COMPANY RESEARCH AND ANALYSIS REPORT

Netyear Group Corporation

3622

TSE Mothers

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Summary

Aiming to be the leading digital marketing technology company

The Netyear Group <3622> (hereinafter, also "the Company") operates a digital marketing support business utilizing Internet technologies. Its customers are primarily major companies, while as its subsidiaries, Tribal Media House is an industry leader in the social-media analysis and consulting sector, and rakumo inc. provides a cloud app that contributes to improved business productivity in offices.

1. Recorded an operating loss for the first time in 8 fiscal years in FY3/17, including due to the effects of the completion of large-scale projects

In the FY3/17 consolidated results announced on May 10, net sales declined 13.2% year-on-year (YoY) to ¥5,906mn, and the operating loss was ¥206mn (compared to operating income of ¥146mn in the previous fiscal year). In addition to the fall in sales from the completion of large-scale projects and the delay in resolving problems that occurred in a project in the previous fiscal year, the main factor behind the lower sales was that on entering 2H, there was a delay in delivering a new project and so an allowance for a loss on orders of ¥69mn was recorded.

2. Forecast is for profits to recover in FY3/18 due to the effects of measures to improve profits implemented in the previous 2H

The forecast for the FY3/18 results is for net sales to increase 5.0% YoY to ¥6,200mn and for operating income of ¥110mn, for a return to profitability. The problem project from the previous fiscal year is expected to have been completed by 1H, and the effects of the improved productivity from the measures implemented from the previous 2H to review the sales process, to strengthen the project management structure, and to transition to an organizational structure in which manufacturing and sales are integrated, are expected to be actualized in this fiscal year. On a fiscal half-year basis, it is possible that the loss will continue up to 1H, but for the full fiscal year, the outlook is for a return to profitability for the first time in two fiscal years.

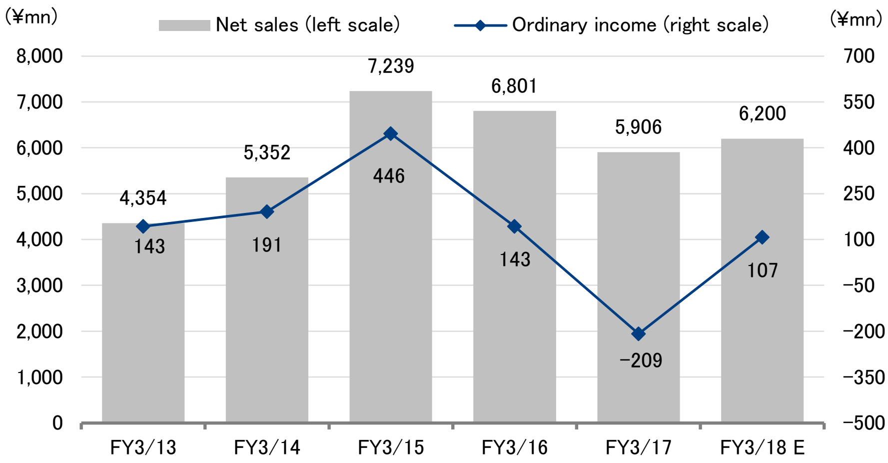
3. Launched "Funmee!!" the Company's in-house media website, which is attracting attention as a new measure

As its medium- to long-term growth strategy, the Company is strengthening its solutions services in the digital marketing field, and in addition it is advancing investment in and the development of the tools to supplement these services, license services, and the Company's in-house media services, while training also appears likely to move ahead. In tools and license services, while combining the marketing automation tools and other tools of U.S. Salesforce, it provides solution proposals to requesting companies. Also, as the Company's in-house media, "Funmee!!," which was launched in December 2016 by the subsidiary Tribal Media House, is attracting attention. "Funmee!!" is a media site that brings together people with shared interests and lifestyles, and it is considered that the Company is developing it to be a site that can be utilized by BtoC companies, such as to capture a fan base and for market research. It also plans to release a smartphone app for it during this fiscal year. At the present time, it is in a phase of accumulating access users, so it cannot be expected to contribute to profits. But if the number of users increase and its media value rises, it will be monetized in the form of advertising revenue and from marketing support services, so we will be paying attention to how it develops in the future.

