

Hottolink, Inc.
3680 TSE Mothers

28-Oct.-15

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at the end of this document.FISCO Ltd. Analyst
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■ Establishing a position as the world's leading social big data distribution company

Hottolink (3680) is developing a core cloud service that provides useful information to business for corporate marketing strategies and risk management by gathering and analyzing data posted on Twitter, blogs and other social media. In January 2015, Hottolink acquired Effyis.inc., a U.S.-based social media data provider, for US\$22mn (approximately ¥2,596mn) (service brand name: Socialgist, hereafter "Socialgist"). The acquisition has established Hottolink's position as the world's leading social big data distribution company.

The Company's results for H1 FY12/15 (January – June, 2015) showed a sharp increase in net sales, which rose 142.3% year on year (yoy) to ¥1,216mn, reflecting the consolidation of Socialgist. However, the Company recorded an operating loss of ¥132mn (compared to operating income of ¥65mn in the same period of the previous fiscal year), due to the recording of goodwill cost and temporary costs related to an M&A.

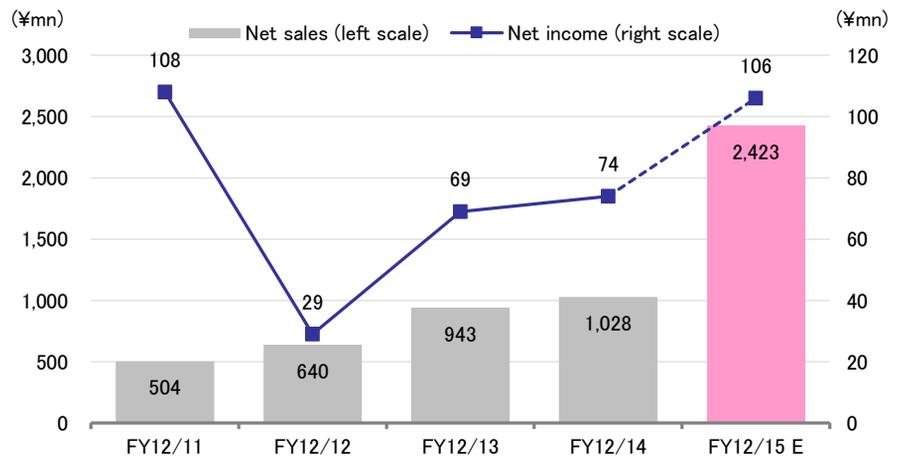
Full-year results forecasts for FY12/15 have been left unchanged from the initial forecast, with net sales of ¥2,423mn, increasing 2.4 times yoy, and operating income of ¥208mn, up 41.9%. The Company will transition to international financial accounting standards, i.e. IFRS (under which amortization of goodwill not recorded) in FY12/15, which will have an inflationary effect on operating income. Looking at operating income before amortization of goodwill, the Company is forecasting a slight increase from the previous fiscal year. At this point, the Company is in a position to expect further sales growth, driven by an expansion in the volume of social data handled with strong sales of the inbound tourism consumption analysis report service Visualized China Trend EXPRESS, while Socialgist has concluded successive data purchase agreements with the financial sector SNS StockTwits® and the leading positional information-based SNS Foursquare®.

As a result, from FY12/16 onward, when the M&A expenses have run their course, the Company is expected to enter a growth stage in terms of profit as well. Steady sales growth is also projected for existing services such as kuchikomi@kakaricho and e-mining with the release of new versions offering significant improvements in usability. The Company also has plans to expand its services into Asia, aiming for net sales of ¥10.0bn by FY12/20.

■ Check Point

- Established position as the world's largest social media distribution company
- Initial plan for significant increases in sales and earnings remains unchanged
- Overseas business expansion through synergies with Socialgist

Business Performance Trend



* Consolidated figures from FY12/13

* Financial forecasts for FY12/15 are based on IFRS.

