OUTSOURCING Inc.

2427 Tokyo Stock Exchange First Section

28-Oct.-15

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FISCO Ltd. Analyst
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In FY12/15 1H, net sales and operating income exceeded management's initial forecasts

OUTSOURCING Inc. (2427) (hereinafter, "the Company") primarily provides staff placement and outsourcing services for factory production lines and engineer outsourcing services for design, development and other processes. The Company also operates the Overseas Business. The Company has a strong customer base in the automobile industry, helping automakers enhance their productivity and innovate technologies while harnessing mergers and acquisitions (M&As) and other vehicles to secure personnel effectively and drive growth. The Company is one of the largest players in its field, having supplied more than 22,000 outside staffers through the end of June 2015, including overseas. The outsourcing industry is going well overall amid strong near-term demand for human resources. The Company has endeavored to overhaul its business structure to eliminate its exposure to economic swings and accommodate changes in the operating climate (notably, production offshoring, a declining domestic population, and shifts in the industrial structure). It is focusing on the information technology and construction sectors which are offering growth potential and high added value. And the Overseas Business is offering markets that are large and geographically dispersed which can level out fluctuations. Also, in the Manufacturing Outsourcing Business the Company has leveraged the PEO scheme, a proprietary business model, in fully deploying a unique growth strategy that aims to cultivate human resources needs in new fields and fence in customers.

In FY12/15 1H, net sales increased 28.3% yoy to ¥36,022mn and operating income climbed 31.5% to ¥937mn. Both figures exceeded management's initial forecasts. The Manufacturing Outsourcing Business performed well, benefiting from a favorable operating climate. The other performance drivers were the Engineering Outsourcing Business, which focuses on the information technology and construction fields, and the Overseas Business.

Management has retained its initial forecasts for FY12/15. It looks to increase net sales 24.5% yoy to ¥74,000mn and boost operating income 54.2% to ¥3,100mn. Both figures would be recorded highs. We consider the company's forecasts achievable in light of a steady 1H performance and a positive operating environment. In fact, it is important to note that performance contributions from a foreign company that is now a subsidiary could push results even higher.

The Company is now promoting a medium-term business plan that ends in FY12/17. That initiative seeks to drive medium-term growth through expansion in the key Engineering Outsourcing Business and the Overseas Business, which encompasses Asia through Europe and the Pacific rim. For FY12/17, the Company Targets net sales of ¥130bn and operating income of ¥8.5bn. The average growth targets over the three years of this plan are high, notably 29.8% annually for net sales and 61.9% for operating income.

We are focusing on the PEO scheme, which stands to expand in light of the recent amendment of the Worker Dispatching Act*, and progress with the Information Technology and Overseas businesses, which management's policies prioritize. In our view, the Overseas Business offers particularly high growth potential. That is because the Company has high growth potential through M&As, by generating global synergies in the financial systems information technology field and leveraging orders from the U.S. military base (Kadena Air Base, Okinawa) to expand into other regions.

* The Worker Dispatching Act was amended on September 11, 2015, and enacted on September 30.

Check Point

- A growth model in which expansion in staffing numbers drives results expansion
- Expected to post record net sales and operating income on dramatic increases in those line items
- Pursuing growth through business deployments in Europe and the Pacific rim

Corporate Overview

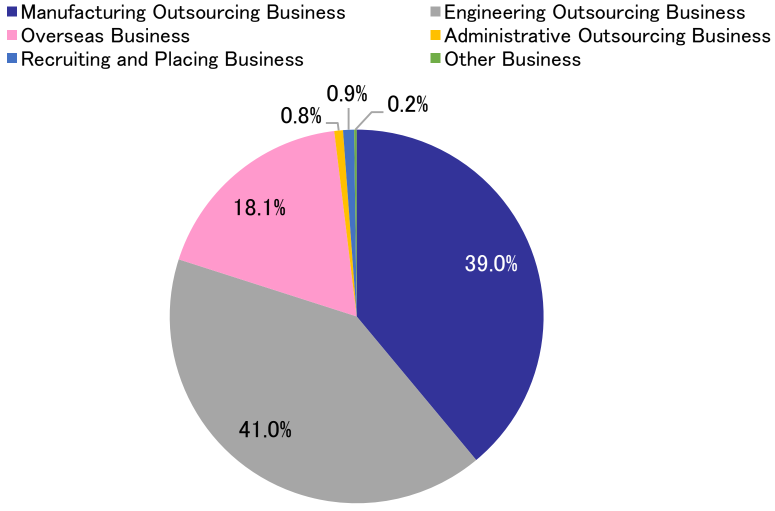
One of the industry's biggest staff placement providers

(1) Description of business

The Company has two main businesses. The first is the Manufacturing Outsourcing Business, which provides staff placement and outsourcing services for manufacturing lines. The second is the Engineering Outsourcing Business, which provides staff placement and outsourcing services for design and development processes. The Company has a strong customer base in the automobile industry, helping automakers enhance their productivity and innovate technologies while harnessing M&As and other vehicles to secure personnel effectively and drive growth. The Company is one of the largest players in its field, having supplied more than 22,000 outside staffers through the end of June 2015, including overseas.

The Company's three core business segments are the Manufacturing Outsourcing, Engineer Outsourcing, and Overseas Businesses. Its three other segments are the Administrative Outsourcing, Recruiting and Placing, and Other businesses. In FY12/15 1H, the Manufacturing Outsourcing Business accounted for 39.0% of net sales, which the Engineering Outsourcing and Overseas businesses represented 41.0% and 18.1%, respectively.