Key Points

- Digital marketing support business utilizing Internet technology is its main strength
- The impact of an unprofitable project has ended and the forecasts are for increases in sales and profits in FY3/18
- Aiming to convert its business structure in the next two years toward realizing sustainable growth

Result trends



Source: Prepared by FISCO from the Company's financial results

Business overview

Digital marketing support business utilizing Internet technology is its main strength

1. Company profile

The Company's vision is to "Create the future of business digitally and with users. Everything starts from the user experience." It is developing businesses to support companies and communities for the reforms required in the digital age. Specifically, this includes digital-marketing consulting, the planning and production of digital content, systems development, the planning and sales of marketing tools, the planning and sales of office tools on the Cloud, and co-creation of businesses with local communities.

The subsidiaries are Tribal Media House (made a subsidiary in 2009), which utilizes social media to provide market support, analysis, and consulting, and rakumo inc. (made a subsidiary in 2013), which conducts development and sales of cloud applications. The subsidiary Netyear Craft, which produces and manages websites, was merged into the Company through an absorption merger in December 2016 with the objectives of improving management efficiency and strengthening profitability.

Up until February 2016, the Company's largest shareholder was TIS <3626> with a shareholding ratio of 31.0%, but it sold all of its shares to Konica Minolta Business Solutions (currently, Konica Minolta Japan), thereby changing the largest shareholder.

Consolidated subsidiaries (business description, capital contribution ratio)

Name	Capital contribution ratio (%)	Main business
Tribal Media House	92.5	Social media marketing support
rakumo	51.0	Development and sales of groupware software

Source: Prepared by FISCO from the Company's results briefing materials

2. Business description

The Company's business area is digital marketing, which refers to the marketing techniques in corporate activities that are centered on the website of the client company and that are coordinated with elements such as existing media, marketing, call centers, and stores. These services are for clients such as companies and local governments, and propose and implement new digital marketing strategies to produce the outcomes that the clients want, including improved brand value, sales growth, and the promotion of business transformations.

A characteristic of the Company is that it is engaged in systems development and design with the focus on improving the "user experience (UX)" on the Internet. Here, "user experience" does not refer to the standard meaning in English, but rather indicates "what users experience when they visit a company's website, and what they become interested in after experiencing that site." Therefore, the final goal is to improve the "user experience" in order to get customers to purchase products or to become fans of that company.

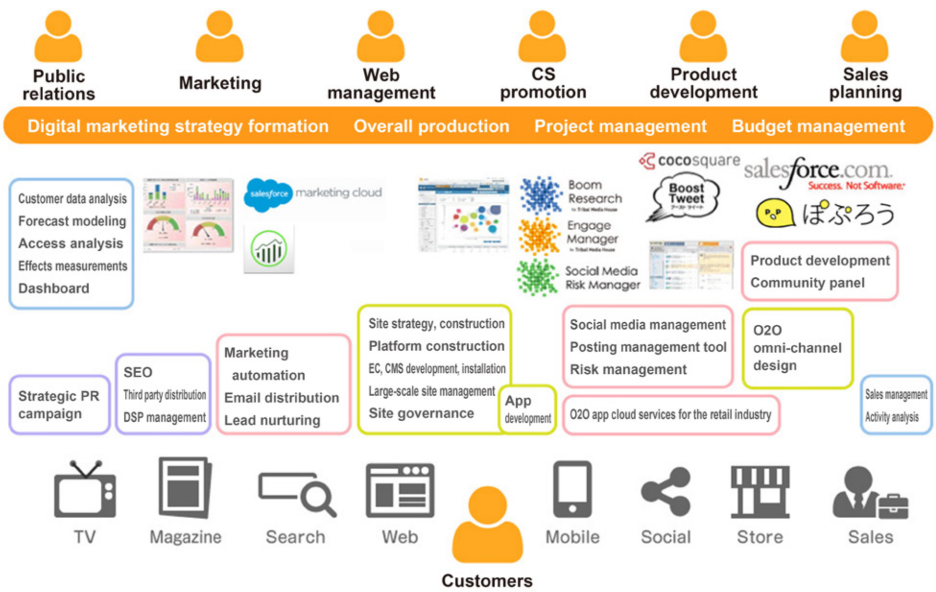
With the arrival of the digital information society and people being able to obtain the information they need at any place and any time via the Internet, heightening the "user experience" on companies' own websites, which have become customer points-of-contact, has today become more important than ever before. Furthermore, these websites also occupy an important position in terms of promoting companies' marketing strategies and brand strategies. As the methods of effectively improving "the user experience" change depending on the nature of the client's business, systems development has come to be carried out through customized projects. Generally, the development period is about three months and even a long development period is about one year. The majority of the systems development part of a project is outsourced, with the unit price of orders varying depending on the content of the project, ranging from ¥100,000 yen at the low end to more than ¥100 million yen at the top end. Recently, however, demand for marketing techniques incorporating "data analysis and utilization" has been increasing and the unit price of projects has been rising.