■ Business Overview

SaaS Business and Solution Business are the core services

(1) Description of business

Hottolink has developed tools for gathering and analyzing postings on a variety of social media, such as Twitter, 2channel, Weibo and various blogs. It provides services that put this information to good use in corporate marketing strategies, risk management, and other functions.

Looking at Hottolink's core services, in the SaaS* Business, Hottolink offers services such as kuchikomi@kakaricho and e-mining, for which the Company enters into subscription agreements with customers. In the Solution Business, Hottolink provides analysis tools and data to systems integrators and tool vendors, along with the inbound tourism consumption analysis report service Visualized China Trend EXPRESS. Moreover, the Solution Business also includes the business of the U.S. company Socialgist, which was consolidated in January 2015. The chart below describes each business segment.

○SaaS Business

In the SaaS Business, Hottolink provides two products: (1) kuchikomi@kakaricho, a social media analysis tool; and (2) e-mining, a risk monitoring tool. The price structure for each of these services consists of an initial registration fee of ¥100,000 and a monthly usage fee starting from ¥100,000. The monthly usage fee is calculated based on the number of usable IDs, the number of media subject to analysis, data capacity and other factors. Some large corporate customers spend up to ¥1mn a month to use these services.

The number of corporate subscribers is over 1,700 for the two services combined on a cumulative basis (over 750 for kuchikomi@kakaricho and over 1,000 for e-mining). Of this, there are currently approximately 500 active corporate subscribers. The industry breakdown shows corporate subscribers span a wide range of sectors, from consumer goods manufacturers to the services and finance sectors. Approximately 80% of the corporate users are major corporations.

kuchikomi@kakaricho has the following features. It possesses Japan's largest social media coverage and it is easy to operate and perform real-time searches, such as trend analysis and attribute analysis. It also has functions such as cross-media analysis spanning television, web news sites and other media, plus a data import analysis function to perform text mining of data held internally by corporate customers (questionnaires and call logs, etc.).

* Software as a Service (SaaS):
A software service in which software is provided to customers over communication networks. Customers are able to use the software when needed by accessing the network. It is a stock-type business model that generates recurring revenues from a fixed customer base by collecting a monthly usage fee.



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Notably, Hottolink has a dominant advantage in Japan in terms of the sheer amount of social data it possesses. For example, the Company holds all historical data on the 2channel bulletin board site and has entered into a marketing agency agreement with Gnip, Inc., which markets Twitter data worldwide. In addition, Hottolink covers approximately 90% of blogs in Japan (more than 37 million bloggers).

The kuchikomi@kakaricho tool can be applied promptly to a company's marketing initiatives through real-time features such as trend analysis. For this reason, kuchikomi@kakaricho is being steadily adopted primarily by major corporations as a support tool that helps to improve return on investment (ROI) for marketing departments.

Meanwhile, e-mining is a tool that automatically collects data from Twitter, 2channel, and other sources according to pre-set risk-related keywords. The e-mining service provides alert functions that enable companies to promptly detect any development of risks. Monitoring covers a wide range beyond 2channel and Twitter, extending to blogs and various news sites. Each day, e-mining monitors approximately 12 million web pages and reports search results by category.

Recently, there has been a notable increase in incidents, such as food contamination problems, in which rumors and pronouncements on issues have spread via postings on social media. There is a growing need for corporations to promptly identify these risks and to implement response measures at an early stage. Accordingly, e-mining is being adopted primarily by major corporations.

○Solution Business

In the Solution Business, Hottolink provides two different services: (1) data platform services that provide systems integrators and other customers with the data and analysis engines that make up kuchikomi@kakaricho; and (2) specialized service relating to consumption trends among inbound Chinese tourists developed by subsidiary Hottolink Consulting Inc. and sales of data by U.S. company Socialgist.

The data platform services have an initial deployment fee of ¥500,000 and a monthly usage fee based on a tiered billing structure according to the number of requests. Customers spend between ¥0.1mn and ¥3mn on these data platform services. Meanwhile, the specialized service relating to consumption trends among inbound Chinese tourists is provided at a price of ¥80,000 per month.

