Analysis of Operating Results and Financial Position

[Review of Operations]

In the fiscal year ended November 30, 2019, the Japanese economy saw a trend toward gentle recovery, which was the result of various economic policies as well as an uptick in personal consumption and capital investment. On the other hand, the economic outlook remained uncertain, based partly on unstable political trends overseas such as prolonged trade friction between the U.S. and China and concerns about the impact of geopolitical risk.

The Japanese government has incorporated the concept of the Fourth Industrial Revolution into its growth strategy. In the Fourth Industrial Revolution, physical things of all kinds, including automobiles and home electric appliances, will be connected to the internet, making Cyber-Physical Systems a reality. A Cyber-Physical System is a system that quantifies various states of the Physical Part of the real world that are subject to control, and quantitatively analyzes this data in the Cyber Part to derive new insights and knowledge, which are then fed back and used to control the Physical Part of the real world. The general belief is that the ability to collect and retain big data from the Physical Part of the real world through IoT technology and the ability to manage and analyze this data through AI and blockchain technologies in the Cyber Part will be crucial.

The Company's main focus is the CPS/IoT market, which grew in 2016 to a scale of ¥194.0 trillion globally and ¥11.1 trillion in Japan. By 2030, the global market scale is projected to grow to ¥404.4 trillion, and the Japanese market scale to ¥19.7 trillion. Furthermore, the agriculture field, which has exhibited remarkable growth in Japan, saw annualized growth of 20.2%. (Source: Survey of Trends Related to Focus Field 2017, Japan Electronics and Information Technology Industries Association)

In addition, the 5th generation telecommunications system ("5G") possesses features such as multiple simultaneous connections and low delay, while achieving high speeds that surpass 4G. It is being reported that commercial services will be launched sometime around the spring of 2020.

In this business environment, UX302NC-R, an LTE/3G USB data telecommunications terminal, passed inter-operability testing performed by NTT DOCOMO, INC. ("DOCOMO") at NCXX Inc. ("NCXX") in November 2019, and are being sold at DOCOMO shops nationwide and on the DOCOMO online shop, along with being listed on the company's website as a product handled by DOCOMO. It is expected to be deployed in the fields of PC/tablet usage and IoT/M2M more widely than before.

Cloud-based vehicle management and automatic vehicle monitoring systems are seeing increased demand due to stricter legal regulations, more efficient vehicle management operations and the social environment surrounding the market such as fewer and older drivers. In this field, NCXX has begun developing versions of GX410NC and GX420NC, OBD II-type automotive telematics data collecting units that have secured a share of the market, that are compatible with LTE from multiple telecommunications carriers. NCXX plans to release these versions in fiscal 2020 in anticipation of announcements by telecommunications carriers about the schedule for discontinuing 3G network service and restricting new multi-year contracts.

[Operating Results]

Looking at consolidated business results, orders for large-scale projects for the retail industry were scheduled at NCXX. Additionally, in August 2019, measures were put in place by the U.S. government which banned procurement from five companies, including Huawei and ZTE. NCXX products can be used with confidence since the company does not outsource manufacturing to the abovementioned five companies or use parts sourced from them. For this reason, demand for changeover parts from the aforementioned five companies has increased, resulting in significant increases in both sales and profit. As for the internet travel business, the 10-day Golden Week holiday had a positive impact, leading to a significant sales increase.

In other news, sales fell at TITICACA, Co. Ltd. ("TITICACA") due to unseasonable weather in July 2019 and a reduction in inventory caused by reevaluation of purchase amounts aimed at improving cash flow in the current fiscal year. Despite implementing discounts during the August sales period, sales and profits from store sales both decreased as recovery was less than anticipated.

In the previous fiscal year, e frontier, Inc. ("e frontier") recorded sales and operating income resulting from investment operations of an AI-based cryptocurrency trading system. However, in the current fiscal year, the company conducted investment operations aimed at accumulating small returns while mitigating risks, resulting in significant decreases in both sales and operating income year on year.

