mn in investments. Since this is within the company's FY2024/8 EBITDA of ¥650 million and short-term borrowing repayments of approximately ¥200 million, it is unlikely that the investments will strain the company's balance sheet.

Factors contributing to changes in EBITDA



Source: Compiled by SIR from the company IR material.

arara has set an FY2024/8 annual transaction value target of ¥1.5 tn for its mainstay cashless service business. The company launched a credit card payment service that enables the use of credit cards to reload funds to the Value Card. Previously, SMEs needed to sign individual contracts with credit card companies, and had to pay higher fees than larger businesses. However, the arara Group now acts as an intermediary between credit card companies and SME businesses that use its *Dokuji Pay* service, and since it expects transaction values at stores using *Dokuji Pay* to grow, the company stepped in to offer credit card reloading at a discounted rate (closer to that of large businesses) compared to individual contracts by entering into a comprehensive lump-sum contract with credit card companies. By extending this service to existing *Dokuji Pay* stores, not only will the transaction value of *Dokuji Pay* increase on the back of reloading with credit cards, but the company will be able to earn a prepayment transaction fee from credit card companies. In addition, the company believes it is about time to review rates and increase the payment fees.

According to the company's disclosure of CP's earnings results for FY2023/8, sales amounted to ¥3,160 mn with operating profit at ¥220 mn, and the FY2024/8 forecast calls for sales of ¥3,370 mn and operating profit of ¥220 mn. Therefore, based on a simple calculation, CP's earnings for 6 months in 2H (sales of approximately ¥1,700 mn and operating profit of approximately ¥110 mn) would be consolidated into the company's results.

Although the company projects an operating profit of ¥200 mn for FY2024/8 in its earnings summary, there is little point in debating whether the company will be able to achieve this target. This is because the basis for calculating the goodwill for the CP acquisition, which will be recorded in 3Q FY2024/8 (March 1, 2024 to May 31, 2024), has not yet been determined. Since all shares of CP were acquired through a share exchange (3.47 shares of arara common stock for each share of CP common stock), the total purchase price of CP will be based on the closing price of arara stock on March 1, 2024, with purchase price allocation taking place thereafter. Since arara’s share price is also an uncertainty, it is impossible to estimate the goodwill cost at this point in time. Incidentally, there will be some dilution in terms of the number of issued shares of the new holding company, with a 31.7% increase in share count from 11,848,563 shares at the end of August 2023 to 15,604,348 shares.

Share price insights

■ Share price level reflecting substantial information asymmetry

It is difficult to evaluate arara's share price valuation as the company provides fewer disclosures compared to other publicly listed companies when it comes to information related to earnings per share, which is often used to determine what the appropriate valuation multiple is. In addition, it is also difficult to compare the company with other companies in the same industry, as there are no longer any publicly listed competitors engaged in prepaid cashless services. While not directly comparable, the following companies are worth mentioning: POS register SaaS service provider Smaregi (TSE Growth: 4431), online payment service collection agency Billing System (TSE Growth: 3623), and product and service-exchangable e-ticket and e-gift distribution provider Giftee (TSE Prime: 4449).

arara has not disclosed its forecast for ordinary profit, net profit, or EPS for FY2024/8. Accordingly, based on the limited information available, the most useful multiple for comparing its share price valuation with the four companies is likely the EV/EBITDA multiple. As shown in the table below, the EV/EBITDA ratio based on the arara's FY2024/8 forecast is 13x, with Billing System at 10x, Giftee at over 30x, and Smaregi at about 50x, indicating that equity investors are giving relatively high valuations to Giftee and Smaregi. A multiple north of 10x suggests that investors have high growth expectations, but it is worth noting that the company's EV/EBITDA multiple is equivalent to a no-growth company at 6x, based on its FY2025/8 EBITDA forecast of ¥1.5 bn, taking into account the dilution from the new shares to be issued after the consolidation of CP (assuming a 31.7% increase in share count immediately following the March 1, 2024 announcement of a share exchange and business integration with CP).

