Cross Marketing Group Inc.
3675 TSE Mothers

26-Oct.-16

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1H FY12/16 Operating Income Reached the Group's Forecast as Cost Controls Offset the Limited Adverse Impact of Yen's Appreciation on Profits

Cross Marketing Group Inc. (3675) is a corporate integrated marketing group offering total support for online services, from marketing research to the development of smartphone apps and the construction of websites. When founded, the company engaged mainly in online research, but through a strategy of business expansion through M&As in Japan and overseas, the Group branched into all aspects of marketing research, including offline research, and in the fields of mobile devices and smartphones, and Web marketing and promotions. With more than 20 offices in 10 countries, the Group aims to become Asia's No.1 marketing group.

In 1H FY12/16 (January-June 2016), the Group's consolidated net sales grew 3.0% year on year (YoY) to ¥7,299mn, but its operating income declined 20.4% to ¥429mn, and its net income attributable to owners of the parent company dropped 65.3% to ¥141mn, resulting in a double-digit decrease in income despite a double-digit increase in net sales. Sales in Japan by the research business, the IT solutions business and the promotion business increased YoY, but operating income decreased due to an increase in investments and expenditures to promote growth. Sales in 1H FY12/16 fell short of the Group's forecast of ¥7,757mn mainly because the yen appreciated against the U.S. dollar more than the Group had expected.* However, as a result of controlling the increase in SG&A expenses, operating income slightly surpassed the Group's forecast of ¥418mn.

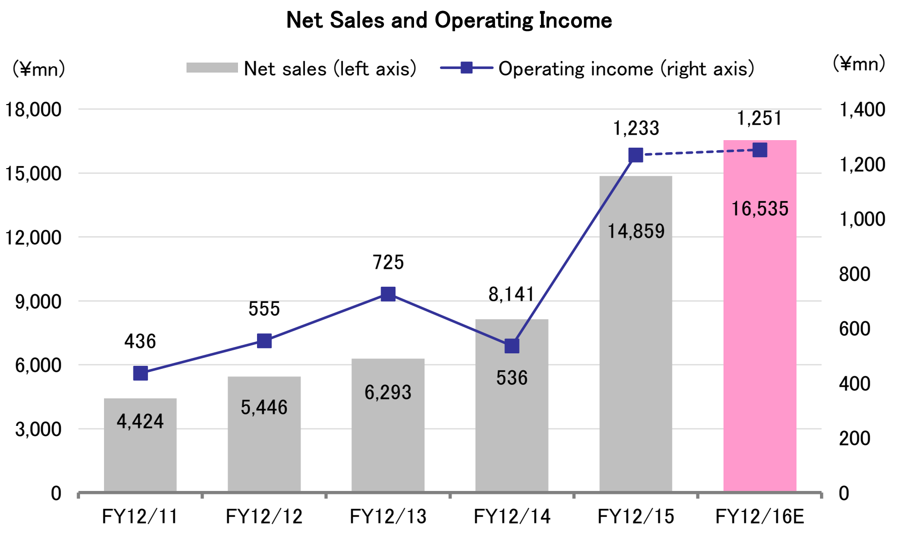
* The Group originally projected an average exchange rate of ¥114.91 per U.S. dollar for FY12/16. At the end of June 2016, this exchange rate was ¥102.91 per U.S. dollar.

For FY12/16, the Group maintained its original forecast of an average exchange rate of ¥114.91 per U.S. dollar, assuming that any likely strength of the yen against the U.S. dollar in excess of this forecast would have a minor impact on profits. The Group also kept its original forecasts of business results for FY12/16: net sales of ¥16,535mn (up 11.3% YoY), operating income of ¥1,251mn (up 1.5%), and net income attributable to owners of the parent company of ¥640mn (up 14.6%). FISCO foresees a high hurdle to the achievement of the Group's net sales forecast and believes that further results are needed to ascertain whether the Group is likely to earn its operating income forecast. Currently, 1) yen's appreciation against the U.S. dollar is still reducing profits in the overseas research business only modestly, 2) sales in the domestic research business, which failed to reach the Group's target in 1H FY12/16, are showing signs of recovery, 3) sales in the IT solutions business and in other businesses are projected to remain brisk, 4) SG&A expenses are being controlled, centering on other costs, as they were in 1H. Despite these positive developments, FISCO will wait for the Group's business results in 3Q FY12/16 before projecting whether the Group is likely to attain its operating income forecast for FY12/16.

From FY12/16, in light of surging current funding requirements, future business investment plans, and other factors going forward, the Group has shifted to a basic policy of determining the amount of dividends by targeting a consolidated dividend payout ratio of around 15%.. Until FY12/15, the company has sought to successively raise the dividend by targeting a consolidated dividend payout ratio of 20%. For FY12/16, the Group plans to pay interim dividends of ¥2.5 per share and year-end dividends of ¥2.5 per share, for annual dividends of ¥5.0 per share and a dividend payout ratio of 15.2%. Although these annual dividends are smaller than the ¥6.0 dividend payment for FY12/15, the Group will continue to pay stable dividends, despite its need for funds.

Check Point

- Although profit fell by double digits YoY in 1H FY12/16, operating income was in line with the Group's original forecast, as were overall results.
- Sales in the overseas research business declined by double digits YOY due to yen's appreciation against the U.S. dollar, but this appreciation had only a modestly adverse impact on operating income.
- Sales in the IT solutions business and in other businesses grew notably YoY.



Company Outline and History

Entering Overseas Markets by Driving M&A Activity and Expanding the Business Portfolio by Developing New Businesses, While Focusing on the Core Research Business in Japan

(1) Company Outline

Cross Marketing Group is a holding company. Its subsidiaries engage in research, IT solutions and other businesses, primarily in the field of marketing, and offer a wide range of services, including in the fields of mobile devices and smartphones and Web marketing. With facilities in Japan and more than 20 offices in 10 other countries in Europe, the Americas, and Asia, the Group is proactively expanding into new business areas and new geographical markets with the aim of becoming Asia's No.1 marketing group.