The strengths of the Company include its many staff with strong planning abilities and progressive sensibilities toward marketing. Furthermore, its customers highly evaluate its project management capabilities and strengths such as the stability and reliability of its systems.

Other than services to support the introduction of customer projects, the Company is also focusing on sales of products developed in-house. In addition to "popurou," which is a customer-attraction support app for stores that was released in 2015, these include "Engage Manager," which is Tribal Media House's social media integrated management tool, and "rakumo," which is the business-use group software of rakumo. Also, as its third-party product lineup, the Company conducts sales and support the introduction of various products, including US. Salesforce.com's and Oracle's marketing automation tools, and Google's and Adobe's access-analysis tools. For the products it develops in-house, it has a stock-type business model from monthly billing, and these products constituted approximately 13% of total sales in FY3/17, but the aim is to increase this ratio to around 50% in the future.

The Company has clients in a wide range of industries, including retail, manufacturing, finance, and information and communication services, and it has in excess of 1,000 customer companies. These include more than 250 customers in its digital marketing support business, centered on major companies that are representative of Japan, and also a wide-range of customers, ranging from major companies to SMEs, for its in-house developed products. As of FYE3/17, 1,130 companies have installed "rakumo."

List of services covering all points of contact with customers



Source: The Company's website. Translation by FISCO

Performance trends

Recorded an operating loss on the completion of large-scale projects and the occurrence of an unprofitable project

1. FY3/17 results overview

In the FY3/17 consolidated results, net sales decreased 13.2% YoY to ¥5,906mn, the operating loss was ¥206mn (compared to operating income of ¥146mn in the previous fiscal year), the ordinary loss was ¥209mn (ordinary income of ¥143mn), and the net loss attributable to the owners of the parent was ¥297mn (net income of ¥74mn). On an operating income basis, it recorded the first loss in 8 fiscal years since FY3/09, when IT investment as a whole was frozen following the Lehman Shock.

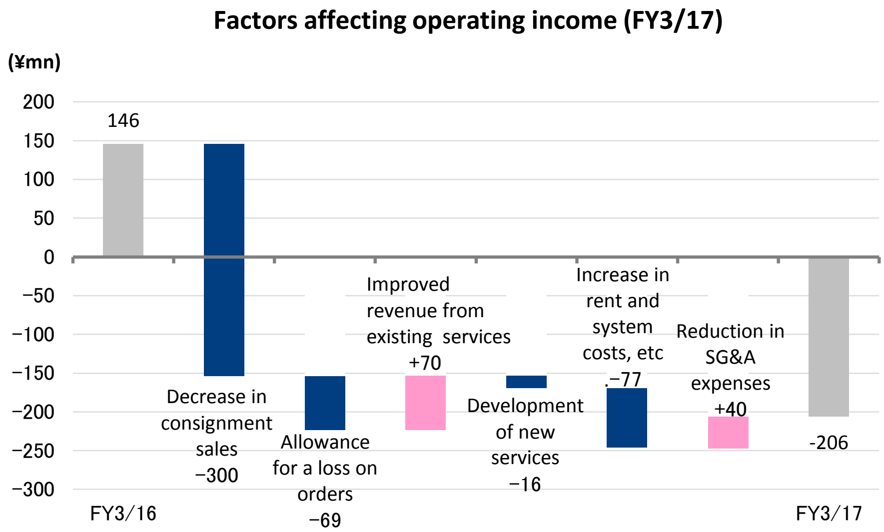
FY3/17 consolidated results

(¥mn)