As a result of these efforts, consolidated net sales were ¥9,670 million, down 13.1% year on year. Operating loss was ¥633 million, compared with operating income of ¥419 million in the previous fiscal year. Ordinary loss was ¥678 million, compared with ordinary loss of ¥47 million in the previous fiscal year. Loss before income taxes was ¥1,218 million, compared with loss before income taxes of ¥265 million in the previous fiscal year. Loss attributable to owners of parent was ¥1,272 million, compared with loss attributable to owners of parent of ¥473 million in the previous fiscal year.

Business performance by segment in the fiscal year under review was as follows:

Analysis of Operating Results and Financial Position

(IoT-Related Business)

NCXX aims to provide new services that utilize "IoT and new technology" such as "IoT and blockchain technology" and "IoT and AI technology" based on IoT technology for various fields including automotive telematics which it has cultivated.

Specifically, in the field of image authentication, which serves as the "eye" of machine learning to analyze and collect large amounts of data, NCXX is developing real-time image authentication technology. This technology uses GPU (operational equipment that conducts parallel arithmetic necessary for image processing and deep learning) supplied by NVIDIA Corporation, which offers various platforms in the field of AI computing. Real-time image authentication technology can be utilized in the security field, such as in facial recognition systems and security camera footage analysis, and various other fields, such as in defective part detection on factory lines and automatic operation or driving assistance for automobiles.

The company began full-scale research and development of image authentication in the previous fiscal year. In the agricultural ICT business, it plans to develop a system that determines the sugar content of tomatoes in a contact-free manner without the use of a saccharimeter This will be achieved through AI learning of images of tomatoes and their sugar content. NCXX also plans to develop robots that can identify the location of harvest-ready tomatoes in growing areas and ultimately perform automated harvesting of the tomatoes.

Looking at existing products, the U.S. National Defense Authorization Act for Fiscal Year 2019 ("NDAA 2019") was passed in August 2018, greatly strengthening restrictions on five companies: Huawei, ZTE, major security camera company HIKVISION, Dahua Technology, and Hytera. In August 2019, measures prohibiting procurement from the five aforementioned companies were implemented by U.S. government institutions. NCXX products can be used with confidence since none of the products currently on the market are manufactured by outsourcing to the abovementioned five companies related to the recently passed NDAA 2019, or use parts sourced from them. For this reason, demand for changeover parts from the aforementioned five companies increased.

The Group will continue to monitor trends carefully, and continuously manage and monitor its contract manufacturing providers while developing trustworthy new contract manufacturing providers. The Group will work to further expand its product groups to meet the needs of the market as a domestic Japanese manufacturer. The Group will continue to provide mobile computing solutions such as LPWA, which is expected to spread in markets in Japan and overseas going forward, and the next-generation 5G telecommunications standards, automotive telematic solutions that integrate high-valued-added communication devices and software, as well as various other types of solutions.

Care Dynamics Limited ("Care Dynamics") is a provider of ASP systems to nursing care businesses. It has already deployed ASP systems at more than 400 nursing care facilities. With the launch of services such as support for the introduction of nursing care robots and the provision of nursing care ICT, Care Dynamics has evolved into a comprehensive nursing care business support enterprise.

As a service for assisting caregivers, Care Dynamics offers nursing care robots as a sales agency, distribution of instructive leaflets of corporations using manga illustrations, and services for creating advertisements. Care Dynamics continues to provide tours of nursing care facilities that have adopted the Drive Care OBD II solution for nursing care transportation services, and offers free trials of the solution.

Moreover, Care Dynamics reviews electricity providers and offers replacement support services to help nursing care facilities cut their electricity bills, in addition to conducting sales of a sleep management system and providing services that introduce water-saving systems and help corporate entities build networks.