At the end of June 2016, the Group was made up of 34 group companies including 33 consolidated subsidiaries and one affiliate accounted for by the equity method. The consolidated subsidiaries included Cross Marketing Inc., which conducts marketing research and is particularly strong in online surveys, and Research and Development, Inc. ("R&D"), which plans, designs, and consults about marketing research and is also strong in offline surveys. The affiliate was Research Panel, Inc.

Group's Business Activities and Main Group Companies

Name of business		Business activities	Main group companies
Research		All aspects of business related to marketing research, including online research	Cross Marketing Inc.
			Research Panel, Inc.
			Research and Development, Inc.
			Cross Marketing China
			Cross Marketing Asia
			Markelytics Solutions India
			MedePanel Online
			UTIL Inc.
			Union Panels
			Kadence International Business Research
			Medilead Inc.
			Jupiter MR Solutions
			Cross Marketing (Thailand)
			Cross Marketing Group USA
IT solutions		Planning, development and operation of services for mobile devices and promotion	Cross Communication Inc.
			Cross Propworks Inc.
			Cross J Tech Inc.
Other businesses	Web marketing	Web and mobile marketing, UI and UX consulting	UNCOVER TRUTH
	Promotion	Businesses related to marketing support, such as promotions	D & M, Inc.

Source: Compiled by FISCO based on the Group's annual securities reports, interviews and other sources.

(2) Company History

The Group can trace its roots to Cross Marketing Inc., a marketing research company with core strengths in online research that was founded in April 2003. In May 2006, Cross Marketing entered into a capital and business alliance with EC Navi (currently Voyage Group (3688): the operator of the EC Navi integrated online shopping site) and its subsidiary Research Panel, Inc. (a research monitor management company). Cross Marketing Group holds a 40% stake in Research Panel, Inc., and Voyage Group holds a 60% stake. In October 2008, Cross Marketing Inc. listed its shares on the Mothers Market of the Tokyo Stock Exchange. Thereafter, the company aggressively expanded its business base through M&A. In June 2013, marking its tenth year, Cross Marketing Inc. converted to a holding company, Cross Marketing Group, in what it refers to as its second founding. The Group then branched into new businesses and expanded into Asian countries other than Japan.

Looking at the size of the Group's core research business, this business forms the second largest group in this sector after the largest cluster formed by the major marketing research firms INTAGE HOLDINGS Inc. (4326) and MACROMILL, INC. At the time of its founding, Cross Marketing Inc.'s main customers were major market research firms such as the former Dentsu Research Inc. However, from around the time of its listing on the Mothers section of the Tokyo Stock Exchange in 2008, the company's customer base has been expanding tremendously as a result of its focus on driving growth in business with corporations.

At the same time, the company expanded its business base in Japan and overseas through M&As. In Japan, the company bought part of Index Inc.'s mobile solutions business in August 2011 and started its own IT solutions business through subsidiary Cross Communication Inc. This subsidiary improves the technical capabilities and the ability to develop engineers of other companies, depending on the needs of those companies. In February 2015, the Group converted Japanese affiliate R&D into a consolidated subsidiary. As mentioned previously, this subsidiary plans, designs, implements and consults about marketing research. In September 2015, Cross Communication Inc. bought JIN SOFTWARE, which develops systems and dispatches engineers to other companies, making it a fully-owned subsidiary. In December 2015, JIN SOFTWARE changed its name to Cross J Tech Inc. In April 2016, the Group acquired shares in mixi research, Inc., which is strong in mystery shopper surveys and other forms of undercover surveys, to strengthen the service lineup of its research business. mixi research, Inc. became a consolidated subsidiary and changed its name to Shopper's Eye, Inc.

Overseas, the Group set up consolidated subsidiaries in Shanghai, China in May 2012 and in Singapore in September 2013. In January 2014, Union Panels Pte. Ltd. was established in Singapore, as a business site mainly to provide a framework for supplying a research panel exchange service that links partner local research panels in multiple countries, primarily in Asia, with research panels created in-house. Moreover, in August 2015, consolidated subsidiary Cross Marketing (Thailand) Co., Ltd. was established in Thailand, marking the Group's entry into its sixth Asian country. In January 2016, the Group established Cross Marketing Group USA, Inc. in the U.S.

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*1 Markelytics is a marketing research company headquartered in Bangalore, India with clients mainly in the U.S. and Europe.

*2 Medical World Panel is a U.S. company that acquires and manages research monitors from hospital staff and patients.

*3 Although Jupiter started operations in January 2014, it has acquired many customers, mainly global research companies, reflecting its ability to attract new customers and the high quality of its research.

In addition to establishing these overseas units, the Group has pushed ahead with proactive M&A activity. In August 2013, the Group acquired shares in Markelytics Solutions India Private Limited*1 ("Markelytics") and in Medical World Panel Online Inc.*2 ("Medical World Panel"). Following on from these acquisitions, in November 2014 the Group converted Kadence International Business Research Pte. Ltd. (active in marketing research business and management of subsidiaries and other entities, "Kadence"), a marketing research group conducting a market research business in eight countries in North America, Europe and Asia, into a subsidiary. Furthermore, the Group made Jupiter MR Solutions Co., Ltd. ("Jupiter")*3 of Thailand a subsidiary (voting interest: 49.0%) in August 2015. In addition, in an effort to cultivate the North American market and make it one of the group's growth platforms, Cross Marketing Group USA (established January 2016) entered into a memorandum of understanding agreement on the transfer of business from Japan Publicity Inc. in November 2015. With this move, the Group put in place a framework for supplying services focused on marketing research in North America.