Net Sales Composition by Segment (1H FY12/15)



Results by segment are as follows.

In the Manufacturing Outsourcing Business, the Company provides staff placement and outsourcing services to fulfill outsourcing needs related to the production processes of manufacturers of transportation equipment, electronic devices and other products. This has been the Company's core business since its founding, and is currently performing steadily. At the same time, this business is vulnerable to fluctuations in the economy and in manufacturing, and the domestic market for its services is expected to shrink over the medium and long terms. By deploying its proprietary PEO scheme, the Company looks to cultivate human resources needs in new areas and fence in customers, thereby playing a role in providing stable employment in Japan while pursuing ongoing growth.

In the Engineering Outsourcing Business, the Company Provides staff placement and outsourcing services to fulfill the need for outsourcing advanced tasks in the design, development, trial and evaluation processes of companies in a wide range of fields. These include transportation equipment, electronics, information technology, construction, health care, and semiconductors. The Company is particularly reinforcing its capabilities in the information technology and construction markets, which are large and offer further growth potential. It has drawn on its school operations, which also serve people wishing to change their career paths, as well as other initiatives, to become one of Japan's largest providers of engineers for outsourcing, currently numbering more than 4,000.

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In the Administrative Outsourcing Business, Group subsidiary ORJ INC. spearheads the provision of service packages to handle worker, housing, and other administrative tasks after manufacturers directly hire fixed-term employees. With the amended Worker Dispatching Act making it easier for companies to use Dispatching individuals, the need for manufacturers to use directly hired fixed-term employees will likely decline.

In the Recruiting and Placing Business, ORJ INC. is also at the fore in handling issues covering everything from employment planning to recruitment and interviews as part of services in this business.

In the Overseas Business, subsidiary OS International Co., Ltd., is leading collaborations among Group companies in Asia to build a human resources network, and has accommodated the staffing needs of Japanese manufacturers shifting production to emerging nations. The Company aims to expand its business and geographic reach by cultivating the European market in the financial systems information technology field and by building its presence in the Pacific rim by accommodating outsourcing needs for U.S. military bases.

Overseas and information technology businesses have driven growth since 2011

(2) History

The Company's origins go back to the establishment in 1987 in Suruga, Shizuoka Prefecture, of Chubu Sogo K.K., (capitalized at ¥1mn) founded by Haruhiko Doi, the current Company Chairman and CEO, as an operations sub-contractor for factory manufacturing lines. The Company was established in Shizuoka Prefecture in 1997, taking over sales and provides outsourcing of production processes.

The Company built a solid customer base with the Toyota Group and other automobile sector operations, expanding its business to accommodate production outsourcing demand around Japan. The Company listed on what was then called the JASDAQ Securities Exchange in 2004. Japanese manufacturers thereafter accelerated offshoring as the yen appreciated. This trend prompted the Company to into the Chinese market in 2010 and five markets in Southeast Asia and Oceania in 2011. It also launched operations in 2013 in Malaysia, 2014 in India, and 2015 in Cambodia as part of an extensive overseas deployment effort. The Company has also endeavored to shift away from businesses that make it vulnerable to swings in the operating climate, previous examples including the Lehman Shock and the Great East Japan Earthquake, and tackle such business environment changes as production offshoring, Japan's declining population, and manufacturing structure shifts. By investing extensively in M&As and human resources, the Company has focused on reinforcing its Engineering Outsourcing Business, with an emphasis on the information technology and construction fields, which offer growth potential and high added value. The Overseas and information technology businesses have driven the Company's expansion since 2011, leading to its listing on the Second Section of the Tokyo Stock Exchange in 2012 and on the First Section of that exchange in March 2013.

In 2015, the Company has so far decided to acquire companies. One is the BLUEFIN GROUP*1, an Australian recruitment services firm with strengths in the information technology and financial systems fields. The others are NHL*2 and NCRL*3, which focus on information technology consulting for Oracle products in the United Kingdom and Belgium. Also this year, the Company also secured orders Kadena Air Base, Okinawa, for its U.S. military base outsourcing business, which offers considerable expansion potential, and entered a new phase for its Overseas and information technology businesses, which are strategic cornerstones.

*1 An abbreviation of BLUEFIN RESOURCES GROUP PTY LIMITED
*2 An abbreviation of NTRINSIC HOLDINGS LIMITED
*3 An abbreviation of NTRINSIC CONSULTING RESOURCES LIMITED

A growth model in which expansion in staffing numbers drives results expansion

(3) Outline of businesses

a) A growth model in which expansion in staffing numbers boosts operating results

The Company's core businesses are based on a growth model in which its results increase as staff placement numbers with customers expand. Except during recessions, therefore, placement numbers are pivotal to boosting operating results. At the same time, it is important to note that trends in employment costs cause earnings to vary. Such costs have been high recently, which has been an issue for the outsourcing industry and employers alike. The Company is engaging in M&As, television commercials and other effective advertising vehicles, strengthening branding through a global employment network and collaborations with universities, and enhancing its post-employment educational system to maintain its competitive edge and secure human resources efficiently.