Valuation comparison of comparable companies

TSE Code			4015	4431	3623	4449
Name			**arara**	**Smaregi**	**Billing System**	**giftee**
Latest act. year			2023/8	2023/4	2022/12	2022/12
Share price	¥	2023/12/5 cp	576	2,847	902	1,867
Shrs out.	1,000 shrs	Latest FY	11,856	19,659	6,564	29,255
		Fully diluted after	15,604			
Mkt cap	¥mn	Latest FY	6,829	55,969	5,921	54,620
		Fully diluted after	8,988			
EV	¥mn	Latest FY	6,594	50,632	4,611	52,923
		Fully diluted after	8,753			
PER	X	Latest FY	59.9	61.5	17.6	5,462
		CE (current period)	N.A.	85.8	23.1	N.A.
		Consensus forecast (next period)	N.A.	59.2	N.A.	N.A.
PBR	X	Latest FY	3.16	11.66	2.51	6.75
PSR	X	Latest FY	1.53	9.23	1.65	11.56
		CE (current period)	0.99	7.10	1.60	7.85
PCFR	X	Latest FY	12.2	55.4	-5.0	128.8
EV/EBITDA	X	Latest FY	14.0	50.8	8.6	79.2
		CE (current period)	13.0	48.9	10.1	35.8
		Consensus forecast (next period)	4.4	32.5	N.A.	N.A.
		Consensus forecast (Fully diluted after)	5.8			
EBITDA	¥mn	Latest FY	497	1,048	536	668
		CE (current period)	650	1,083	455	1,462
		Consensus forecast (next period)	1,500	1,551	N.A.	N.A.
ROE	%	Latest FY	6.3	20.0	15.1	0.1

Note: Medium-term management plan target used for arara's consensus FY2025/8 EBITDA forecast.
Enterprise Value of Billing System adjusted to include clients' deposits as a type of interest-bearing debt.
Source: Complied by SIR from SPEEDA data.

arara has very limited investor relations disclosure materials available in English. According to the company, there are some foreign investors in its shareholder list, but it does not disclose their shareholding ratios. Although Billing System does not provide investor relations information in English, it discloses on its website that foreign shareholding ratio stood at 12.9% as of the end of December 2022. In contrast, Smaregi's foreign shareholding ratio was at 14.3% according to the most recent Toyo Keizai Shikiho. In addition, Smaregi's website shows multiple sell-side analyst coverage, with investor relations information disclosed in English as well. Giftee does not disclose shareholding ratios by investor category, but it shows multiple sell-side analyst coverage on its website and discloses investor relations information in English.

One might speculate that the high valuations of Smaregi and Giftee may be linked to their relatively well-known profile. Information asymmetry may be at the root of arara's valuation discount.

■ Will a company name change trigger a rerate?

However, once the company takes advantage of its name change to Paycloud Holdings, which better reflects its business activities, to refine its IR disclosure and rectify the information asymmetry in the process, the market may gain more conviction of the company's ability to reach or surpass ¥1.5 bn in EBITDA in FY2025/8 and see the growth potential for FY2026/8 onward and evaluate arara as a high-growth fintech company.

With that said, the company's growth strategy going forward includes creating new businesses through M&A deals, and it has occasionally resorted to equity financing through stock swaps and issuing new shares since its IPO, diluting its shares each time. While equity financing would be one option for raising funds in the event of major M&A opportunities in the future, the company's management has made it clear that it has no intention of increasing its cost of capital by raising capital at the current share price level of around ¥600.

Income Statement

¥mn, %	2019/8	2020/8	2021/8	2022/8	2023/8	2024/08(CE)	2025/08(CE)
Total Revenue	**1,043**	**1,201**	**1,461**	**1,165**	**4,476**	**6,900**	**7,000**
Cost of Sales	396	428	435	418	2,180		
Gross Profit	647	773	1,027	748	2,297		
Gross Margin(%)	*62.03*	*64.36*	*70.29*	*64.21*	*51.32*		
Selling, General and Administrative Expenses	541	637	721	908	2,133		
Operating Profit	**106**	**137**	**306**	**(161)**	**164**	**200**	
Operating Profit Margin	***10.2***	***11.4***	***20.9***	***(13.8)***	***3.7***	***2.9***	
Non-Operating Income	9	9	10	0	14		
Interest and Dividends Income	0	0	0	0	1		
Non-Operating Expenses	3	3	36	1,346	44		
Interest Expenses	1	1	2	19	24		
Income from Equity Method - Non-Operating				(1,325)	5		
Ordinary Profit	**112**	**142**	**280**	**(1,506)**	**133**		
Ordinary Profit Margin(%)	***10.7***	***11.8***	***19.2***	***(129.3)***	***3.0***		
Extraordinary Gains/Losses	(12)	0	(1)	(295)	2		
Extraordinary Gain		1		10	14		
Extraordinary Loss	12	1	1	305	12		
Pretax Profit	**100**	**142**	**279**	**(1,801)**	**136**		
Pretax Profit Margin(%)	*9.6*	*11.8*	*19.1*	*(154.6)*	*3.0*		
Income Taxes	(15)	*(2)*	50	*33*	22		
Income Taxes - Current	13	*16*	35	*2*	73		
Income Taxes - Deferred	(28)	*(18)*	16	*31*	(51)		
Net Profit Attribute to parent company shareholders	**115**	***144***	**229**	***(1,834)***	**114**		
Net Profit				*(1,834)*	114		
Net Profit Margin (Attribute to parent company shareholders)(%)	***11.0***	***12.0***	***15.7***	***(157.4)***	***2.5***		
Adjusted EBITDA					**497**	**650**	**1,500**
Adjusted EBITDA Margin(%)					***11.1***	***9.4***	***21.4***