History

Date	沿革
April 2003	Founded in Shibuya, Tokyo
May 2006	Entered into a capital and business alliance with Voyage Group and its subsidiary Research Panel, Inc.
October 2008	Listed on the Mothers section of the Tokyo Stock Exchange
August 2010	Entered into a capital and business alliance in the mobile research field with Net Asia Co., Ltd.
August 2011	Subsidiary Cross Communication Inc. commenced operations after succeeding to a portion of Index Inc.'s mobile solution business
May 2012	Established subsidiary Cross Marketing China Inc. in Shanghai, China
April 2013	Established UNCOVER TRUTH Inc.
June 2013	Transitioned to a holding company framework by establishing Cross Marketing Group Inc.
August 2013	Acquired shares in Markelytics Solutions Private Limited and Medical World Panel Online Inc.
September 2013	Established subsidiary Cross Marketing Asia Pte. Ltd. in Singapore
November 2013	Converted UTIL Inc. into a wholly owned subsidiary
January 2014	Established Union Panels Pte. Ltd. in Singapore
May 2014	Relocated headquarters to Shinjuku, Tokyo
November 2014	Converted Kadance International Business Research Pte. Ltd. into a wholly owned subsidiary
February 2015	Converted affiliate Research and Development, Inc. into a consolidated subsidiary
April 2015	Cross Communication Inc. established subsidiary Cross Propworks Inc. in Hakodate
July 2015	Established two wholly owned consolidated subsidiaries, Medilead Inc. and D & M, Inc.
August 2015	Converted Jupiter MR Solutions Co., Ltd. of Thailand into a subsidiary. Established Cross Marketing (Thailand) Co., Ltd.
September 2015	Cross Communication Inc. converted JIN SOFTWARE (renamed Cross J Tech Inc. on December 1) into a subsidiary.
November 2015	Entered into a memorandum of understanding agreement on the transfer of marketing business from Japan Publicity Inc.
January 2016	Established Cross Marketing Group USA, Inc.
April 2016	Converted mixi research, Inc., a subsidiary of mixi, Inc., into a subsidiary and changed its name to Shopper's Eye, Inc.

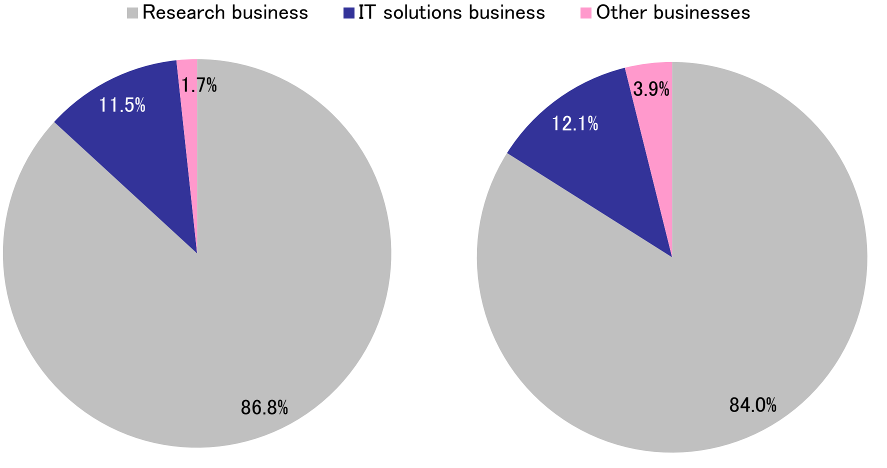
Source: Compiled by FISCO based on Cross Marketing Group Inc.'s website, annual securities reports, earnings presentation materials and other sources

Description of Businesses

Expansive Customer Base in the Core Research Business, Spanning Research Firms to Corporations

The Group has three main businesses: research business in Japan and abroad, IT solutions business, including the development of smartphone apps and other businesses, including Web marketing and promotions. In FY12/15, the research business supplied 86.8% of the Group's total consolidated net sales, the IT solutions business accounted for 11.5%, and other businesses, for 1.7%. In 1H FY12/16, the research business provided 84.0% of total consolidated net sales, the IT solutions business contributed 12.1%, and other businesses supplied 3.9%.The proportion of IT solutions and other businesses is increasing.

Segment Sales Composition (FY12/15 and 1H FY12/16)



Source: Compiled by FISCO based on the company's earnings presentation materials

Weighting of Overseas Research Business Grows Higher

(1) Research business

In the research business, the Group provides services such as online research*1, where questionnaire programs are developed in line with the content of research plans and questionnaires are collected from research collaborators via Internet servers, as well as offline quantitative research services*2 and qualitative research services*3.

The research business is divided into the research business in Japan and the overseas research business. The research business in Japan is carried out by the core company Cross Marketing Inc., as well as R&D and UTIL Inc., which were converted into subsidiaries. Meanwhile, the overseas research business is carried out by Cross Marketing China and Cross Marketing Asia, as well as Kadence, Markelytics, and Medical World Panel, which were converted into subsidiaries. In FY12/14, the research business in Japan accounted for 74.7% of overall net sales, while the overseas research business accounted for 7.1%. In FY12/15, the weighting of the overseas research business rose, with 56.1% of net sales generated in Japan and 30.7% generated overseas. This increase was the result of the conversion of Kadence into a consolidated subsidiary.

In the research business in Japan, the Group's customers include market research firms, advertising agencies, think tanks and consulting firms, along with corporations (spanning a wide range of sectors, including media and publishing, chemical products manufacturers, mobile phone companies, social games, and home electric appliances), government offices, and schools. In the overseas research business, the Group's customers include European and North American multi-national companies (spanning a wide range of sectors, including finance, beverages, food, home electric appliances, electronic equipment), as well as Japanese companies that have entered or are planning to enter Asian markets.

*1 Internet research involves preparing questionnaire programs in line with research requests, sending the questionnaires to registered monitors (respondents) who have already agreed to participate in research, and collecting the responses over the Internet. The company has more than 1.80 million questionnaire monitors in Japan. These monitors are classified based on their basic attributes, and are also grouped into around 20 categories such as seniors, mobile phone users, automobile owners and cosmetics users. This classification enables the company to smoothly conduct research focused on specific targets.