	FY3/16		FY3/17				
	Result	% of sales	Forecast	Result	% of sales	YoY	Change
Net sales	6,801	-	5,800	5,906	-	-13.2%	-894
Cost of sales	5,636	82.9%	-	5,134	86.9%	-8.9%	-501
SG&A expenses	1,019	15.0%	-	978	16.6%	-4.0%	-40
Operating income	146	2.1%	-200	-206	-3.5%	-	-353
Ordinary income	143	2.1%	-200	-209	-3.6%	-	-353
Net profit attributable to the owners of the parent	74	1.1%	-280	-297	-5.0%	-	-372

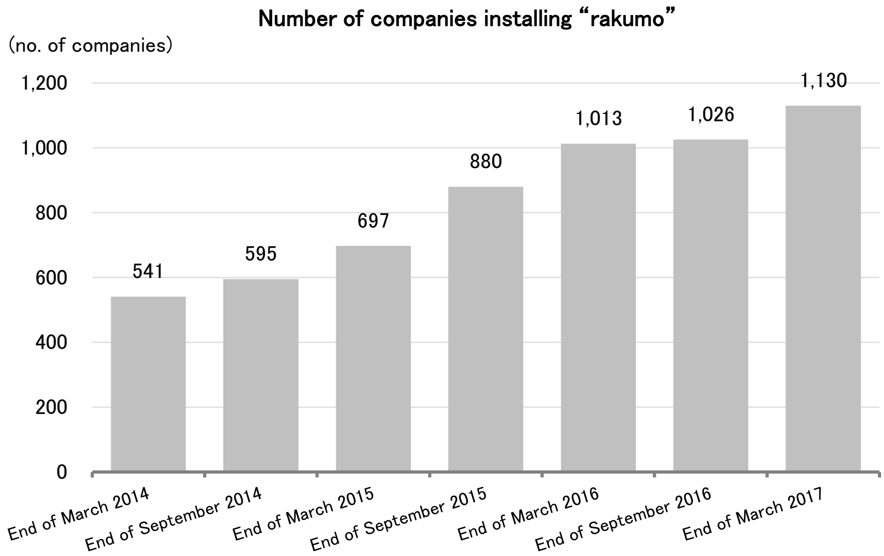
Note: Forecast is revision announced in October 2016.
Source: Prepared by FISCO from the Company's financial results

IT investment within Japan continues to expand, but a factor behind the lower sales in the Company was the completion of large-scale, omni-channel related projects that were recorded in net sales in the previous fiscal year. Also, there was a delay in resolving the problems that occurred in a project in the previous Q3 and the Company had no choice but to allocate sales- and production-related personnel to it. Therefore, it was unable to sufficiently conduct activities to acquire orders and as a result, sales fell by double digits. Also, on looking at the breakdown of the factors behind the decline in operating income, we see that consignment sales declined ¥300mn, that the allowance recorded for a loss relating to a problem project in the previous Q3 was ¥69mn, that development costs for new services were ¥16mn, and the increase of costs, including rent and for systems development, was ¥77mn. The reasons why profits declined was that although the revenue from existing and new services improved ¥70mn and SG&A expenses were reduced ¥41mn, they were not enough to cover for the factors causing profits to decline. With regards to the new problem project, as it involved measures for a project that is highly novel technically, its delivery was delayed and the number of processes increased more than anticipated. It has currently reached the stage of test operations, and if there are no more problems, its delivery is expected to be completed during 1H, and there is considered to be little possibility that any additional costs will be incurred.



Source: Prepared by FISCO from the Company's results briefing materials

Looking at the revenue trend by company, in the Netyear parent company, net sales decreased 19.2% YoY to ¥3,950mn and the operating loss was ¥198mn (compared to operating income of ¥27mn in the previous fiscal year), which were the main factors being the worsened performance. Conversely, results trended positively in the subsidiary Tribal Media House, with net sales increasing by double digits of ¥1,700mn. In a situation in which companies are actively undertaking marketing measures using social media, there has been a rise in inquiries to the Company, which has a track record of conducting many marketing-support projects in this field. However, profits declined due to the establishment of a development base in Vietnam and the efforts to strengthen the personnel structure. In rakumo, net sales increased by a single digit YoY to ¥300mn, as the number of companies introducing “rakumo” steadily increased by 104 compared to the end of the previous fiscal year to 1,130 companies, although profits remained at the same level as the previous fiscal year.