b) Businesses exposed to economic swings and impact of Worker Dispatching Act

The Manufacturing Outsourcing Business is vulnerable to economic and production swings because of variations in mass production processes. It is important to note that this business is also greatly exposed to changes in the Worker Dispatching Act and other legislation. The April 2013 amendment of the Labor Contract Act, for example, included a provision that meant that when fixed-term employment contracts were updated for a total of more than five years for contract and fixed term workers, these individuals have the right upon application to convert to permanent employee status. The recent amendment of the Worker Dispatching Act did away with the three-year limit on Dispatching contracts for regular full-time employees of outsourcing agencies. This has made it more convenient for companies accepting Dispatching people. At the same time, the risk for outsourcing agencies is that switches of fixed contract employees to permanent employee status will generate fixed employment costs. With the labor market currently tight and the cost of hiring fixed term employees rising, the Company has an opportunity in harnessing permanent employees to help the outsourcing industry progress by offering stable employment in Japan.

Proprietary PEO scheme to accommodate human resources needs in new fields

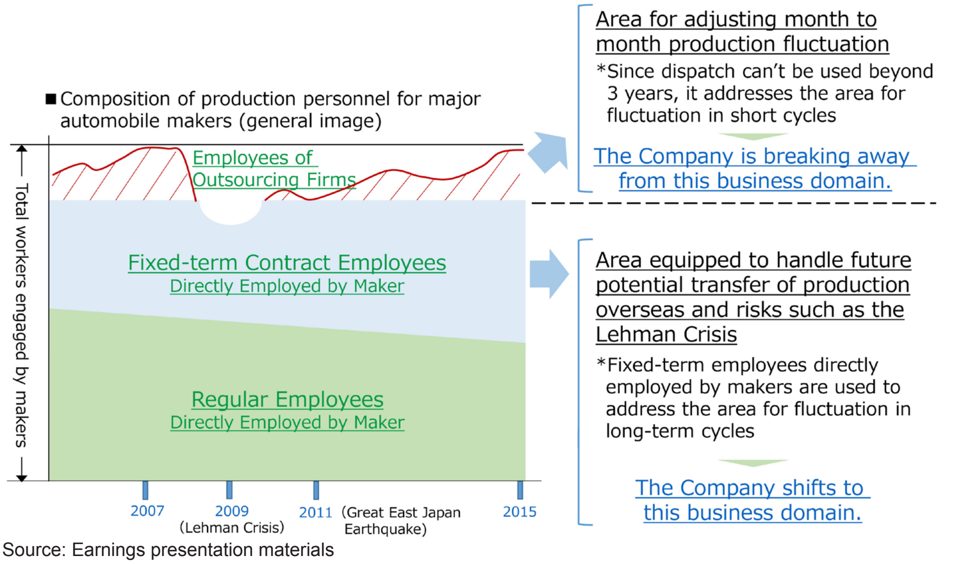
(4) Corporate characteristics

a) Leveraging PEO scheme to cultivate human resources needs and fence in customers

The Company launched its PEO scheme in September 2014. it made this move because it expects the market for its mainline Manufacturing Outsourcing Business to contract over the medium and long terms as Japanese manufacturers shift production offshore, the industrial structure changes from one focused on industry to that centering on information technology and civil engineering and construction, and Japan's population continues to decline. The Company timed the scheme launch ahead of the expected amendment in the Worker Dispatching Act. There are three broad categories of manufacturing process worker. The first is temporarily Dispatching workers who cover variations during short cycles (not Dispatching for more than three years and used to adjust for monthly production variations). The second category is fixed-term employees that manufacturers hire directly to handle fluctuations in long-term cycles (to cover the risks of large numbers of Dispatching contract discontinuations, notably when production offshoring is likely or as happened after the Lehman Shock). The third category is regular employees. The key feature of the PEO scheme is that it goes beyond traditional temporary staffing to focus on cultivating human resources in areas where manufacturers have resorted to directly hiring fixed-term employees.

Under the PEO scheme, Group subsidiary PEO Co., Ltd., has client manufacturers become members of its PEO Association. The directly hired fixed-term employees of those manufacturers become regular, permanent employees of PEO Co., Ltd., which "leases back" those people to those clients. Under the 2013 amendment of the Labor Contract Act, contracts for directly hired fixed-term employees are limited to five years. So, this scheme benefits client manufacturers by enabling them to indefinitely assign people they have employed long-term and who have raised their efficiency. The demand potential for such a setup seems particularly high among automakers, among which the Company has a solid presence, as product life cycles are relatively long. At the same time, while the Company takes on the risks of fixed personnel costs from having regular, permanent employees, it can also benefit by reducing recruitment costs, which have remained high. Another advantage of the PEO business model is that it functions as a platform for pooling human resources that are vital for clients, thereby offering scale and competitive advantages. So, by fencing clients in, the Company looks very well placed to enjoy the benefits that come from being a pioneer in PEO schemes. Such setups also have great social significance in that workers can secure stable employment with the Company.

Manufacturing process worker structure and PEO scheme target areas



Source: Earnings presentation materials

b) Leveraging school business to help people change career paths

The Company aims to differentiate itself by harnessing its school business to cultivate human resources in the information technology and construction fields on which it is focusing. For example, Group operation KEN School offers an information technology course that it developed with a client telecommunications carrier. It also maintains a civil engineering and construction course that it created with former employees of a leading general contractor. By helping people to cultivate new careers, the school is helping the Company to penetrate the information technology and civil engineering and construction sectors, which are experiencing growth and need more engineers. As of the end of June 2015, the company maintained one of Japan's largest engineering outsourcing businesses, with 1,017 information technology engineers (from 788 a year earlier) and 548 construction engineers (from 82 a year earlier).