Care Dynamics concluded a new customer referral agreement with SmartHR, Inc., and began introducing cloud-based HR and labor-related software provided by the company.

e frontier sells various types of software, primarily software for graphic design creation, geared toward creators. In addition, the company has concluded an exclusive agency agreement for Japan with Other World Computing, Inc. ("OWC"), which develops many peripheral devices for creators, and conducts sales of peripheral devices for computers such as Thunderbolt 3*1 products and eGPUs*2, as well as ancillary services, in Japan. In addition to preexisting sales on Amazon.com, it launched sales of 630 products, including the new brand AkiTio which it began handling in summer 2019, on a new Yahoo shop opened in October 2019 and began contributing to earnings increases. Starting from January 2020, it even launched sales on Rakuten Ichiba through a sales outlet.

The Company also sells AI versions of mahjong, shogi and go games, which were developed internally, and aims to continue increasing customer acquisition. For example, at the end of 2018, it provided the AI mahjong program as the core engine of the Doman Mahjong game in Final Fantasy XIV, a major online game operated by SQUARE ENIX CO., LTD.

*1 Thunderbolt 3 is a high-speed, all-purpose data transmission technology jointly developed by Intel and Apple that uses USB-C cables.
*2 eGPU refers to an externally attached GPU unit that can be used even with laptop computers.

Looking at the agricultural ICT business NCXX FARM, we advanced "sixth-order industrialization business" for the production, processing and sale of agricultural produce. We also promoted franchise business entailing sales of a packaged system with chemical soil management based on a patented farming method and digital management based on ICT systems.

In addition to cultivating mini tomatoes in five colors in the "sixth-order industrialization business," we set up a website dedicated to GOLDEN BERRY (edible ground cherries) (https://farm.ncxx.co.jp/services/goldenberry/), an incredibly popular superfood that we began selling in 2018. In addition to the vegetables, we launched sales of GOLDEN BERRY Ice Cream, and received a favorable response. Because supply is currently insufficient, we intend to increase the area of the orchard by more than five times in the next fiscal year and secure a larger supply.

Analysis of Operating Results and Financial Position

In the franchise business, we introduced an environmental management prediction system NCXX FARM, which combines elements necessary for vegetable growth and health management and manages environments automatically. We are continuing to evaluate the effects of controls. Although the total yield amount is less than that of mini tomatoes, we will commercialize and launch sales of a franchise system for GOLDEN BERRY, which produce a stable yield and are highly profitable.

As a result, segment sales in the fiscal year ended November 30, 2019 were ¥1,243 million, up 30.8% year on year. Segment profit was ¥115 million, up 137.6% year on year.

(Internet Travel Business)

Amid an overwhelming number of new travel services, e-tabinet.com and its subsidiaries in the internet travel business specialize in personalized online travel quotes. In order to address consumer needs, which are becoming extremely sophisticated as years go by, the Company has also strengthened business alliances aimed at acquiring quote requests, while working to improve usability with services such as chat support for quote requests and AI concierge support.

At Gloria Tours Inc. (“Gloria Tours”), demand for support of domestic and overseas tournaments grew ahead of the commencement of the Tokyo 2020 Paralympic Games. The Company also launched a service to select Paralympic athletes and human resources and a service to plan and manage events such as lectures and hands-on lessons by Paralympic athletes. Going forward, it will focus even more effort on various markets related to sports for people with disabilities.

Web travel Co., Ltd. (“Web travel”) has increased its order volume and acquired repeat customers by improving the level, speed and strength of its support system for concierge services to make them even more appealing, with travel concierge business as its core. The crowdsourcing business, which began as an opportunity to leverage the skills of concierge agents outside the travel industry, also performed well. Furthermore, the business alliance with Saison UC Card, which it has promoted since February 2018, continued to grow steadily. Going forward, Web travel plans to expand into new markets and build even stronger relationships.

Net sales managed to cross the ¥2 billion mark for the first time since the Company’s founding due to positive impacts from the 10-day Golden Week holiday and last-minute demand before the consumption tax hike. Overseas travel business sales were ¥2,461 million, while domestic travel business sales came to ¥171 million. The total annual number of requests handled was 2,947 (up 6.0% year on year), and the total annual number of customers handled was 7,726 (up 3.7%).