*2 Quantitative research is research designed to quantitatively grasp the behavior patterns, awareness and preferences of consumers. Data is collected according to product characteristics, via research conducted using postal mail and telephone, in addition to the aforementioned Internet channel. Another data collection channel is CLT research (on-site venue research) where research participants are assembled at a venue to collect questionnaires and conduct interviews.

*3 Qualitative research refers to a research technique in which in-depth assessments and opinions about products are gathered through dialogue with consumers and other users. This approach is employed when performing research to verify hypotheses, understand consumer awareness, assess new products and so forth. Research involves focus group interviews, where research participants are interviewed in a roundtable format; in-depth interviews, where research participants are interviewed one by one, and home or office visits where staff conduct questionnaires and interviews by visiting research participants in their homes or at their workplaces.

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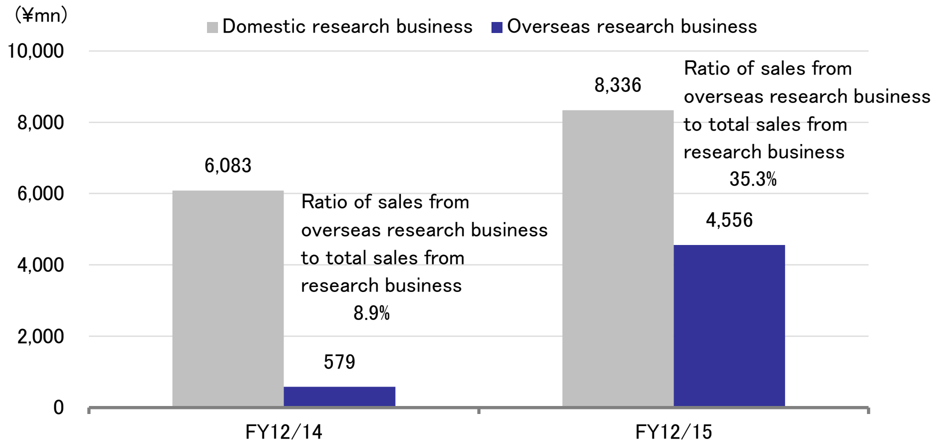
Breakdown of Consolidated Net Sales of the Research Business by Domestic Business and Overseas Business, FY12/14–FY12/15



Source: Compiled by FISCO based on the company's earnings presentation materials

Acquisition of an Engineering Service Company That Develops Highly Original Websites and Apps

(2) IT solutions business

The IT solutions business is carried out mainly by Cross Communication Inc. Cross Communication serves as a full-line provider of all manner of functions needed for services such as planning, development, operation and promotions for websites, applications and systems centered on mobile platforms and smartphones. There is an expansive range of main users, from financial institutions engaged in securities and foreign exchange trading and other activities, to major travel agencies. The Hakodate Technical Center was set up in Hakodate, Hokkaido to enhance development capabilities by securing human resources who have become difficult to recruit and retain in the Tokyo metropolitan area. Moreover, Cross Propworks Inc. (Established in April 2015; Headquarters: Hakodate, Hokkaido), a subsidiary of Cross Communication Inc., conducts outsourcing services such as data processing and other tasks within the Group. In addition, Cross J Tech Inc. (Acquired in September 2015; Headquarters: Tokyo) provides system engineering services where engineers are staffed and stationed at the offices of customers.

(3) Other businesses

The other businesses is made up of the Web marketing business and the promotion business. In the Web marketing business, consolidated subsidiary UNCOVER TRUTH Inc. conducts businesses such as Web and mobile marketing and UI and UX consulting*1. Its core services are the sale of USERDIVE*2, a tool for internal analysis of websites and smartphone sites, and the provision of consulting services using this tool. The number of companies that have introduced USERDIVE has surpassed 200 (as of December 31, 2015), with these companies spanning a wide range of sectors such as chemicals, pre-owned car sales, ISP, and satellite broadcasting.

Meanwhile, the promotion business is conducted by consolidated subsidiary D & M, Inc. and consists of marketing support services, such as the sirukuru nurturing*3 promotion.

*1 UI stands for User Interface. It refers to the words and other expressions used in on-screen displays, windows, and menus when operating computers, mobile devices and other equipment, and the ease of operation when using those devices. UX stands for User Experience. It collectively refers to the experience a user has when using or consuming a particular product or service. The UX concept emphasizes how enjoyably and comfortably users are able to do what they really want, in addition to specific functions and user friendliness.

*2 A tool that uses a "heat map" and video to visualize the activity of users visiting websites.

*3 Nurturing is the process of converting potential customers to likely customers.

Strengths and Business Risks

Strengths Lie in Top-Level Questionnaire Collection Capabilities in Japan and Support Network in Asia

(1) Group strengths

Cross Marketing Group's strengths lie in having top-level questionnaire collection capabilities in Japan with more than 1.85 million questionnaire monitors in its mainstay online research services. In addition, as the production of questionnaires becomes automated, other companies have been increasingly offering speed and low cost as their main selling points. Against this backdrop, another strength of Cross Marketing Group is that it customizes the design of its questionnaires to obtain even more accurate data according to the needs of user companies. These strengths have been strongly appreciated by its customers, leading to growth in direct sales to corporations generated without going through research firms and advertising agencies, and have served as a major engine behind sales growth.

Moreover, the company has business sites in six Asian countries (as of December 31, 2015: India, Indonesia, China (Shanghai, Hong Kong), Vietnam, Singapore, Thailand). As a Group, the company has a system in place to conduct research for Japanese companies seeking to enter the Asian region and to provide support for marketing and other activities. This is yet another strength of Cross Marketing Group.

(2) Business risks

In terms of business risks and other risks, in the research business, the company is susceptible to the impact of business cycles, and may easily fall prey to price competition due to the low barriers to entry in this business. Both of these factors are general risks common to the entire marketing research industry. Moreover, in terms of risks specific to the company, the business results of Kadence, which was acquired in FY12/14, are reliant upon the human networks of each of its group companies (especially that of the CEOs in each country). Therefore, we must be mindful of the fact that personnel turnover could have an impact on the company's business results. Incidentally, to minimize this risk, the acquisition price of Kadence has been set within the range of US$13.99mn to US$28.99mn, with the acquisition price conditional upon Kadence achieving its business targets from 2015 to 2017.