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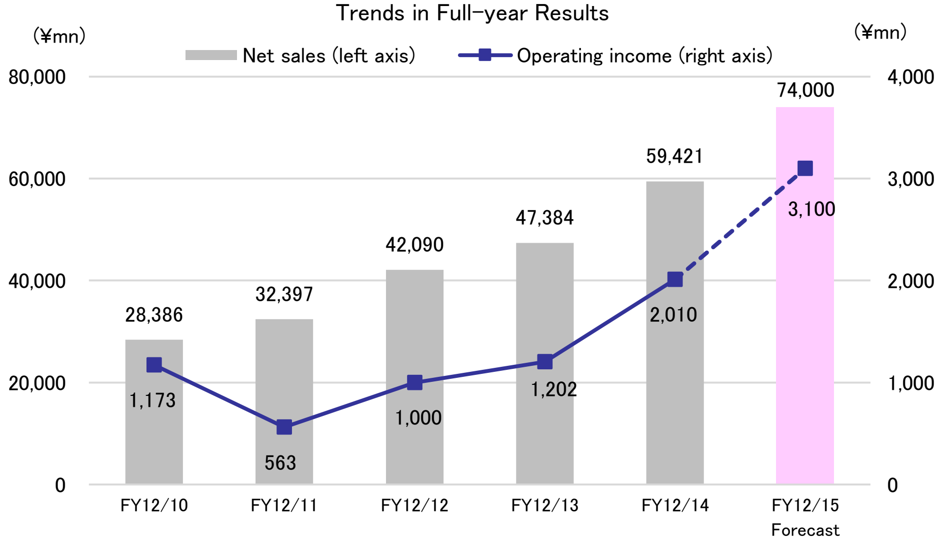
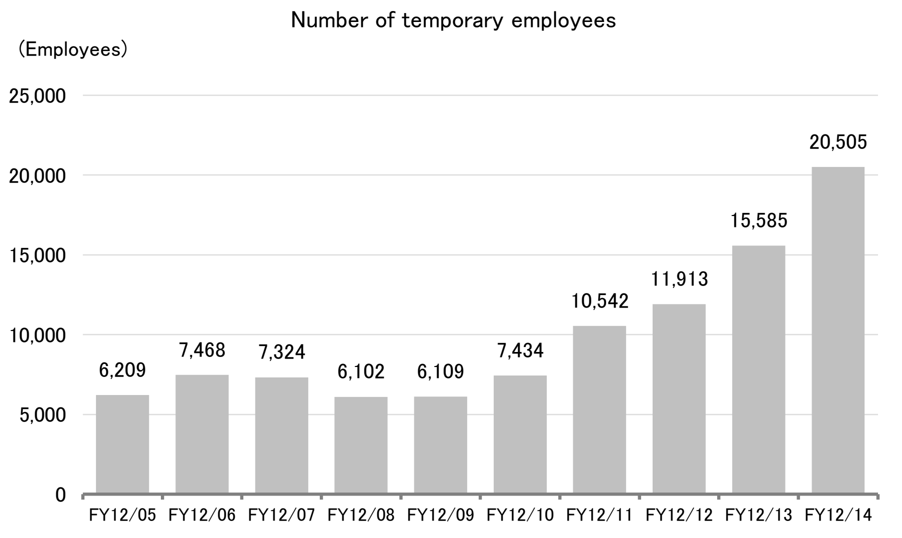
Results Trends

Materializing autonomous growth by transforming business structure to minimize vulnerability to economic swings

(1) Business trends

From FY12/07, the Company grew on the strength of efforts to expand the number of outside staffers supplied to accommodate the outsourcing needs of manufacturing processes, notwithstanding its exposure to economic fluctuations. Operating income declined in FY12/09 and FY12/11 as a result of the impacts of the collapse of Lehman Brothers and the Great East Japan Earthquake, as well as because of a domestic production downturn owing to the yen's appreciation. From FY12/12, however, results improved greatly, as the Company accommodated offshoring by Japanese manufacturers and changes in the domestic industrial structure (a shift from industrial activity to information technology and civil engineering and construction), with steady growth in the Overseas and Engineering Outsourcing businesses contributing to performance. The staff placement market is generally booming, reflecting an overall labor shortage and the impact of deregulation in light of the amendment of the Worker Dispatching Act. The Company has endeavored against this backdrop to transform its business structure to minimize its vulnerability to economic fluctuations. That approach seems to have produced autonomous growth.