As a result, segment sales in the fiscal year ended November 30, 2019 were ¥2,632 million, up 11.2% year on year. Segment loss was ¥13 million, compared with segment profit of ¥38 million in the previous fiscal year.

(Brand Retail Platform Business)

In the stores business, TITICACA, which had 94 stores as of October 31, 2018, closed 1 store (Kichijoji) this year to end with 93 stores as of October 31, 2019, and the e-commerce business maintained its 8 stores. Following on from the previous fiscal year, the company also continued to promote structural reforms such as closing unprofitable stores and revising personnel organization.

This year, the Company established improvements to operating cash flow as its largest initiative. In concrete terms, it shifted purchases and sales from lifestyle goods such as plates and utensils, which have low inventory turnover, to clothing and accessories, which have high inventory turnover, thereby restoring the balance between purchases and sales. This resulted in significant improvement with operating cash flow at ¥(16) million in the fiscal year ended October 31, 2019 (¥(378) million in the fiscal year ended October 31, 2018).

In terms of sales, the Company closed an unprofitable store (Kichijoji) and carried out structural reforms in order to capture 90% of sales compared to the previous fiscal year. As new initiatives, it opened a booth called Latin-Inspired Diverse Living for a limited time at the Hankyu Umeda department store in Osaka from September 4–10 and a booth at the Toyota Group Thanks Sale from September 28–29. Companywide net sales in the fiscal year ended October 31, 2019 were ¥5,151 million in contrast to ¥5,759 million in the fiscal year ended October 31, 2018 (down 10.5% year on year). Although this was a difficult situation, the Company was able to keep the range of decrease within its projections.

In September 2019, our Head Office moved from Shin-Yokohama to Bakurocho in Nihonbashi, Tokyo. TITICACA is deriving benefits from this relocation on many fronts. For example, it is achieving synergetic effects with Group apparel companies, acquiring product information at an early stage by reducing the physical distance between business vendors, and securing talented human resources in the Tokyo metropolitan area. In addition, we endeavored to further improve cash flow by reevaluating payment terms with overseas suppliers and through negotiations, and also launched initiatives to prevent delivery delays by concluding delivery agreements with all overseas suppliers for each product.

As a result, segment sales in the fiscal year ended November 30, 2019 were ¥5,776 million, down 10.4% year on year. Segment loss was ¥423 million, compared with segment loss of ¥460 million in the previous fiscal year.

Analysis of Operating Results and Financial Position

(Cryptocurrency and Blockchain Business)

e frontier will continue to develop an AI-based cryptocurrency trading system. The Company aims to establish a system that will allow for operations that account for capital efficiency based on trends in the cryptocurrency market, and it will continue to promote development of a cryptocurrency trading system using complex AI by accumulating and studying transaction data from Zaif, whose operations were assumed by FISCO Cryptocurrency Exchange Inc. in partnership with the Company.

As a result, segment sales in the fiscal year ended November 30, 2019 were ¥9 million, down 99.3% year on year. Segment loss was ¥16 million, compared with segment profit of ¥1,320 million in the previous fiscal year.

[Financial Position]

(Assets)

Total assets were ¥6,685 million as of November 30, 2019, a decrease of ¥2,617 million from a year earlier. The main components of this change were decreases of ¥108 million in cash and deposits, ¥104 million in merchandise, ¥1,015 million in short-term loans receivable, ¥165 million in property, plant and equipment, ¥523 million in investment securities, ¥634 million in long-term loans receivable, and ¥94 million in guarantee deposits.

(Liabilities)

Total liabilities were ¥4,450 million, a decrease of ¥899 million from a year earlier. The main components of this change were decreases of ¥731 million in interest-bearing debt*, ¥43 million in accounts payable—other, ¥63 million in advances received, ¥42 million in asset retirement obligations—non-current, and ¥39 million in deferred tax liabilities. These factors were partly offset by an increase of ¥53 million in notes and accounts payable—trade.

(Net Assets)

Total net assets were ¥2,234 million, a decrease of ¥1,718 million from a year earlier. The main contributing factors were decreases of ¥1,272 million in retained earnings and ¥485 million in valuation difference on available-for-sale securities.