In the IT solutions business, given that the company conducts system development, it faces risks associated with the incidence of unprofitable projects. Although the company is recently seeing an increase in projects exceeding ¥50mn, the main projects have been relatively small projects between ¥10mn and ¥30mn for which risk management is easy. That said, even if unprofitable projects were to arise, we believe the impact on business results would be fairly limited.

Growth Strategy

Further Accelerate the Medium-Term Growth Pace and Steadily Lay the Groundwork for Becoming Asia's No. 1 Marketing Group

(1) Outline of the Mid-term Management Plan

The company has delivered top-line growth for 11 consecutive years through to FY12/14, while maintaining growth at a faster pace than overall market growth in the online research field. This has been achieved by appropriately investing capital in a well-timed manner to capture market expansion in the online research field. Investments have focused on forming questionnaire panels through tie-ups, investing in online research systems, expanding the size of business by increasing sales staff, and assuring quality by securing researchers.

Aiming to sustain and further accelerate this pace of growth, the company has formulated a three-year mid-term management plan running from FY12/15 to FY12/17, announcing the plan on November 2014. The three years covered by the plan have been positioned as a period for accelerating efforts to lay the groundwork for becoming Asia's No.1 marketing group by proactively working to expand business fields and business areas. Under this plan, the company will implement various measures based on four priorities: existing businesses, human resources strategy, new businesses and overseas expansion.

Specific details include:

Existing businesses : Stable growth in the research business and secure an earnings base
Personnel strategy : Enhance the training of the many employees hired through FY12/14 to improve their professional skills.
New businesses : Develop and expand the scope of the IT solutions business and the Web marketing business.
Overseas development : Establish offices in Asian countries where the Group does not yet have offices, so it can serve all of Asia.

When the mid-term management plan was first announced, it targeted consolidated net sales of ¥15,725mn and operating income of ¥1,440mn for FY12/17. However, in August 2015, after acquiring R&D in February of that year, the Group raised its targets for FY12/17 to consolidated net sales of ¥17,985mn and operating income of ¥1,545mn.

Business Results Targets in Mid-term Management Plan

(¥mn)

	FY12/15 target	FY12/15 result	FY12/16 target	FY12/16 forecast	FY12/17 target
Net sales	14,733	14,859	16,287	16,535	17,985
Operating income	945	1,233	1,249	1,251	1,545
Ordinary income	900	1,185	1,200	1,213	1,500

Net Sales Targets by Business in Mid-term Plan

(¥mn)

	FY12/15 target	FY12/15 result	FY12/16 target	FY12/16 forecast	FY12/17 target
Research business	12,892	12,902	13,781	13,832	14,910
Japan	8,889	8,336	8,938	9,050	9,259
Overseas	4,003	4,566	4,844	4,782	5,650
IT solutions business	1,691	1,704	2,065	2,094	2,505
Other businesses	150	253	440	609	570

Source: Compiled by FISCO based on Cross Marketing Group's disclosure materials

(2) Developments in 2016

To develop stable growth in the mainstay research business and build an earnings base, the Group established Cross Marketing Group USA in January, enabling it to provide marketing research services primarily on the west coast of North America. To prepare to offer neuro-marketing services, the Group concluded a business agreement with CENTAN Inc., a Japanese company possessing technology and knowhow in the use of brain waves for marketing. Thus, the Group has built an integrated marketing support system from research to promotion.

Furthermore, in April 2016, to strengthen the services lineup of the research business, the Group acquired shares in mixi research, Inc., which is strong in mystery shopping surveys and other forms of undercover surveys, making it a consolidated subsidiary. This subsidiary then changed its name to Shopper's Eye, Inc.

Business Trends

Group Exceeded its Operating Income Forecast Despite the Adverse Impact of Yen's Appreciation

(1) 1H FY12/16 Results

In 1H FY12/16 (January-June 2016), the Group's consolidated net sales grew 3.0% YoY to ¥7,299mn, but its operating income declined 20.4% to ¥429mn, and its net income attributable to owners of the parent company dropped 65.3% to ¥141mn.

Summary of 1H FY12/16 Consolidated Results

(¥mn)

	FY12/15		FY12/16					
	1H result	Versus sales	Target	1H result	Versus sales	YoY change	Result/ target	Difference from target
Net sales	7,084	-	7,757	7,299	-	3.0%	94.1%	-458
Cost of sales	4,081	57.6%	-	4,392	60.2%	7.6%	-	-
Gross profit	3,002	42.4%	-	2,907	39.8%	-3.2%	-	-
SG&A expenses	2,464	34.8%	-	2,479	34.0%	0.6%	-	-
Operating income	539	7.6%	418	429	5.9%	-20.4%	102.6%	11
Ordinary income	526	7.4%	399	369	5.0%	-30.0%	92.4%	-30
Net income attributable to owners of the parent company	405	5.7%	183	141	1.9%	-65.3%	76.8%	-42

Source: Compiled by FISCO based on the company's earnings presentation materials

Consolidated net sales grew YoY due to growth in subsidiaries including mainstay subsidiary Cross Marketing Inc., which handles the domestic research business, and D&M, Inc., which engages in the promotion business, in addition to the contribution of Cross J Tech Inc., which was made a consolidated subsidiary in September 2015. The cost of sales climbed by 7.6% YoY to ¥4,391mn due to increased investment and spending for future growth and due to the inclusion of low-margin sales by Cross J Tech Inc., which eroded the sales mix. The gross profit margin fell by 2.6ppts from 42.4% in 1H FY12/15 to 39.8% in 1H FY12/16. In contrast, SG&A expenses were kept mostly the same at ¥2,478mn (up 0.6% YoY), as these expenses, mainly other costs, were strictly controlled. Consequently, the ratio of SGA costs to sales fell by 0.8ppt, from 34.8% in 1H FY12/15 to 34.0% in 1H FY12/16. As a result of these changes, consolidated operating income contracted by 20.4% YoY, and the operating income margin dropped by 1.7ppts YoY to 5.9%.