Source: Prepared by FISCO from the Company’s materials

The number of stores introducing “popurou” (a POP creation and a message-and-coupon delivery app), which is a customer-attraction support app for retail stores that was released in November 2015, had increased from more than 10 stores at the end of the previous fiscal year to 231 stores at the end of March 2017. It seems that it is being well received from its convenience of enabling users to easily create digital POP and to deliver information in real time, such as discount information combined with photos and other such information. Also, the Company has developed “built-in popurou,” which incorporates into “popurou” an app for in-house management by retail companies. Since the end of December 2016, it has been used by the major supermarket chain Daiei (at 176 supermarkets), which also contributed to the increase in the number of stores introducing it.

The monthly usage fees are ¥7,800 to ¥13,000 for “popurou” and ¥51,000 for “built-in popurou.” As the fees are inexpensive, its impact on results is only slight, but it is one of the services for which there are expectations for the future.

“popurou” services fees (fees per store)

(¥)

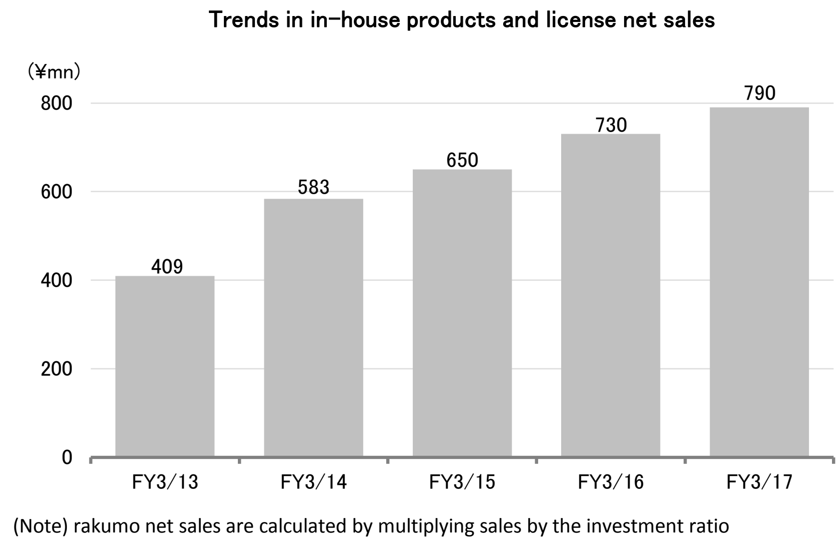
	Initial costs	Monthly usage fees	At the time of the annual contract
Individual-store plan			
(stores with annual sales of ¥30 million or more)	30,000	13,000	140,400
(stores with annual sales of less than ¥30 million)	10,000	7,800	-
Chain-store plan			
(no. of stores, 2 to 9 stores)	30,000	12,500	135,000
(no. of stores, 10 to 19 stores)	50,000	12,000	129,600

“built-in popurou” service fees

Initial costs	Monthly usage fees	
	Basic fee	Usage fees
300,000~	50,000	1,000~/ store

Note: the monthly usage fees change according to the number of stores using it
Source: Prepared by FISCO from the Company's website

The Company’s policy is to further stabilize management by increasing net sales, including from sales of the products it has developed in-house like “popurou,” “rakumo,” and “Engage Manager,” and license sales of other companies’ products. In FY3/17, net sales of these products rose steadily by slightly less than ¥800mn for a single-digit increase YoY. The main contributions to the higher sales were from Salesforce Marketing Cloud and “rakumo.”



Source: Prepared by FISCO from the Company's results briefing materials

The financial condition is sound and the outlook is for profitability to improve from FY3/18 onwards

2. Financial position and management indicators

Looking at the financial condition at the end of March 2017, total assets were down ¥3mn on the end of the previous fiscal year to ¥3,172mn. The main change factors were that in current assets, cash and deposits decreased ¥167mn and notes and accounts receivable fell ¥214mn. Also, in non-current assets, security deposits and guarantee deposits increased ¥75mn following the increase in floor space at the head office.

Liabilities were up ¥270mn on the end of the previous fiscal year to ¥1,404mn. The main change factors were increases in interest-bearing debt of ¥133mn, in deferred income of ¥73mn, and in accounts payable of ¥69mn. Net assets were down ¥274mn to ¥1,768mn. Retained earnings decreased ¥321mn due to the recording of a net loss attributable to the owners of the parent and dividend payments, while capital and capital surplus increased ¥42mn following the exercising of stock options.