* Interest-bearing debt is the sum of short-term loans payable, current portion of long-term loans payable and long-term loans payable.

[Cash Flows]

Cash and cash equivalents ("cash") at November 30, 2019 were ¥914 million, a decrease of ¥108 million from the previous fiscal year-end.

Cash flows during the fiscal year under review and analysis of the main components are as follows:

(Cash Flows from Operating Activities)

Net cash used in operating activities was ¥602 million, compared with net cash provided by operating activities of ¥981 million in the previous fiscal year. The primary reason was loss before income taxes of ¥1,218 million. This factor was partly offset by depreciation and amortization of ¥112 million, impairment loss of ¥124 million and gain on sales of investment securities of ¥381 million.

Analysis of Operating Results and Financial Position

(Cash Flows from Investing Activities)

Net cash provided by investing activities was ¥1,230 million, compared with net cash used in investing activities of ¥1,099 million in the previous fiscal year. This was mainly due to proceeds from sales of investment securities of ¥1,056 million and collection of long-term loans receivable of ¥580 million. These cash proceeds were partly offset by outflows of ¥85 million for purchase of property, plant and equipment and ¥332 million for increase in long-term loans receivable.

(Cash Flows from Financing Activities)

Net cash used in financing activities was ¥733 million, compared with net cash used in financing activities of ¥1,389 million in the previous fiscal year. This was mainly due to net decrease in short-term loans payable of ¥33 million and repayment of long-term loans payable of ¥807 million. These cash outflows were partly offset by proceeds from long-term loans payable of ¥110 million.

[Risk Information]

The Group presents the main factors that could pose a risk to its business development and related activities. From the standpoint of actively disclosing information to investors, the Group discloses matters that could have a material impact on investor judgment, even external factors beyond the control of the Company and matters that may not necessarily be considered as business risks.

The items outlined below do not represent an exhaustive listing of all risks affecting investment in the Company's stock.

The items in the following section that concern the future were assessed by the Group based on information available as of November 30, 2018. They are subject to uncertainties and may differ from actual results.

(1) Business Characteristics

1. Group Driven by Research and Development

The Group primarily comprises companies driven by research and development (R&D), and its source of competitiveness is the constant internal accumulation of new technology. If the Group has difficulty securing and nurturing competent technicians, or suffers an outflow of competent human resources, this could have a material impact on the Group's business and operating results.

As a policy, the Group adapts to technological and other advancements through its R&D activities. However, the Group may not be able to adapt promptly to changes in the business environment if they were brought about by new unforeseen technologies. Adapting to changes in the business environment may also involve large sums of R&D expenses and other expenses. Such events could have a material impact on the Group's business and operating results.

2. Fabless Manufacturing

The Group outsources the manufacturing of mobile telecommunications devices and other products to a large extent. As a result, business conditions at the outsourcing contractors, as well as the Group's cultivation and retention of outsourcing contractors and the Group's in-house manufacturing capabilities, could have a material impact on the Group's business and operating results.

3. Relationship with Telecommunications Service Providers

The Group's core products are data telecommunications terminals and other mobile devices developed and manufactured based on the specifications of telecommunications service providers. Furthermore, in these transactions the telecommunications service providers purchase all of the contracted output. As a result, changes in the content of the contracts, sales prices, and transaction terms with the telecommunications service providers, as well as the success or failure of renewing the contracts, could have a material impact on the Company's business and operating results.

4. Changes in Demand for Mobile Devices

Data telecommunications terminals and other mobile devices developed and manufactured by the Group are subject to severe product competition. As such, the trend in their demand has a tendency to change dramatically depending on such factors as technological advancement and the status of the product competition. The business is also characterized by the short turnaround in launching new products. As a policy, the Group seeks to adapt to changes in demand with fabless manufacturing. However, the Group is currently dependent on specific products because it develops and manufactures a limited variety of products. Consequently, drastic changes in demand and falls in the sale price of mobile devices brought about by factors such as business strategies of competitors and changing customer needs could have a material impact on the Group's business and operating results.