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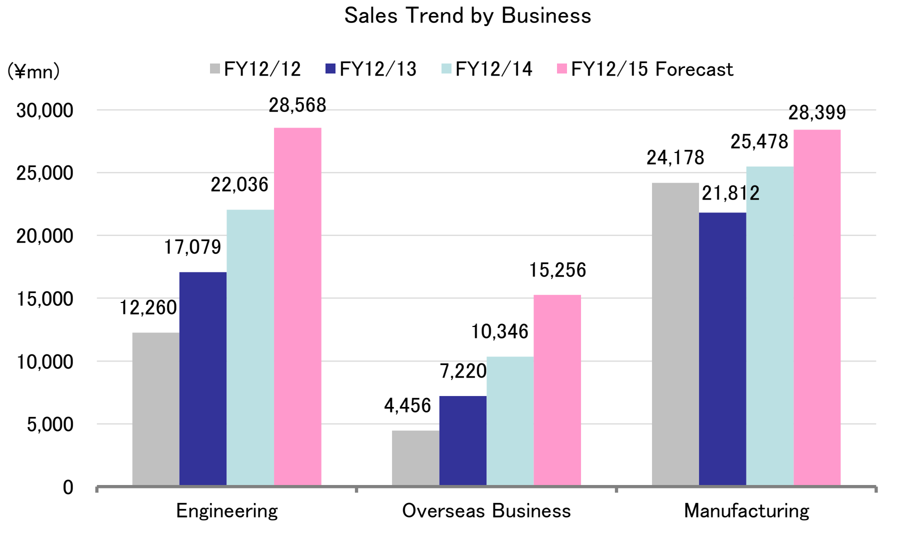

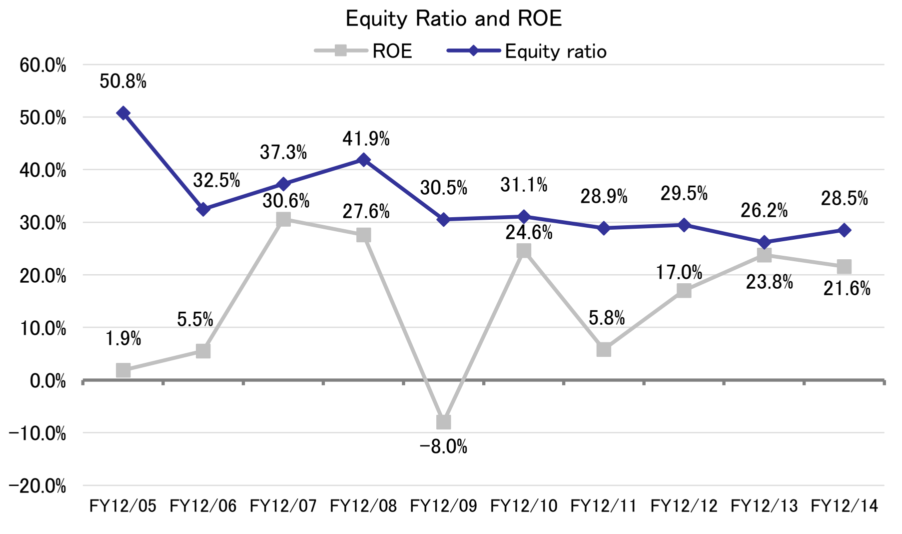

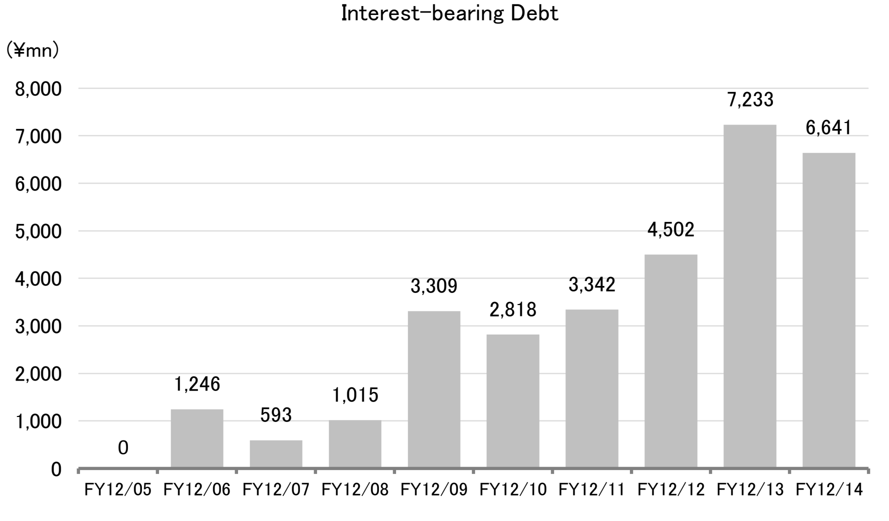

Interest-bearing debt has expanded amid heavy investments in M&As and other areas. So, while the equity ratio stands at around 30% there are no concerns about the Company's short-term payment capabilities because the current ratio is 131.6%. At the same time, the return on equity is solid, exceeding 20%.

Surpassing initial operating income forecast

(2) Outline of performance trends for 1H FY12/15

In FY12/15 1H, net sales increased 28.3% to ¥36,022mn. Operating income rose 31.5% to ¥937mn, ordinary income was up 32.0% to ¥1,003mn. Net income jumped 30.3% to ¥488mn. Net sales were basically as initially planned, while operating income exceeded management's forecast.

Net sales growth reflected favorable conditions in the Manufacturing Outsourcing Business amid solid human resources demand, as well as expansions in the Engineering Outsourcing and Overseas businesses. The Engineering Outsourcing Business is enjoying solid growth in the priority information technology and construction areas. Although the Overseas Business expanded, it did not reach its targets owing to such factors as a coup d'état in Thailand and demonstrations in Hong Kong and Vietnam. Sales of the Administrative Outsourcing and Recruiting and Placing businesses were down slightly because staff placement demand rose in view of an increasing likelihood of deregulation under an amendment to the Worker Dispatching Act. The declines in those businesses were probably matched by gains in the Manufacturing Outsourcing Business.