Looking at the management indicators, we see that the financial structure worsened slightly, with the equity ratio falling from 63.7% at the end of the previous fiscal year to 55.0% due to the decline in shareholders' equity following the recording of a loss, and the interest-bearing debt ratio rising from 8.9% to 17.9% because of the increase in interest-bearing debt. However, net cash (cash and deposits – interest-bearing debt) was a surplus and the Company can be judged to be maintaining its financial soundness. All of the indicators of profitability, including the operating income margin, ROA, and ROE, significantly worsened YoY due to the recording of an operating loss. But thanks to the measures to improve profits that the Company has been implementing since the previous 2H, a recovery is forecast from FY3/18 onwards.

Consolidated balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	Change
Current assets	2,495	2,947	2,806	2,753	-53
Cash and deposits	1,031	1,463	1,219	1,052	-167
Fixed assets	647	405	369	419	50
Total assets	3,143	3,352	3,176	3,172	-3
Current liabilities	957	1,220	1,046	1,231	184
Fixed liabilities	276	159	87	173	86
Interest-bearing debt	393	266	179	313	133
Total liabilities	1,234	1,380	1,134	1,404	270
Net assets	1,909	1,972	2,042	1,768	-274
Stability					
Current ratio	260.6%	241.6%	268.2%	223.6%	
Equity ratio	60.4%	58.4%	63.7%	55.0%	
Interest-bearing debt ratio	20.7%	13.6%	8.9%	17.9%	
Profitability					
ROA (return on assets)	6.8%	13.8%	4.4%	-6.6%	
ROE (return on equity)	3.2%	3.8%	3.8%	-15.8%	
Operating income margin	3.5%	6.1%	2.1%	-3.5%	

Source: Prepared by FISCO from the Company's financial results

Future outlook

The unprofitable project will be completed and the forecasts for FY3/18 are for higher sales and profits

1. The FY3/18 outlook

The forecasts for the FY3/18 consolidated results are for a return to profitability for the first time in 2 fiscal years, with net sales to increase 5.0% YoY to ¥6,200mn, operating income of ¥110mn (compared to a loss of ¥206mn in the previous fiscal year), ordinary income of ¥107mn (a loss of ¥209mn), and net profit attributable to the owners of the parent of ¥97mn (a loss of ¥297mn). Net sales are forecast to continue to trend positively, as the problem project will be completed during 1H and the number of projects will increase following the normalization of sales activities. In addition, sales at the subsidiary, Tribal Media House, are set to grow 15%. Conversely, profits are forecast to increase because the allowance for a loss on orders ¥69mn recorded in the previous fiscal year will be eliminated and also from the effects of the measures to improve profits implemented from the previous 2H.

The FY3/18 consolidated outlook

(¥mn)

	FY3/17		FY3/18		
	Result	YoY	Forecast	YoY	Change
Net sales	5,906	-13.2%	6,200	5.0%	+294
Operating income	-206	-	110	-	+316
Ordinary income	-209	-	107	-	+316
Net profit attributable to the owners of the parent	-297	-	97	-	+394

Source: Prepared by FISCO from the Company's financial results

As its measures to improve profits, the Company is reviewing the sales process, and in addition it has newly established a quality control team to prevent the occurrence of problem projects, which have continuously occurred over the last two years. Also, following the absorption merger of Netyear Craft, it expects positive effects from integrating the manufacturing and sales structures. But it is not the case that there are no issues to addressed. As the scale of projects is growing larger, it needs to recruit more highly skilled engineers. But there is a chronic shortage of engineers in the IT industry and it is continuing to experience recruitment difficulties. On a stand-alone basis, the number of Company employees increased by 59 following the merger with Netyear Craft, but on a consolidated basis, there was actually a decline of 8 employees. Recently, the scale of projects has grown larger and moreover, their degree of difficulty has been increasing. The Company specializes in systems' upstream processes (planning and design), but it needs to strengthen its system-development capabilities in order to expand its business in the future, so it can be said that a problem it is facing is securing the highly skilled engineers needed for this. In April 2017, it recruited around 10 new employees and it is developing their skills through in-house training, while it is also continuing to acquire the human resources it needs through mid-career recruitment.