Net income attributable to the owners of the parent company fell sharply because of the absence of the ¥233mn extraordinary profit claimed in 1H FY12/15 stemming from negative goodwill accompanying the acquisition of shares in of R&D.

The Group had projected net sales of ¥7,757mn, operating income of ¥418mn and net income attributable to owners of the parent company of ¥183mn for 1H FY12/16. Thus, actual sales fell short of the Group's forecast by ¥458mn, while operating income surpassed the Group's projection by ¥11mn. The sales shortfall was attributed mainly to the impact of yen's appreciation against the U.S. dollar* and to weaker sales by the research business in the U.S. and the UK than the Group had projected. Operating income in the domestic research business and in the overseas research business declined YoY because both businesses failed to achieve their sales targets. Furthermore, the cost of sales in the IT solutions business increased YoY. However, operating income from other businesses (the marketing business and the promotion business) rose by ¥16mn YoY, surpassing the Group's target. Furthermore, the YoY increase in SG&A expenses was limited to ¥187mn by cutting many costs. As a result, operating income in 1H FY12/16 was larger than the Group had foreseen.

Net income attributable to owners of the parent company was ¥43mn smaller than the Group had projected, due mainly to a ¥32mn foreign exchange loss and recording a loss of ¥23mn in equity method investment losses by equity method affiliate, Research Panel Inc.

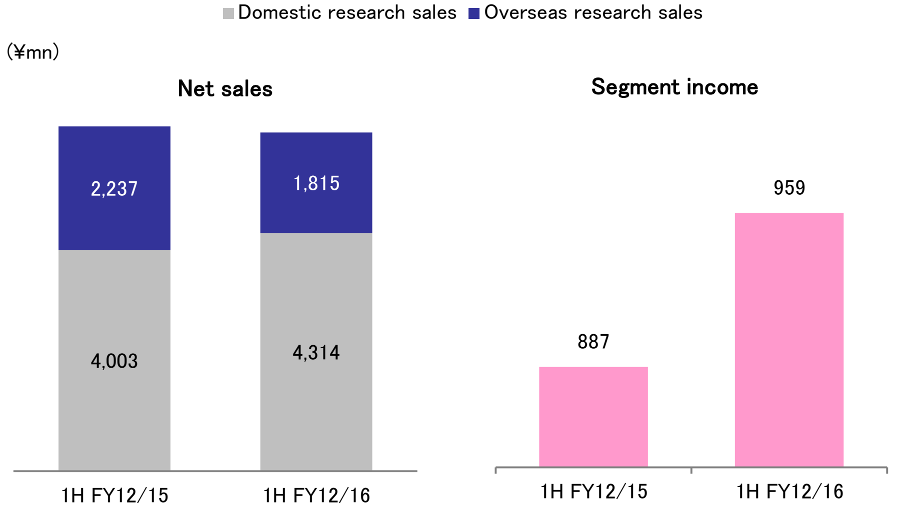
* In FY12/15, the Group's average exchange rate was ¥122.34 per U.S. dollar. At the start of FY12/16, the Group projected an average exchange rate of ¥114.91 per U.S. dollar for FY12/16. At the end of 1H FY12/16, the rate was ¥102.91 per U.S. dollar.

a) Research business

Net sales in the research business increased by 1.8% YoY to ¥6,129mn, and segment income advanced by 8.1% to ¥959mn. Net sales in the domestic research business rose by 7.8% YoY to ¥4,314mn, reflecting upturns in sales of services in medical and new business areas. Net sales in the overseas research business fell by 18.9% YoY to ¥1,815mn, for three main reasons: 1) yen's appreciation against the U.S. dollar, 2) a YoY decline in sales in the U.S. following strong sales growth in 1H FY12/15, and 3) a YoY decrease in sales in the UK because of the impact of that country's decision to leave the European Union.

Segment income in the research business grew despite segment income falling YoY in the overseas research business as segment income in the domestic research business increased enough to more than offset the drop in the overseas business.

Net Sales and Segment Income in the Research Business



b) IT solutions business

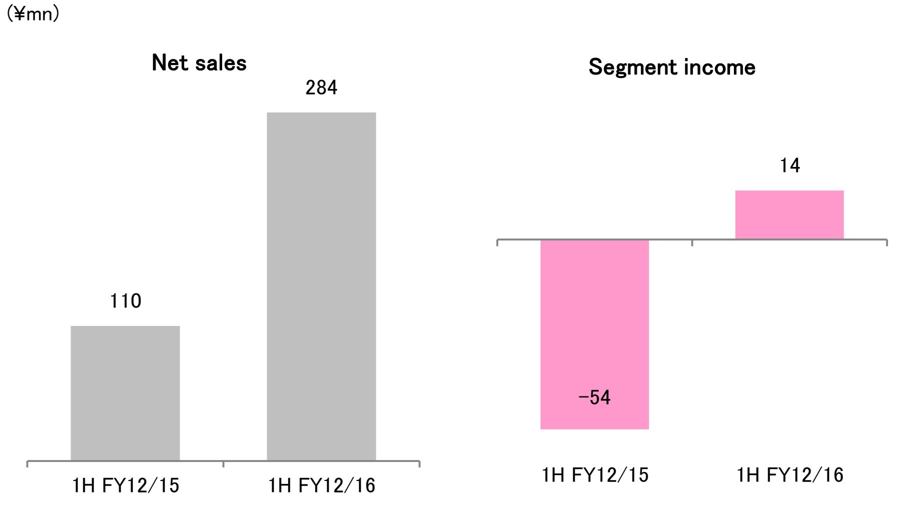
Net sales in the IT solutions business climbed 20.9% YoY to ¥886mn in 1H FY12/16, but segment income fell 26.0% to ¥52mn, resulting in a double-digit decrease in income despite a double-digit increase in net sales. Net sales and orders grew YoY because the business attracted new customers through aggressive sales and received more orders from existing customers, primarily financial companies. However, segment income decreased by double digits because the Group recruited more personnel for future growth, increasing recruiting and other personnel costs.