U.S.-based subsidiary Socialgist collects and provides social media data from sources such as blogs, bulletin boards, Q&A, and review sites worldwide. Socialgist is notable for being the world's only company to acquire a marketing license with full access rights to the data of Weibo, which has been dubbed the "Chinese Twitter." Weibo data sales currently represent just over 30% of Socialgist's net sales. Socialgist does business with customers that include the world's major social big data analysis firms and marketing platforms, as well as CRM, business intelligence (BI) and other tool vendors, along with financial institutions and governments.

(2) Hottolink's strengths

Hottolink's strengths lie in having established a position as the world's largest social media data distribution company by consolidating Socialgist, as well as bringing together world class big data analysis technologies and Socialgist's high data streaming technologies.

Financial results trends

Consolidated net sales for H1 FY12/15 doubled yoy, progressing largely as planned

(1) Outline of performance trends for H1 FY12/15

Consolidated financial results for H1 FY12/15 were announced on August 12, 2015. Net sales were ¥1,216mn, up 2.4 times yoy, and operating loss was ¥132mn, compared to ¥65mn operating income in the same period of the previous fiscal year.

Cumulative financial result for FY12/15 Q2

	FY12/14 Q2 cumulative		FY12/15 Q2 cumulative		
	Actual	vs sales	Actual	vs sales	y-o-y change
Net sales	502	-	1,216	-	142.3%
Cost of sales	194	38.8%	737	60.6%	278.3%
Selling, general and administrative expenses	241	48.2%	611	50.3%	152.8%
Operating income	65	13.0%	-132	-10.9%	-
Ordinary income	65	13.0%	-182	-15.0%	-
Net income (loss)	27	5.6%	-162	-13.3%	-
(Operating income before amortization of amortization)	94	18.8%	0	0.1%	-

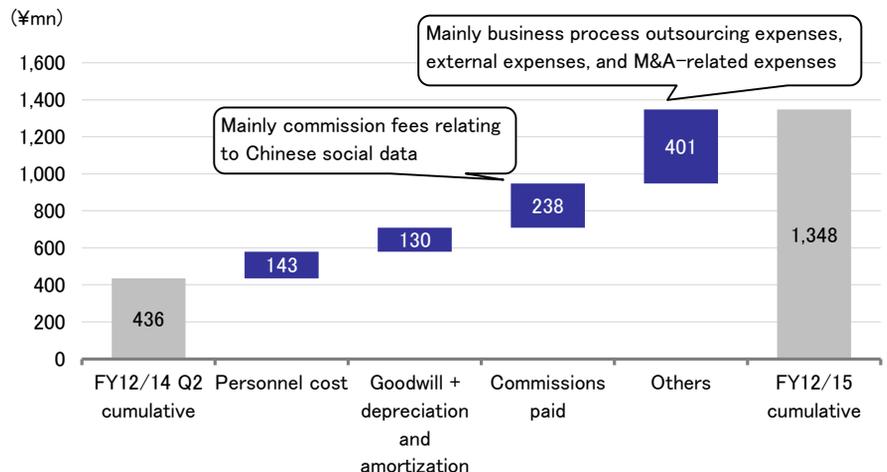
Net sales received a significant boost of approximately ¥680mn from the inclusion of Socialgist's results from the start of the year. Excluding the impact of Socialgist, net sales increased by around 6% yoy, progressing largely as planned.

On the other hand, an operating loss was recorded, with income declining ¥197mn from the previous year. This was mainly attributable to a rise in amortization of goodwill from ¥28mn in the same period of the previous fiscal year to ¥132mn following the consolidation of Socialgist. Moreover, expenses of around ¥52mn were recorded, comprising temporary costs associated with M&As (auditors' remuneration, IFRS consulting fees, PMI* expenses, etc.) and royalty fees connected with conclusion of a marketing license agreement with a leading Chinese social media company, while increases in personnel costs and other expenses associated with business expansion also reduced profits.