Measures to improve profits (implemented FY3/17 2H)

Measures		Description, objectives
Sales	Reviewing the sales process	• Strengthening top-down sales, such as seminars for managers • Strengthening marketing functions, including inside sales
Delivery	Building a structure to prevent problem projects	• Newly establishing a quality control team • Strengthening project management training
Organization, human resources	Transitioning to an integrated manufacturing-sales structure through the absorption merger of Netyear Craft, etc. Transiting to a business head office structure Reforming the personnel system and ways of working	• Constructing a structure to integrate sales and delivery for new fields and highly difficult projects • Making operational conditions easier to visualize and improving internal operations • Accelerating decision making • Introducing the "Issues for discussion" consultation desk, a second-mentor system, prohibition of late-night overtime, a new evaluation system, etc.

Source: Prepared by FISCO from the Company's results briefing materials

The current order situation is progressing as planned, but there will be seasonal factors in 1H, so at FISCO we think the Company is highly likely to record an operating loss in 1H and that the recovery in profits will become apparent from the current 2H onwards.

Aiming to change the business structure in the next two years toward realizing sustainable growth

2. Strategy for the future

The Company's medium- to long-term growth strategy is to provide companies with solutions services to support their digital marketing activities, and also to provide tools that supplement these services and license services, and to develop its in-house media services. Through this, it is aiming to be No.1 in its industry as a marketing technology company that realizes the best customer experiences (CX).

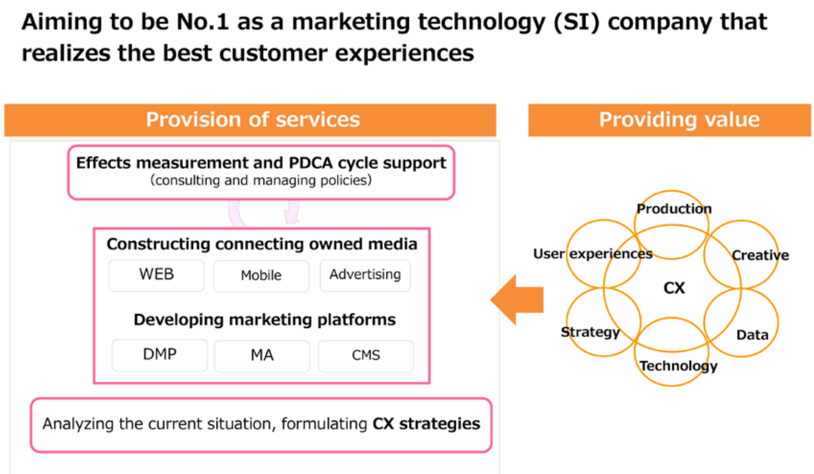
It is particularly focusing on the technologies that will be necessary for marketing in the future, mainly CMS*1, DMP*2, MA*3, and e-commerce. Also, as a strategy to differentiate itself from its industry peers, for systems development, it is developing "systems to expand sales" based on "customer experience requirements," unlike traditional SI companies that develop them based on business requirements. This entails conducting development from the perspective of the customers visiting websites. The Company is able to realize this because it has a unique culture in which it works collaboratively with experts in each of the fields of UX, strategy, creative, technology, and data.

*1 CMS (Content Management System)… Software that stores and manages information in an integrated manner, including images and text constituting web content, and layout information, and for constructing and editing websites. In its broader sense, it is the generic term for systems that manage digital content.
*2 DMP (Data Management Platform)…a platform for ultimately realizing the optimization of action plans, such as for ad delivery, through the integrated management and analysis of information, including big data accumulated on various servers on the Internet, and log data on in-company websites.
*3 MA (Marketing Automation)…a framework and mechanism for automating the actions in each of the marketing processes. It records what actions were taken for customers and prospective customers, and this information is then used for the objective of "delivery the optimal contents at the optimal timing using the optimal method."

As its business plan going forward, in the two years from FY17 to FY18 the Company is aiming to transition to a business structure to realize sustainable growth. In terms of the specific measures for this, first it is working to increase operational efficiency to improve productivity, while it is also acquiring highly skilled employees to raise the order unit price per employee. Second, it is engaging in high-value-added projects that combine the five specialized fields of "UX, strategy, creative, technology, and data," and thereby enhancing its competitiveness within the industry. Third, it is aiming to convert its business structure to a highly profitable technology business. Toward this, it is newly establishing a technology company and preparing a system from which it can provide marketing SI using CMS, MA, DMP, and other functions.