Net Sales and Segment Profit in the IT Solutions Business

c) Other businesses

Net sales from other businesses jumped by 157.5% YoY to ¥284mn, and the businesses earned a segment income of ¥14mn, reversing their segment loss of ¥54mn in 1H FY12/15. Sales in both the marketing business and the promotion business grew as these businesses focused on cultivating new customers. Due to the rise in sales, the segment turned profitable. Profits by business are not divulged, but it appears particularly the promotion business saw solid growth.

Net Sales and Segment Profit in Other Businesses



Financial Soundness Improved with a Decline in Debt

(2) Financial position

At the end of 1H FY12/16, the Group's assets totaled ¥8,273mn, which was ¥1,698mn less than its total asset at the end of FY12/15. Current assets shrank by ¥1,391mn in the six months through June 2016, due mainly to a ¥817mn decline in cash and deposits and a ¥438mn drop in notes and accounts receivable. Noncurrent assets decreased by ¥307mn, due mainly to a ¥250mn fall in intangible noncurrent assets, of which ¥239mn was a drop in goodwill.

Total liabilities contracted by ¥1,390mn in the six months through June 2016 to ¥4,635mn, reflecting a ¥1,076mn drop in current liabilities and a ¥314mn fall in noncurrent liabilities. The drop in current liabilities was due mainly to a ¥410mn decline in short-term debt, a ¥146mn decrease in accounts payable, and a ¥323mn fall in income taxes payable. Noncurrent liabilities decreased mainly because of a ¥289mn drop in long-term debt. The balance of interest-bearing debt decreased by ¥719mn to ¥2,118mn, due mainly to the repayment of borrowings taken out to acquire Kadence.

Net assets declined by ¥308mn in the six months through June to ¥3,637mn. This is reflecting a negative foreign currency translation adjustment of ¥266mn in 1H, whereas it had been positive by ¥48mn in FY12/15, in addition to a ¥43mn decrease in minority interest despite a ¥41mn increase in retained earnings due to recording net income attributable to owners of the parent company.

Looking at cash flow, cash and cash equivalents decreased by ¥818mn in the six months through June to ¥1,566mn. Net cash provided by operating activities was ¥57mn. The main components increasing cash were ¥369mn of income before income taxes and ¥291mn of trade notes and accounts receivable which outweighed a ¥502mn in payment of income taxes and a ¥61mn decrease in the reserve for bonuses. Net cash used in investment activities was ¥59mn. The Group received ¥14mn of subsidies and ¥10mn from the acquisition of shares in subsidiaries accompanying a change in the scope of consolidation. However, it paid ¥62mn for tangible and intangible noncurrent assets. Net cash used in financial activities was ¥781mn, mainly because of a net decrease of ¥387mn in short-term debt and because the Group repaid ¥289mn of long-term debt.

Among key performance indicators, the equity ratio rose to 42.4%, reflecting the repayment of short-term and long-term debt. This indicates that the Group's financial soundness improved.

Balance Sheets, Cash Flow Statements, and KPIs

Balance Sheet (¥mn)

	FY12/15	FY12/16 1H	YoY change	Main factors behind changes
Current assets	6,423	5,032	-1,391	Cash and deposits -817, notes and accounts receivable -438
Noncurrent assets	3,548	3,241	-307	Intangible noncurrent assets -250, (of which, goodwill -239)
Total assets	9,970	8,273	-1,698	
Current liabilities	4,090	3,014	-1,076	Short-term debt -410, Accounts payable -146, Income taxes payable -323
Noncurrent liabilities	1,935	1,622	-314	Long-term debt -289
Total liabilities	6,025	4,635	-1,390	
(balance of interest-bearing debt)	2,837	2,118	-719	
(net cash)	-453	-551	-98	
Net assets	3,945	3,637	-308	Retained earnings +41, Foreign currency translation adjustment -315, Minority interests -43
Total liabilities and net assets	9,970	8,273	-1,698	

Cash Flow Statement

	FY12/15	FY12/16 1H	YoY change
Operating cash flow	801	57	
Investment cash flow	-18	-59	
Financial cash flow	204	-781	
Balance of cash and cash equivalents at term-end	2,384	1,566	-818

Key Performance Indicators

	FY12/15	FY12/16 1H	
Measures of financial soundness			
Current ratio	157.0%	167.0%	
Equity ratio	37.8%	42.4%	
Measures of profitability			
ROA	13.3%	-	
ROE	17.2%	-	
Operating margin	8.3%	5.9%	

Source: Compiled by FISCO based on earnings reports and company materials

Hurdle to Achieving Sales Forecast Appears High, too Early to Judge Probability of Achieving Profit Forecasts

(3) Group forecasts for FY12/16

For FY12/16, the Group maintained its original forecast of an average exchange rate of ¥114.91 per U.S. dollar, assuming that any likely strength of the yen against the U.S. dollar in excess of this forecast would have a minor impact on profits. The Group also kept its original forecasts of business results for FY12/16: net sales of ¥16,535mn (up 11.3% YoY), operating income of ¥1,251mn (up 1.5%), and net income attributable to owners of the parent company of ¥640mn (up 14.6%).