Operating expenses (cost of sales + selling, general and administrative (SG&A) expenses) comprised personnel costs of ¥143mn, goodwill and depreciation and amortization expenses of ¥130mn, and commissions paid of ¥238mn, and other expenses (business process outsourcing expenses, outsourcing expenses, M&A-related expenses). The cost of sales ratio increased sharply from 38.8% in the same period of the previous fiscal year to 60.6%, primarily reflecting an increase in the cost of purchasing data from social media following the consolidation of Socialgist.

* Post Merger Integration. The process of management integration following an M&A.

Analysis of Operating Expenses



Source: Consolidated financial results of the Company



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Launch of new version e-mining 7 improves subscription cancellation rate

(2) Net sales by service

○SaaS Business

Net sales in the SaaS Business rose 6.1% yoy to ¥390mn. The increase was driven by e-mining sales, which rose primarily due to growth in demand from not only large corporations, but also mid-sized enterprises, amid growing interest in risk management relating to reputational damage on social media. Furthermore, with the release in Q1 of a new version, e-mining 7, featuring improved usability, the subscription cancellation rate improved by 4.5% yoy, which helped to improve earnings. New features include functions for viewing re-tweeted articles on Twitter and articles featuring the same overlapping content and so forth on multiple media, and a function for eliminating unneeded articles. These functions help to improve work efficiency for the person handling social media on the company side.

Meanwhile, sales growth of kuchikomi@kakaricho faltered despite steady growth in new subscriptions, due to a need for further progress improving the subscription cancellation rate. Nevertheless, the service is expected to see a reduction in subscription cancellation rates in H2, following the announcement in August of a new version with new functions and greatly improved usability. Specifically, the number of search conditions that can be applied or a single search has been expanded significantly from three to ten (one of the largest available in Japan), while the maximum searchable period has been extended from 3 months to 13, significantly reducing the number of individual searches that need to be executed. Furthermore, the search speed has been increased by around 30%. As a result the time required for company personnel in charge of social media to perform a kuchikomi@kakaricho analysis has been reduced to around one third of the previous version. Moreover, with real-time search results and customizable dashboard functions, the service is ready to meet diverse customer needs.

○Solution Business

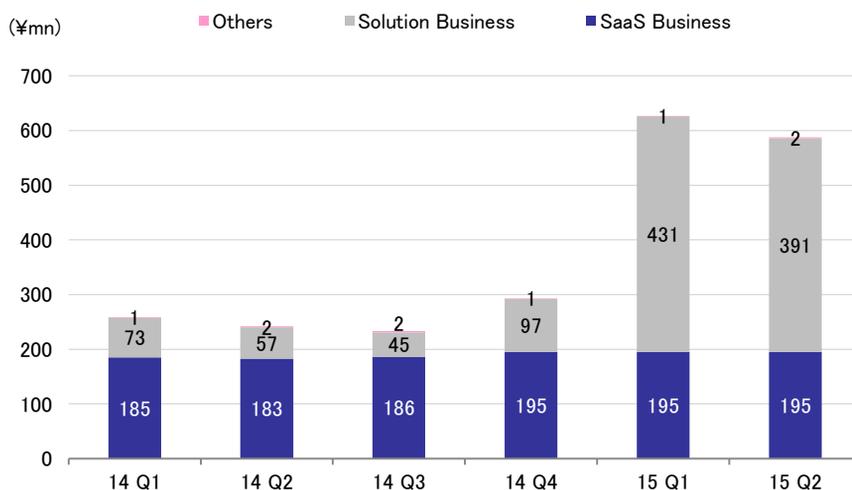
Net sales in the Solution Business surged, increasing 532.4% yoy to ¥822mn. The increase mainly reflected the addition of social big data sales in the U.S. and China due to the consolidation of Socialgist. While Socialgist's results are not disclosed, the overseas sales ratio is 56%, or around ¥680mn in terms of net sales, and has continued to increase at a double-digit rate yoy. Reasons for the brisk sales growth include an increase in the types of social data sold to global IT companies such as International Business Machines Corp. (IBM) and Oracle Corporation and an increase in new customers. On the other hand, as explained above, profits have been affected by negative factors such as amortization of goodwill, temporary costs associated with M&As, and royalty fees due to conclusion of an agreement with a major Chinese SNS, which have amounted to approximately ¥160mn.