With recruiting costs soaring, the Company incurred around ¥260mn in temporary expenses (including those relating to consulting expenditure in preparation for the transition to International Financial Reporting Standards, the costs of launching of a special purpose subsidiary that employs persons with disabilities, and financial advisor expenses for M&As). Goodwill amortization was up 49.1% yoy to ¥360mn. Still, the Company was able to absorb these higher costs by boosting sales. The operating income margin was basically unchanged, at 2.6%.

Total assets stood at ¥27,418mn, up 13.6% yoy, owing to the impact of acquisitions. Shareholders' equity was ¥10,773mn, up 56.5% yoy, owing to ¥3,910mn in funds from the issuance of stock acquisition rights through a third-party allocation. The equity ratio was thus 39.3%, from 28.5% a year earlier.

Summary of Results for 1H FY12/15

(¥mn)

	1H FY12/14 Actual		1H FY12/15 Actual		YOY Change		1H FY12/15 Forecasts		%
		Ratio		Ratio				Ratio	
Net sales	28,070	100.0%	36,022	100.0%	7,952	28.3%	35,700	100.0%	100.9%
Manufacturing Outsourcing Business	12,049	42.9%	14,031	39.0%	1,981	16.4%	14,049	39.4%	99.9%
Engineering Outsourcing Business	10,381	37.0%	14,765	41.0%	4,384	42.2%	13,991	39.2%	105.5%
Administrative Outsourcing Business	289	1.0%	270	0.8%	-19	-6.6%	282	0.8%	95.9%
Recruiting and Placing Business	370	1.3%	341	0.9%	-28	-7.7%	375	1.1%	91.1%
Overseas Business	4,879	17.4%	6,535	18.1%	1,655	33.9%	6,860	19.2%	95.3%
Other Business	99	0.4%	78	0.2%	-21	-21.8%	143	0.4%	54.7%
Cost of sales	22,549	80.3%	28,947	80.4%	6,398	28.4%			
SG&A expenses	4,807	17.1%	6,136	17.0%	1,329	27.6%			

	1H FY12/14 Actual		1H FY12/15 Actual		YOY Change		1H FY12/15 Forecasts		%
		Profit margin		Profit margin				Profit margin	
Operating income	713	2.5%	937	2.6%	224	31.5%	830	2.3%	113.0%
Manufacturing Outsourcing Business	195	1.6%	189	1.3%	-6	-3.1%	107	0.8%	177.0%
Engineering Outsourcing Business	494	4.8%	949	6.4%	455	92.1%	678	4.8%	140.1%
Administrative Outsourcing Business	41	14.4%	30	11.5%	-10	-25.8%	18	6.4%	172.1%
Recruiting and Placing Business	167	45.3%	142	41.6%	-25	-15.2%	115	30.7%	123.7%
Overseas Business	34	0.7%	-19	-0.3%	-54	-156.7%	95	1.4%	-20.9%
Other Business	4	4.8%	7	9.8%	2	59.3%	8	5.6%	95.8%
Adjustment	-225		-362		-136		-191		
Ordinary income	759	2.7%	1,003	2.8%	243	32.0%	800	2.2%	125.4%
Net income (loss)	375	1.3%	488	1.4%	113	30.3%	430	1.2%	113.7%

Staff Placement Numbers

(Employees)

	1H FY12/14 Actual	1H FY12/15 Actual	YOY Change	
No. of Worksite Employees at Term-end	19,266	22,791	3,525	18.3%
Domestic	9,178	11,291	2,113	23.0%
Manufacturing Outsourcing Business	6,213	6,935	722	11.6%
Engineering Outsourcing Business	2,893	4,285	1,392	48.1%
IT-related	788	1,017	229	29.1%
Construction & Plant-related	82	548	466	568.3%
Administrative Outsourcing Business	72	71	-1	-1.4%
Overseas Business	10,088	11,500	1,412	14.0%
Production Outsourcing Business	7,545	8,417	872	11.6%
Other Business	2,543	3,083	540	21.2%
No. of Outsourcing Administrative Workers at Term-end	2,018	1,730	-288	-14.3%
No. of Placed Workers	1,455	1,194	-261	-17.9%

Ratio of Sales by Industry

(¥mn)

	1H FY12/14 Actual	1H FY12/15 Actual	YOY Change
Manufacturing Outsourcing Business	12,049	14,031	1,981
Foods	793	734	-58
Electrical & Electronics	3,075	3,914	838
Transport Equipment	3,962	5,442	1,480
Pharm. & Chemicals	1,947	1,805	-141
Metals & Construction Materials	1,083	971	-111
Others	1,187	1,161	-25
Engineering Outsourcing Business	10,381	14,765	4,384
Electrical & Electronics	1,449	2,282	832
Transport Equipment	3,187	3,926	738
Pharm. & Chemicals	423	687	264
Metals & Construction Materials	46	49	3
IT-related	3,880	4,861	981
Construction & Plant-related	279	2,060	1,781
After-sales Maintenance	160	62	-98
Others	953	834	-119

Results for core businesses were as follows.