(2) Dependence on a Specific Business Partner

In the fiscal year ended November 30, 2019, the Group outsourced the manufacturing of mobile devices to TRICHEER TELECOMMUNICATION LTD. Consequently, changes in the business transaction policy and manufacturing framework between the Group and this contractor could have a material impact on the Group's business and operating results.

Analysis of Operating Results and Financial Position

(3) Risks Related to Protection of Intellectual Property Rights

The Group is driven by R&D and is the rightful owner of numerous intellectual properties that have been submitted and registered for patent and registered with design rights and trademarks. The Group also strives to make sure that the products it develops and manufactures do not infringe on the intellectual property rights of third parties, and understands that there are no infringements at present. However, the possibility of infringing on the intellectual property rights of a third party in the future cannot be eliminated. Should the Group infringe on the intellectual property rights of a third party, it may experience legal action seeking damages, a decline in credibility, a deterioration in its corporate brand, and so forth, which could have a material impact on the Group's business and operating results. Conversely, should the intellectual property rights of the Group suffer infringement by a third party, the Group would be obliged to divert management resources toward taking the party to court and other defensive measures, which could have a material impact on the Group's business and operating results.

(4) Quality Control

The Group must recall and repair the mobile devices it develops and manufactures in the event of a product malfunction. Moreover, should an accident caused by defective products occur, the Company may be subject to claims for damages under the Product Liability Act.

In order to prevent such product defects and accidents from occurring, the Group has developed a quality control system that also encompasses the management of outsourcing contractors and suppliers to improve product safety and promote compliance with laws and regulations. In addition, the Group also subscribes to product liability insurance as a contingency in the event of product accidents. However, should a serious product defect or incident violating the Product Liability Act occur, the Group may have to bear product recall and repair expenses and payment of damages, as well as experience a decline in its credibility with corporate clients and society, a deterioration in its corporate brand value, and so forth, which could have a material impact on the Group's business and operating results.

(5) Statutory Regulations on Telecommunications

The Group mainly develops products regulated by the Radio Act of Japan. As a result, trends regarding the Radio Act and other statutory regulations on telecommunications could have a material impact on the Group's business and operating results.

(6) Protection of Personal Information

The Group holds the personal information and so forth of its customers in the conduct of its business of selling and providing product support and so forth for mobile communication devices and selling apparel and general merchandise. To prevent the acquired personal information and so forth of customers from leaking externally, the Group takes ample precautions such as limiting access to the personal information and strengthening the internal control system by periodically conducting internal audits. However, should a leak in personal information occur, the Company may be in violation of laws and regulations as well as its confidentiality agreements with client companies. As a result, the Group may receive claims for damages from client companies and other customers as well as experience a decline in its credibility with corporate clients and society, a deterioration in its corporate brand value, and so forth, which could have a material impact on the Group's business and operating results.

(7) Corporate Organization

In order to continue growing while strengthening the internal control system further at the same time, the Group sees a need to bolster competent human resources, as well as further enhance the organization of its administrative divisions, at each stage of business development. Consequently, should the Group be unable to bolster human resources as required at each stage of business development, or suffer an outflow of competent human resources, this could have a material impact on the Group's business and operating results.

(8) Relationship between the Parent Company and Other Related Companies

FISCO Ltd. ("FISCO"), which is listed on the Tokyo Stock Exchange JASDAQ (Growth) market and holds 19.96% of the voting rights of the Company directly as of November 30, 2019, and Sequedge Japan Holdings Inc., which holds 28.55% of the voting rights indirectly, are both treated as other related companies of the Company.

Because the Company belonged to a parent company group centered on FISCO until July 2019, changes in the management policies of this company could have an impact on the Company's business and results.