Group Forecasts for FY12/16 and 1H Results Progression rate

(¥mn)

	FY12/15		FY12/16			
	Full-year result	Ratio to sales	Full-year forecast	Ratio to sales	YoY % change	1H FY12/16 progression rate
Net sales	14,859	-	16,535	-	11.3%	44.1%
Research business	12,902	86.8%	13,832	83.7%	7.2%	44.3%
Japan	8,336	56.1%	9,050	54.7%	8.6%	47.7%
Overseas	4,566	30.7%	4,782	28.9%	4.7%	38.0%
IT solutions business	1,704	11.5%	2,094	12.7%	22.9%	42.3%
Other businesses	253	1.7%	609	3.7%	140.6%	46.7%
Operating income	1,233	8.3%	1,251	7.6%	1.5%	34.3%
Ordinary income	1,185	8.0%	1,213	7.3%	2.3%	30.4%
Net income attributable to owners of the parent company	559	3.8%	640	3.9%	14.6%	22.0%

Source: Compiled by FISCO based on the company's earnings presentation materials

Group forecasts for each segment in FY12/16 are discussed below.

1) Research business
In the research business, net sales are projected to grow steadily to ¥13,832mn (up 7.2% YoY). In the research business in Japan, net sales are forecast at ¥9,050mn (up 8.6% YoY). In the overseas research business, net sales are forecast at ¥4,782mn (up 4.7% YoY), representing a lower level of projected growth than in Japan. This forecast is mainly based on the absence of the positive impact of the adoption of the percentage-of-completion method recorded in the previous fiscal year, which will serve as negative factor, as well as a conservative outlook in consideration of the economic environment and forex movements in Asia.

In 2H FY12/16, the Group intends to continue to improve its productivity and added value, as it did in 1H, to cultivate the North American market, and to strengthen synergy among its operations in Asia. It also aims to expand its service areas to include brand diagnostics, workshops, and neuro-marketing.

b) IT solutions business
In the IT solutions business, net sales are forecast at ¥2,094mn (up 22.9% YoY), marking double-digit growth. The main reason is that Cross J Tech Inc., which was converted into a subsidiary in September 2015, is expected to make a full positive contribution to sales throughout the year. The Group will make strides to develop new customers by enhancing its consulting-based sales capabilities, while working to enhance productivity and quality. Moreover, the Group seeks to expand into new services and business fields by developing recurring revenue-based services in the IT solution field, such as engineer staffing services and the private DMP service.

c) Other businesses
In the other businesses, the Group is projecting a high rate of sales growth, with net sales forecast at ¥609mn (up 140.6% YoY). The Group’s basic policy is to target top-line growth by proactively recruiting staff. In addition to these efforts, in the Web marketing business, the Group will strive to enhance and differentiate its services by forming tie-ups with third-party partners. Meanwhile, in the promotion business, the Group will address customer needs by making fine-tuned improvements to services.

FISCO foresees a high hurdle to achieving the Group’s net sales forecast for FY12/16 and remains non-committal on prospects for profits until 3Q results are announced. Sales in the domestic research business, which were adversely affected by yen’s appreciation in 1H, are showing signs of recovery, and sales in the IT solutions business and in other businesses are likely to grow in FY12/16. However, the overseas research business is likely to miss the Group’s sales target for it because the yen remains stronger against the U.S. dollar than the Group’s assumed average rate of ¥114.91.

Yen’s appreciation is exerting only a moderate negative impact on profits in the overseas research business. Sales in the domestic research business, which were weaker than the Group had planned in 1H, are showing signs of recovery. Prospects for sales growth in the IT solutions business and other businesses remain strong. The growth of SG&A expenses, centering on other costs, is being curtailed as it was in 1H. Despite these positive developments, FISCO will wait to see 3Q results before projecting profits for FY12/16.

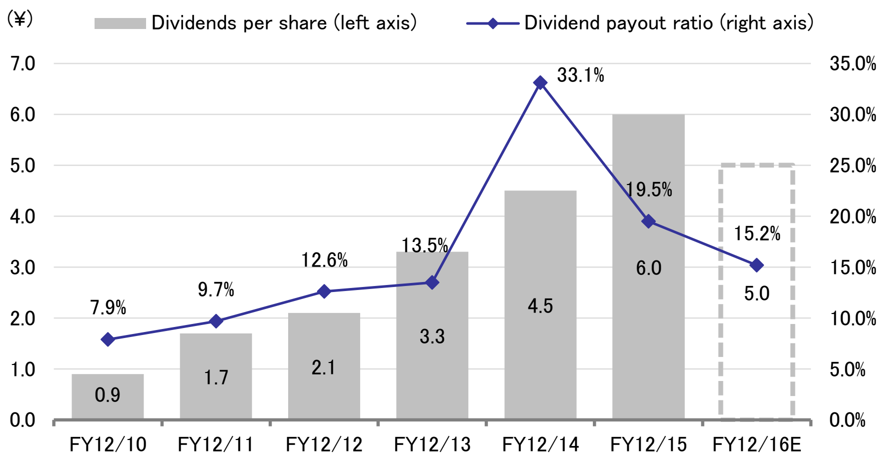
Shareholder Returns

Basic Policy is to Pay Stable Dividends Targeting a Consolidated Payout Ratio of Around 15%

Making fair returns to shareholders is an important priority of Group management. The Group's basic policy is to return part of its profits to its shareholders as dividends after considering business needs such as investments and cash flow. Until FY12/15, the company has sought to successively raise the dividend by targeting a consolidated dividend payout ratio of 20%. From FY12/16, in light of surging current funding requirements, future business investment plans, and other factors going forward, the Group has shifted to a basic policy of determining the amount of dividends by targeting a consolidated dividend payout ratio of around 15%.

Thus, for FY12/16, the Group plans to pay interim dividends of ¥2.5 per share and year-end dividends of ¥2.5 per share, for annual dividends of ¥5.0 per share and a dividend payout ratio of 15.2%. Although these annual dividends are smaller than the ¥6.0 dividend payment for FY12/15, the Group will continue to pay stable dividends, despite its need for funds.

Trend in Dividends Per Share and Dividend Payout Ratio



Note 1: The company conducted a 2-for-1 stock split on February 18, 2013, and a 3-for-1 stock split on June 1, 2014. Dividends per share for prior years are adjusted for these stock splits retrospectively.

Note 2: Dividends per share for prior years are rounded down to the first decimal place after adjusting for stock splits retrospectively.

Source: The company's earnings presentation materials

Disclaimer