Sales of the Manufacturing Outsourcing Business increased 16.4% yoy to ¥14,031mn. Operating income was down 3.1% to ¥189mn. Both figures were basically in line with forecasts. The higher sales reflected solid production levels among Japanese manufacturers, with growth centering on transportation equipment amid some moves to repatriate production. While operating income was down, it was basically as management envisaged owing to higher recruiting expenses. Although there were moves among electrical equipment manufacturers and other producers to adopt the PEO scheme, adoption by automakers, among which demand potential is greatest, was expected to be after the amendment of the Worker Dispatching Act. The PEO scheme's full-fledged contributions to performance are thus likely to be in the years ahead.

Sales of the Engineering Outsourcing Business rose 42.2% yoy to ¥14,765mn. Operating income was up 92.1% to ¥949mn. Both figures exceeded forecasts. Growth was greatest in the construction field because of synergies with Kyodo Engineering Corporation, acquired in January 2015, contributing to successes with training programs for career changers. This enabled the Company to steadily expand placements with large general contractors.

Sales of the Overseas Business rose 33.9% yoy to ¥6,535mn. This business posted an operating loss of ¥19mn, from ¥34mn in operating income a year earlier. While the company was able boost revenues by taking advantage of its strengths as a Japanese human resources company in the fast-growing Asian region, it apparently did not reach its targets as there was a slight slowdown in operations. The operating loss reflected temporary expenditures to rebuild operations in light of the impacts of a coup d'état in Thailand, demonstrations in Hong Kong and Vietnam, and other factors.

Expected to post record net sales and operating income on dramatic increases in those line items

(3) FY12/15 business results forecast

For the full year, the Company forecasts net sales of ¥74,000mn (up 24.5% yoy), operating income of ¥3,100mn (up 54.2% yoy), ordinary income of ¥3,000mn (up 36.5% yoy), and net income of ¥1,620mn (up 23.1% yoy). Sales and profits will be poised to significantly boost to record levels.

Management anticipates growth in the core Manufacturing Outsourcing, Engineering Outsourcing, and Overseas businesses. The Engineering Outsourcing Business, which is doing particularly well in the information technology and construction fields, and the Overseas Business, will likely be the prime performance growth drivers.

Management projects an operating income margin of 4.2% (up from 3.4% in FY12/14), with higher revenues absorbing growth in fixed expenses.

We consider management's forecasts amply achievable given a steady 1H performance, a favorable operating climate, and other factors. In fact, it is important to note that contributions from Australian and British firms that are now subsidiaries could drive results even higher.

Company forecasts for FY12/15

(¥mn)

	FY12/14 Actual		FY12/15 Forecast		YOY Change	
		Ratio		Ratio		% change
Net sales	59,421		74,000		14,579	24.5%
Manufacturing Outsourcing Business	25,478	42.9%	28,399	38.4%	2,921	11.5%
Engineering Outsourcing Business	22,036	37.1%	28,568	38.6%	6,532	29.6%
Administrative Outsourcing Business	601	1.0%	620	0.8%	19	3.2%
Recruiting and Placing Business	779	1.3%	783	1.1%	4	0.5%
Overseas Business	10,346	17.4%	15,256	20.6%	4,910	47.5%
Other Business	178	0.3%	374	0.5%	196	110.1%
Cost of sales	47,457	79.9%	58,900	79.6%	11,443	24.1%
SG&A expenses	9,953	16.8%	12,000	16.2%	2,047	20.6%

	FY12/14 Actual		FY12/15 Forecast		YOY Change	
		Profit margin		Profit margin		% change
Operating income	2,010	3.4%	3,100	4.2%	1,090	54.2%
Manufacturing Outsourcing Business	584	2.3%	713	2.5%	129	22.1%
Engineering Outsourcing Business	1,423	6.5%	1,965	6.9%	542	38.1%
Administrative Outsourcing Business	92	15.3%	59	9.5%	-33	-35.9%
Recruiting and Placing Business	354	45.5%	237	30.3%	-117	-33.1%
Overseas Business	87	0.8%	497	3.3%	410	471.3%
Other Business	6	3.4%	9	2.4%	3	50.0%
Adjustment	-537		-380		157	-29.2%
Ordinary income	2,197	3.7%	3,000	4.1%	803	36.5%
Net income (loss)	1,316	2.2%	1,620	2.2%	304	23.1%

In early August 2015, the Company decided to acquire two overseas companies. On August 6, it purchased all of the shares of Australia's BLUEFIN GROUP at a total cost of around ¥1,800mn. On August 25, it bought 65% stakes each in NHL and NCRL of the United Kingdom at a total cost of about ¥1,200mn. Management is currently evaluating the prospective impacts of these companies on FY12/15 results.

In the year ended June 30, 2014, the most recent year for which results are available, BLUEFIN GROUP posted net sales of AUD*1 506,000 and net income of AUD 504,000.*2

In the year ended December 31, 2014, NHL recorded GBP*3 20,748,000 in net sales and GBP 366,000 in net income. For the same term, NCRL posted GBP 1,720,000 in net sales and a net loss of GBP 39,000.

*1 Australian dollar

*2 In the year ended June 30, 2014, BLUEFIN RESOURCES PTY LIMITED, which is a business company of BLUEFIN GROUP posted net sales of AUD 40,226,000 and net income of AUD 1,592,000.

*3 British pounds

Growth Strategy

Reduce exposure of business structure to economic fluctuations and generate sustainable growth

(1) Medium-term business plan

The Company is now promoting a medium-term business plan that ends in FY12/17. That initiative aims to address changes in the operating climate and reduce the exposure of the business structure to economic fluctuations, thereby materializing sustainable growth. These changes include offshoring by Japanese manufacturers as they contract domestic production, a declining domestic population, and a paradigm shift in the industrial structure (from one focused on industry to one centering on information technology and civil engineering and construction).