(9) Fluctuations in the Foreign Exchange Markets

The Company subcontracts the manufacturing of some of its products to overseas manufacturers and so forth to enhance price competitiveness and profitability. As a result, business transactions denominated in foreign currencies may be affected by fluctuations in the foreign exchange markets. To reduce this impact, the Company strives to make use of instruments such as foreign exchange forward contracts, and to reconfigure its product portfolio. However, trading conditions and foreign exchange markets trends in the future could have a material impact on the Group's business and operating results.

Also, fluctuations in the foreign exchange markets could impact the Group's operating results and financial position since the Group has assets overseas. Further, in the event that changes in legislation or government policies in Japan or overseas hinder smooth remittances, the Group's business operations and accounting processes may be affected, which could in turn impact the Group's operating results and financial position.

Analysis of Operating Results and Financial Position

(10) Profitability of System Development Projects

When undertaking system development, the Group estimates in advance the total number of work hours (labor hours) needed to meet customer requirements and determines the costs necessary to create the system as part of its activities to win orders. However, if problems arise during system development and work hours exceed the budgeted time, the Group could end up bearing that cost.

Additionally, the Group may be called on to bear the cost of an increase in labor hours even if it relates to specification changes made during development.

Further, the Group may incur the cost of fixing defects that arise after the developed system has been delivered to the customer and the customer has finished inspecting it and determined it to be free of issues.

The Group therefore strives to increase the accuracy of estimates at the time of the contract by creating detailed estimates for each development process (phase), and taking other steps to keep the actual number of labor hours in line with the budgeted number. While the Group gives sufficient consideration to project profitability, profitability could deteriorate due to factors such as development projects becoming large in scale and escalating competition to win orders.

(11) Investments and Loans

To expand business going forward, the Group may undertake M&As or business investments targeting alliances, or engage in joint venture business development, subsidiary establishment, or capital expenditures in Japan or overseas.

The Group's policy in making investments and loans is to thoroughly evaluate the recoverability and risks of those prospective investments and loans in advance. However, it is sometimes difficult to accurately project the impact on the Group from business conditions at investees and should investments or loans become unrecoverable, the Group's operating results and financial position could be affected.

(12) Merchandise Purchases

The Group company TITICACA mostly sells imported products. Therefore, events in relevant countries such as unanticipated changes in legislation, political uncertainty, major natural disasters, social unrest, and sharp fluctuations in foreign exchange rates could affect TITICACA's merchandise supply framework and the Group's operating results and financial position.

(13) Impairment of Property, Plant and Equipment

The Group recognizes impairment losses on the portion of the assets of stores that are persistently unprofitable or that it has decided to relocate or close for which the book value of property, plant and equipment is determined to be unrecoverable. In the event of an increase in such unprofitable stores going forward, the posting of significant impairment losses would be expected, which could affect the Group's business performance and financial position.

(14) Losses from Store Relocations and Closings

The Group may relocate or close stores due to tenancy agreements expiring. In that event, costs will arise for the removal of property, plant and equipment to restore the leased space to its original condition, new investments in relocation sites, and so forth. If store relocations and closings increase in the future, the posting of a large amount of losses associated with the removal of property, plant and equipment, as well as selling, general and administrative expenses would be expected, which could affect the Group's business performance and financial position.

(15) Investment in Cryptocurrency

The Group faces risks associated with investment in cryptocurrency, including price movements in cryptocurrency, the risk of losses stemming from the inability to trade in the cryptocurrency markets or being forced to trade on terms that are less advantageous than normal due to factors such as turmoil in the cryptocurrency markets. Other risk factors include disruptions in derivative trading systems for cryptocurrency, system disruptions and business failure of cryptocurrency exchanges, and theft due to unauthorized access to servers. The Group makes every effort to rigorously implement risk management. However, if the aforementioned risks materialize, the Group could incur higher costs to deal with the issue or suffer a decline in its credibility, which could have a material impact on the Group's business results and financial condition.

(16) Disasters, etc.

In the event that a major natural disaster or accident in the vicinity of stores, warehouses, and so forth causes physical damage to such facilities; disrupts sales, distribution, purchasing, or other business activities; or causes personal injury, the Group's business performance and financial position could be affected.