Source: Complied by SIR from SPEEDA data.
Note: Non-consolidated financial results until FY2021/8.

Balance Sheet / Statements of Cash Flows

¥mn	2019/8	2020/8	2021/8	2022/8	2023/8
Total Assets	**556**	**1,055**	**3,387**	**3,856**	**4,402**
Current Assets	**383**	**844**	**707**	**1,777**	**2,350**
Cash & Cash Equivalents And Short-term Investments	252	700	561	1,094	1,491
Cash & Cash Equivalents	117	133	134	441	699
Accounts Receivables	4	1		150	88
Non-Current Assets	**172**	**211**	**2,680**	**2,080**	**2,052**
Property, Plant & Equipment (PPE)	26	22	25	92	68
Intangible Assets	78	103	250	1,878	1,897
Goodwill				*1,601*	*1,045*
Investments and Other Assets	68	86	2,404	110	87
Investment Securities (inc. Subsidiaries and Affiliates)	**2**	**0**	**2,333**	**0**	**0**
Deferred Tax Assets - Non-Current	28	47	31		30
Current Liabilities	**273**	**634**	**577**	**2,162**	**1,135**
Trade Payables	30	21	52	134	349
Accounts Payable - Other and Accrued Expenses	71	44	47	155	127
Short-Term Debt	20	100	300	1,664	317
Short-Term Borrowings		*100*	*100*	*50*	*5*
Current Portion of Long-term Debt	*20*		*200*	*1,614*	*312*
Advances Received	111	118	106	151	188
Non-Current Liabilities	**6**		**1,500**	**263**	**1,104**
Long-Term Debt	*6*		*1,500*	*194*	*903*
Straight Bonds				*68*	*36*
Deferred Tax Liabilities - Non-Current					163
Total Shareholders' Equity	**277**	**421**	**1,310**	**1,431**	**2,163**
Capital Stock	332	332	662	695	1,002
Capital Surplus	332	332	662	2,559	2,866
Retained Earnings	*(387)*	**(243)**	*(13)*	**(1,848)**	**(1,733)**
Share Warrants				25	30

¥mn	2019/8	2020/8	2021/8	2022/8	2023/8
Cash Flows from Operating Activities	**146**	**417**	**47**	**-218**	**562**
Depreciation and Amortization - CF	32	28	33	37	334
Cash Flows from Investing Activities	*(63)*	**(43)**	*(2,511)*	**(194)**	**(88)**
Proceeds from Sales of Securities and Investment Securities		2			
Payments for Purchases of Stocks of Subsidiaries and Affiliates			(2,333)		5
Purchases/Sales of PPE	(2)	*(4)*	(9)	*(9)*	(20)
Purchases/Sales of Intangible Assets	(53)	*(44)*	(170)	*(181)*	(111)
Cash Flows from Financial Activities	**(43)**	*74*	**2,324**	*(97)*	**(81)**
Repayments of Short-Term Borrowings	(15)	100		(50)	(50)
Increase in Long-Term Debt			1,683		984
Proceeds from Issuance of Bonds				100	
Repayments of Long-Term Debt	(28)	(26)		(200)	(1,593)
Redemption of Bonds					(32)
Proceeds from Issuance of Stock			660	54	613
Changes in Cash	40	448	(140)	534	397
Cash & Cash Equivalent - Beginning	212	252	700	561	1,094
Cash & Cash Equivalent - Ending	252	700	561	1,094	1,491
Free Cash Flow (FCF)	**83**	**374**	**(2,464)**	**(412)**	**474**

Source: Complied by SIR from SPEEDA data.
Note: Non-consolidated financial results until FY2021/8.

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Sessa Partners Inc.

#5a i-o Azabu, 2-8-14
Azabujyuban, Minato-ku, Tokyo
info@sessapartners.co.jp