Specifically, that initiative seeks to drive medium-term growth through expansion in the Engineering Outsourcing Business, centered on the information technology and construction fields, and the Overseas Business, which encompasses Asia through Europe and the Pacific rim. For FY12/17, the Company targets net sales of ¥130bn and operating income of ¥8.5bn (with an operating income margin of 6.5%.) The average growth targets over the three years of this plan from FY12/14 are high, notably 29.8% annually for net sales and 61.9% for operating income. For FY12/17, the Company looks to generate 31% of net sales from the Manufacturing Outsourcing Business, with the Engineering Outsourcing and Overseas businesses accounting for 37% and 32%, respectively. The greatest growth would come from the Overseas Business.

The Company looks to maintain a gross margin of 20% while reducing cost overlaps through M&As and cutting the SG&A expense ratio by boosting sales to absorb fixed costs, thus raising the operating income margin.

Medium-term business plan

(¥mn)

	FY12/14 Actual		FY12/15 Plan		FY12/16 Plan		FY12/17 Plan		Growth rate
		Ratio		Ratio		Ratio		Ratio	
Net sales	59,421		74,000		100,000		130,000		29.8%
Manufacturing Outsourcing Business	25,478	42.9%	28,399	38.4%	37,000	37.0%	40,300	31.0%	16.7%
Engineering Outsourcing Business	22,036	37.1%	28,568	38.6%	38,000	38.0%	48,100	37.0%	29.7%
Overseas Business	10,346	17.4%	15,256	20.6%	25,000	25.0%	41,600	32.0%	59.2%
Cost of sales	47,457	79.9%	58,900	79.6%	79,300	79.3%	102,900	79.2%	29.5%
SG&A expenses	9,953	16.8%	12,000	16.2%	15,300	15.3%	18,600	14.3%	23.2%
Operating income	2,010	3.4%	3,100	4.2%	5,400	5.4%	8,500	6.5%	61.9%

Leveraging a business model that harnesses the PEO scheme to create markets in new fields

(2) Strategy for the Manufacturing Outsourcing Business

With the domestic market expected to contract, the Manufacturing Outsourcing Business aims to deliver sustainable growth by drawing on a business model that leverages the PEO scheme to create markets in new fields. The Company estimates that the potential market resulting from entering new areas through the PEO scheme would encompass around 200,000 people, representing fixed-term employees that manufacturers have hired directly to date. We will keep tabs on progress with the PEO scheme, as companies in the automobile industry, where potential demand is large, are likely to adopt it in light of the September 30 enactment of the amended Worker Dispatching Act.

Differentiating by building human resources development structure to secure engineers

(3) Strategy for the Engineering Outsourcing Business

The Company plans to expand this business by focusing on the information technology and construction fields, which offer growth potential and high added value and strong human resources demand. In information technology, it looks to accommodate new sources of demand, notably in the areas of the Internet of Things and big data businesses and cloud computing. In the construction field, management anticipates strong demand for enhancing the road and railway infrastructure, as well as from preparations for the 2020 Tokyo Olympic and Paralympic Games and for earthquake reconstruction. The Company embarked on a strategy of leveraging its school business to build a structure for training people seeking to change career paths, the goal being to secure the engineers that are pivotal to its success.

Pursuing growth through deployments in Europe and the Pacific rim

(4) Strategy for the Overseas Business

The Overseas Business aims to generate growth through deployments in Europe and the Pacific rim. It looks to enter the European market by drawing on the financial systems information technology outsourcing operations that it has already deployed in Singapore and Hong Kong. The Company seeks to build a global network for its financial systems information technology outsourcing business by drawing on an Indian information technology outsourcing business that became a subsidiary in January 2014, as well as Australian and British firms that it recently acquired. At the same time the Company aims to generate synergies through the sharing of expertise, service models, client lists, and other management resources.

Globalizing the Company's businesses at U.S. military base will be central to expansion throughout the Pacific rim. The Company has already secured facilities operation outsourcing orders at a U.S. military base in Kadena, Okinawa, and expects to secure orders at bases in Iwakuni, Yokota, Yokosuka, and Zama. The Company also aims to expand operations at other major U.S. military bases in the Pacific rim, notably in California, Alaska, Hawaii, and Guam and in Australia and Korea. By FY12/18, management looks for the Overseas Business to become a cornerstone of operations, generating annual sales of ¥15bn.

■ Shareholder Returns

Lifting consolidated dividend payout ratio and with ample scope to increase dividends on earnings growth

In FY12/14, the Company paid an annual dividend of ¥35 per share (which included an interim dividend of ¥8 per share to commemorate the 10th anniversary of the stock's listing and a year-end dividend of ¥27 per share). The dividend payout ratio was thus 39.0%. Through FY12/13, management had set the dividend payout ratio at 10%, in principle, so it could reinvest some earnings to expand operations. From FY12/14, management raised the dividend payout ratio to 30%, in principle, as it determined that it had established a sufficiently solid foundation for growth.

For FY12/15, management forecasts an annual (year-end) dividend of ¥35 per share, representing an effective increase from the regular level, for a dividend payout ratio of 32.1%. In our view, there is considerable scope for higher dividends over the medium-term as earnings grow.

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