Socialgist has been conducting sales of Weibo's social big data in China. Approximately 30% of Socialgist's sales are of data for the Weibo SNS. In Q2, Socialgist started data sales of another major social media, thereby enhancing its social big data content in the Chinese market. In June, Socialgist commenced selling social big data in the finance domain, after concluding a data marketing license agreement with StockTwits®, which operates one of the largest SNSs in the global financial markets. The StockTwits® SNS receives over 65,000 posts a day (91% original, 88% in English) relating to financial instrument such as stocks, bonds, and foreign exchange. Socialgist sells the data to IT companies that supply analysis tools to investors and others who seek to improve their investment performance by utilizing the big data formed by these posts.

Meanwhile, in Japan, OEM sales appear to have plateaued, however the commissioned development service created through API sales of kuchikomi@kakaricho expanded steadily. In June, the Company published the first issue of Visualized China Trend EXPRESS, a report on consumption trends among inbound Chinese tourists made using social media data-based analysis, and commenced sales to companies and other entities looking to capture inbound tourism demand. With a large number of companies looking to capture consumption from inbound Chinese tourists, there is a strong demand for the Company's weekly analysis report publication service, and subscriptions have grown very briskly. At this point, subscribers appear to be concentrated mainly distribution companies, pharmaceutical and cosmetic manufacturers, hotels, and various public entities. The Company aims to acquire 100 corporate subscribers in the inaugural fiscal year. Furthermore, there has been an increase in customized report contracts from corporate subscribers to Visualized China Trend EXPRESS, and sales of individual surveys can also be expected to grow going forward.

In its efforts to expand its business using Chinese social big data going forward, the Company concluded a capital alliance with its business alliance partner Ideal Marketing Strategist Co., Ltd. (Pu Qian (Shanghai)) in June, acquiring 19.9% of Ideal Marketing Strategist's shares in July (the monetary amount was minimal). Ideal Marketing Strategist conducts integrated media monitoring of advertising and articles relating to brands and products being developed in the Chinese market, mainly by Japanese advertising and PR companies and major Japanese brand corporations. Based on the gathered data, Ideal Marketing Strategist produces data analysis and reports, and provides consulting services involving proposals for marketing strategies and so forth. The Company formed a business alliance with Ideal Marketing Strategist in July 2014.

Sales Trends by Service (Quarterly)



Initial plan for significant increases in sales and earnings remains unchanged

(3) Financial forecasts for FY12/15

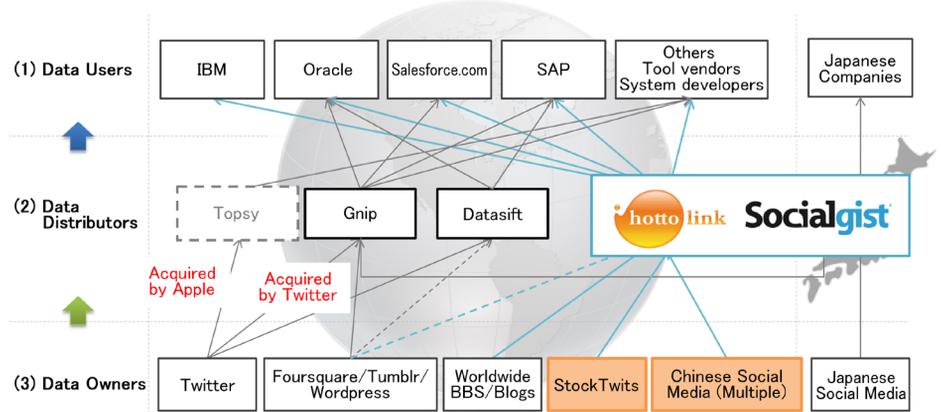
In terms of consolidated financial forecasts for FY12/15, Hottolink has left its initial forecasts unchanged. Net sales are projected at ¥2,423mn, up 135.7% yoy. Operating income is forecast at ¥208mn, up 41.9%, and net income for the year is forecast at ¥106mn, up 42.8%. The Company had an achievement rate of 50% on its net sales target by Q2, and appears fully capable of achieving it. Meanwhile, in profits, with the change to the IFRS accounting standard the Company will no longer book amortization of goodwill, and profits are therefore expected to rebound (the current accounting standard will remain in use until Q3). In real terms, the Company is expecting a slight increase in profit, as operating income before amortization of goodwill was ¥204mn in FY12/14. The lack of growth in profits against the growth in sales is attributable mainly to the abovementioned increase in temporary costs such as M&A-related expenses and royalty fees, as well as an increase in personnel costs. Profits lagged somewhat behind target through to Q2, but the Company plans to achieve its earnings plan despite the high hurdles in H2 by further increasing sales, mainly in the Solution Business.

