

Nihon Equity Research

Company Note

Raccoon: Fallen Angel or Rising Phoenix? The Jury Is Still Out on the B2B Wholesale Broker

KEY POINTS

- Stock price fell over 90% following IPO
- Still near their bottom, shares beginning to look more attractive
- Changes in fee structure will stabilize revenue stream
- Expected losses in April 2007 and 2008, but April 2009 should be positive

Summary and Investment Conclusion

The shares of Raccoon (Mothers; 3031), a Japanese online B2B wholesale broker that went public in April 2006, has fallen about 90% from the high of 3,860,000 yen reached a few days after its IPO. But the Company may now deserve another look. Gross revenues and gross profit were up sharply for the midyear period ended October. Moreover, the losses expected for April 2007 and 2008 are mainly due to a change in the Company's fee structure, which should stabilize the Firm's revenue stream and bring Raccoon back to profit in April 2009. We're not ready to recommend purchase yet. But now selling at about 400,000 yen, or only 20 times April 2006 profits and 15 times anticipated April 2009 net, Raccoon no longer looks so frightening.

Deja-Vous All Over Again - Or a Buying Opportunity?

For a U.S.-based analyst, even thinking about recommending a company like Raccoon (Mothers; 3031), a Japanese online B2B wholesale broker that went public in April 2006, is a little scary. Raccoon's stock price, after hitting 3,860,000 yen a few days after its IPO and listing on the TSE's Mothers section -- known for its "new economy" companies with sky-high PEs -- continued to decline to a low of 285,000 yen, almost a 93% drop. Along the way, the Company, which had been profitable for two fiscal years prior to the IPO, incurred a midyear loss in October, and revised its forecasts downward to net losses for the years ending April 2007 and 2008. Is this merely a replay of the bust in US Internet stocks, circa 1999?

Or are things really not that bad? Perhaps at the current price of 400,000 yen the Company deserves another look. While it incurred a net loss of 77 million yen for the 6 months ended October 2006, compared with 35 million yen in net income for the year-earlier period, gross revenues increased 60.5%, and gross profit was up 28.2%. The net loss included a revaluation

Prepared by
Chako Ando and
Bob Schneider

March 6, 2007

for the write-off of deferred taxes of 57 million yen. Operating cash flow was positive at 29 million yen.

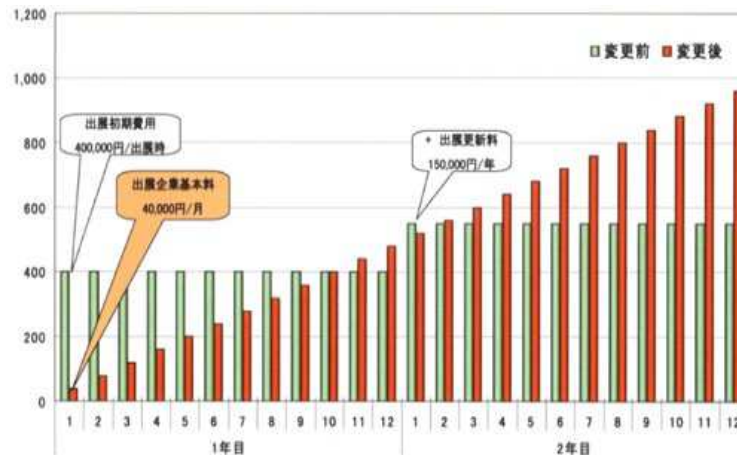


"However, the company's belief that the new fees will bring in continuing monthly income seems to make sense."

More important, the revised forecasts to negative territory for 2007 and 2008 are largely due to the Company's shift in its medium-term strategy. Judging that there is a significant opportunity in bridging the B2B business for Japan's small- and medium-size firms -- a sector known for its complicated, fragmented, and inefficient supply chain -- Raccoon decided to (1) change its fee structure from payments upfront to a recurring fee model, and (2) invest heavily in advertising to attract a retail-store customer base.

The changes in fee structure had an immediate, negative effect on the bottom line, since some existing customers departed and there was a drop in initial, one-time revenues when new merchants signed up. However, the Company's belief that the new fees will bring in continuing monthly income seems to make sense (see the chart on the next page prepared by Investment Bridge, Raccoon's IR firm).

Is the increased advertising bringing in new customers and merchants? The jury's still out, but customer/merchant acquisition data shows an increase in the customer base of around 4% per month since October, and as of the end of January it is up 37.3% since the end of last fiscal year in April 2006. The Company doesn't release monthly revenues, but in the past they have been strongly correlated to the number of customers.



Green bar - revenue model with former fee structure

Orange bar - revenue model under new fee structure

"...Even with a positive turnaround, the stock price may take a while to react."

We're not ready to call Raccoon a buy until we find out the relationship between new advertising/customer acquisition costs and their impact on revenues. The PE based on last year's results is approximately 20, while the forward PE based on the Company's April 2009 results would be approximately 15. We know that Japan's new exchanges, especially Mothers, are supposedly scary places, full of new, risky companies with lofty PEs. But at least compared to some of the U.S. bubble-economy companies that in 1999 had PEs of 500 based on EPS five years or so down the road, Raccoon does not look so frightening.

One final note, however: The pool of available investors in the Company is limited. At a per-share price of 400,000 yen (about US\$3,300), quotes are too high for most individual investors, while at a market cap of about US\$30 million, the Company would be too small for many institutions.

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