For its services line-up also, in addition to responding to requests for fully customized large-scale projects, the Company is enhancing its service menu to meet the needs of a wide range of customers. This is because the digital-marketing market itself is growing and its fields are expanding in various directions, and the fact is that customer companies do not know how to deal with this situation. The Company segments the services in its lineup according to field and supports their introduction to make it easier for its customer companies to tackle digital marketing. It is also working on various other measures, including the construction of owned media to realize CX (Web, Mobile, and advertising) and of marketing platforms (DMP, MA, CMS), and it is aiming to realize the optimal CX for customer companies through implementing the PDCA cycle alongside measuring effects.

Strengthening CX management support services



Source: The Company's FY3/17 results briefing materials. Translation by FISCO

As the services that supplement its solution services, the Company is working to strengthen sales of each type of product tool and license services, and it plans to continue to invest in and develop its in-house media services. Among the Company's in-house media, attention is focusing on "Funmee!!," which was launched by the subsidiary Tribal Media House in December 2016.

"Funmee!!" is an information media site that gathers people with common interests and lifestyles. The β version was launched in December 2016, and the plan is to also release a smartphone app version during the current fiscal year. It currently consists of six categories like beer and bread, in addition to the lifestyle category of camping and Shonan life. The Company posts pictures and articles on the site, and all of this content can be reposted on sites like twitter and Facebook. In addition to advertising revenue, the monetization method is a usage fee when BtoC companies use the site for in-house marketing activities. It can be said to be an in-house media service in a more open form than the previous "cocosquare," which was provided in an ASP format as a co-creation marketing platform. The number of categories are expected to naturally increase as the number of access users rise in the future. At the present time, it is in a phase of accumulating access users, so it cannot be expected to contribute to profits. But if user numbers increase and its media value rises, advertising revenue and the number of companies utilizing it for marketing support services will also grow, and it will then contribute to profits. It seems that the Company is also considering developing new services on this site in the future using BtoB and CtoC, so we will be paying attention to how it develops.

In-house media Funmee!!

Supporting the establishment of lifestyles, starting from "groups with common interests and lifestyles" and "likes"

It provides services for companies to strengthen connections with the core fan base and for research and co-creation

Prospects for new business in fields including B2B, B2C, and C2C

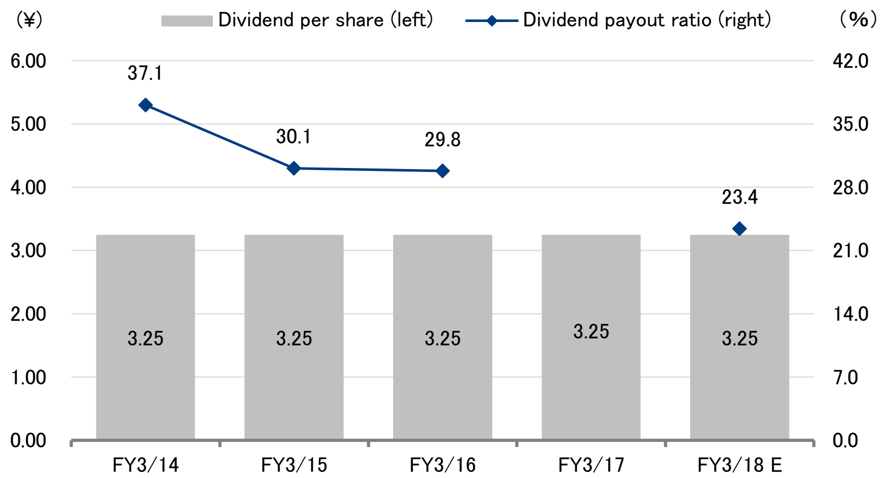
Source: The Company's FY3/17 results briefing materials. Translation by FISCO

Shareholder return policy

Basic policy is to retain internal reserves and to pay dividends stably and continuously

The Company pays dividends in order to return profits to shareholders. Its basic dividend policy is to stably and continuously pay dividends while ensuring it retains the internal reserves necessary to develop its businesses in the future and to strengthen its business structures. For this reason, from FY3/08 onward it has fixed dividends per share at ¥3.25, including in FY3/17 in which a loss was recorded. However, the Company intends to introduce performance-linked dividends in the future if it further supplements its internal reserves and obtains a stable cash flow in each fiscal period.

Dividend per share and dividend payout ratio



Source: Prepared by FISCO from the Company's financial results

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