Looking at forecasts by service, the SaaS Business is expected to achieve a slight yoy increase in sales. By releasing new versions, first of e-mining and then of kuchikomi@kakaricho, the Company anticipates an increase in new orders and a decline in the subscription cancellation rate. However, the companies using social big data are still concentrated mainly around large corporations, with full penetration into the mid-size and SME sectors expected to take some time.

On the other hand, in the Solution Business, sales of Socialgist are expected to continue expanding. Demand for social big data analysis of Chinese market trends for use in corporate marketing strategies and risk management is as strong as ever. Moreover, in a follow-on from the alliance with the major financial market SNS provider StockTwits®, in September the Company announced a business alliance agreement with the world's leading positional information-based SNS Foursquare® of the U.S., which has opened the way to selling user review data with Foursquare® location information around the world.

In this way, the Company is now able to promote development of insight analysis for online-to-offline (O2O) strategies and Internet of things (IoT)-related services, providing more accurate marketing support services and other diverse services than ever before. Even from a global perspective, there are only a handful of major players in social big data distribution, and the Hottolink Group has secured its position as the leading independent player. It is expected to expand its business going forward.

Conclusion of Data Purchase Agreement with StockTwits® and New Chinese Social Media Company



In its domestic business, the Company has started providing social big data using e-mining for the financial sector. For example, The Miyazaki Bank Ltd. (8393) uses social big data to establish standard for solatium payments for its investment product featuring “measures against damage caused by harmful rumors, with solatium payment service.” Specifically, when certain predetermined key words begin to appear on social media at a frequency greater than a certain level, it is deemed to be reputational damage, The Miyazaki Bank Ltd. pays a solatium payment to the loan recipient. This is the first time that social big data has been utilized in a financial product, and with strong potential for similar financial products to be commercialized by other financial institutions in the future, the Company is poised to see expanding business opportunities in this area.

Furthermore, in the tourism market, in August the Company announced a business collaboration with Yamatogokoro, Inc., the operator of Japan’s largest B2B portal site for foreign tourists visiting Japan, Yamatogokoro.jp (over 14,000 corporate members). Through this alliance, the Company will conduct joint development and sales related to promotion measures and service development for companies concerned with inbound tourist consumption. The first step is to begin sales through joint promotion of Visualized China Trend EXPRESS.

■ Medium-Term Targets

Overseas business expansion through synergies with Socialgist

Guided by the business concept of “Big Data × Social × Cloud,” Hottolink’s strategy is to drive growth by providing platforms such as social media data and analysis engines in various market sectors, and developing new services that make use of them. The Company’s medium-term targets for FY12/20 are net sales of ¥10.0bn, with an overseas sales ratio of 80%. In the future, the Company plans to create a business on a scale of ¥100.0bn.

With particularly high growth potential for overseas sales, the Company also intends to expand its business while leveraging synergies with Socialgist. Initially, the Company plans to sell Visual China Trend EXPRESS in Asian markets, since South Korea, Hong Kong, Taiwan, and Thailand are among the major overseas travel destinations for Chinese travelers, and these markets are seen as having a strong need for inbound tourist consumption trend analysis. Currently, the Company is in negotiations with local partner companies, and plans to launch the services as soon as the negotiations have been settled.

Through this business strategy, the Company will be enabled for the first time to provide a service that brings together Socialgist’s Chinese social big data and the Company’s data analysis capabilities. The consolidation of Socialgist has increased the long-term potential of the Company to a higher level. Looking ahead, the Company is expected to promote the use of social big data in various sectors in addition to tourism, using its strengths from building the leading platform in the data distribution sector to enter a new growth stage for earnings going forward.

Social Big Data

Expansion in the areas utilized



Source: Company materials

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■ Financial status and risk factors, shareholder return policy

Acquisition of Socialgist increases interest-bearing debt

(1) Financial status

Looking at the financial status of Hottolink as of June 30, 2015, total assets were ¥4,566mn, up ¥1,322mn from December 31, 2014. The main factors in the increase / decrease were a ¥1,842mn decrease in current assets due to a decrease in cash and deposits associated with the acquisition of Socialgist's shares, while non-current assets increased by ¥3,164mn, of which ¥3,040mn was due to an increase in goodwill following the Socialgist acquisition.

Total liabilities were ¥3,280mn, up ¥1,387mn from December 31, 2014. This mainly reflected an increase in interest-bearing debt of ¥1,179mn associated with the acquisition of Socialgist. Net assets were ¥1,285mn, down ¥64mn, reflecting a slight decline overall as the net loss of ¥162mn absorbed the positive factor of foreign currency translation adjustments and the exercise of stock options.

Looking at key financial indicators, Hottolink's financial health has declined somewhat, with the equity ratio and interest-bearing debt ratio deteriorating with the increase in interest-bearing debt. However, the recent M&As have also had an impact and with greater earnings expected, the Company's financial status is also forecast to improve gradually. Moreover, the Company issued subscription rights to shares through a third-party allotment (minimum exercise price ¥889, number of potential shares 1,363,000) in January 2015 in association with the acquisition of Socialgist. Following this, the share price slumped, and the exercise rate as of August 31 was 0%. However, as the share price improves going forward, some of the subscription rights to shares may be exercised once the share price exceeds the minimum exercise price.

Consolidated balance sheet

	(¥mn)			
	FY12/13	FY12/14	FY12/15 Q2	Changes
Current assets	1,113	2,934	1,092	-1,842
(Cash and deposits)	949	2,772	744	-2,027
Non-current assets	353	309	3,473	3,164
Total assets	1,467	3,244	4,566	1,322
Liabilities	198	1,893	3,280	1,387
(Interest-bearing debt)	0	1,700	2,879	1,179
Total assets	1,268	1,350	1,285	-64
(Stability ratio)				
Current ratio	572.3%	155.2%	38.4%	
Equity ratio	86.5%	41.6%	27.9%	
Interest-bearing debt ratio	0.0%	52.4%	63.1%	

(2) Risks

Looking at business risks, changes in management policy by companies that purchase social media data could lead to a cancellation of current subscriptions, and this could have an impact on financial results. That said, Hottolink already has approximately 500 corporate customers in Japan. Furthermore, the amount of data purchased is expected to continue to increase mainly based on expansion in the data platform business. Therefore, FISCO believes there is an extremely low likelihood that subscriptions will be cancelled.

The same holds true for Socialgist. Notably, in the event of a change in contractual conditions with Weibo, a major data supplier, there is the risk of an impact on financial results.

(3) Shareholder return policy

Regarding the return of profits to shareholders, Hottolink plans to pay out dividends to shareholders in the future. However, Hottolink believes that it is currently in an upfront investment phase where it should actively allocate funds primarily to investment in businesses, and the recruitment and training of talent. Accordingly, Hottolink plans to maintain its no dividend policy in FY12/15.

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