GMO AD Partners
4784 TSE JASDAQ

29-May-15

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Shifting to a Pure Holding Company Structure to Accelerate Profit Growth

GMO AD Partners Inc. (4784) is one of the core companies of the GMO Internet (9449) group, responsible for the Internet advertising and media business. In January 2015 the company shifted to a pure holding company structure in order to strengthen the group management function and speed up management decision-making within each business. The company has adopted policies for accelerating profit growth.

The company's consolidated operating results for the fiscal year through December 2014, i.e. FY12/14, were announced on February 5, 2015. Sales increased 25.5% year on year (y-o-y) to ¥23,742mn, and operating profit declined 0.6% to ¥656mn. The results exceeded the company's guidance revised in December 2014. The company recorded a dramatic increase in sales as growth in social ads and the contribution of newly consolidated group companies GMO Solution Partner Inc. and GMO Concierge Co. Ltd. outweighed a contraction in managed placement in the media rep business. Meanwhile, on the profit front, both operating profit and recurring profit declined slightly as the company recorded lower profits in the media rep and agency businesses along with a group wide increase in personnel costs.

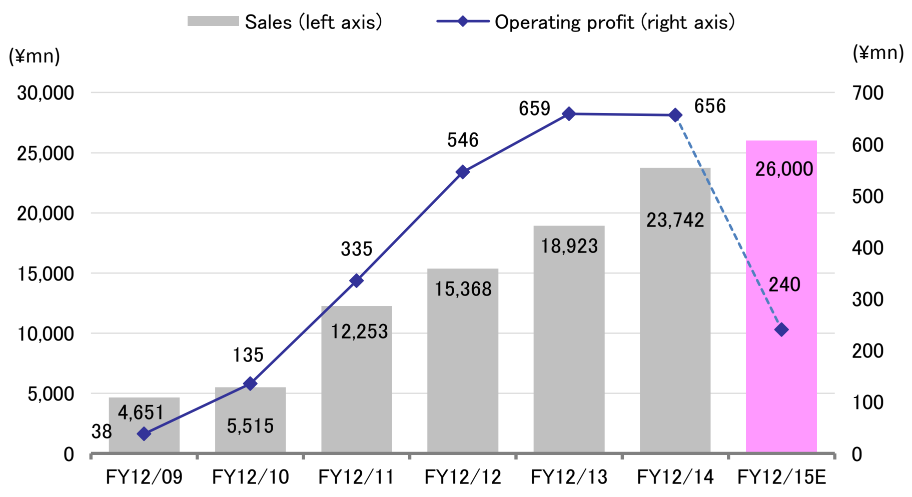
For FY12/15, the company is projecting higher sales and lower profits, with a 9.5% y-o-y increase in sales to ¥26,000mn and a 63.4% decline in operating profit to ¥240mn. The company is projecting this decline because it has positioned FY12/15 as a year for preparing its internal structure to increase the pace of growth, and is factoring in an increase in costs for strategic investments, mainly to strengthen its human resources. The theme for this effort is "evolve into a technology-oriented Internet advertising company."

The company will make investments to strengthen its competitive capabilities in core fields for enhancement, primarily growth fields such as the smartphone advertising domain, and private data management platforms (DMPs). At the same time, the company will enhance its media development. In customer development, the company intends to develop Japanese clients with nationwide scale to help drive faster growth from 2016 onwards.

Check Point

- FY12/14 results surpassed the company's guidance
- Signs of recovering momentum in the core Internet Advertising segment
- 2015 a year for building platforms to support growth acceleration

Full-Year Consolidated Sales and Operating Profit

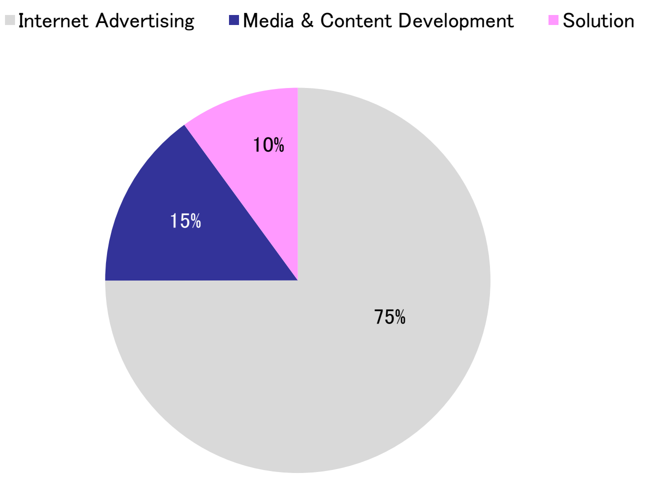


Company Profile

Internet advertising is the main business, accounting for 75% of sales

The company's three business segments are the Internet Advertising segment, the Media & Content Development segment, and the Solution segment. Looking at the breakdown of sales, the Internet advertising business is the main business, accounting for 75% of sales. Details of each business are as follows.

Breakdown of sales by business segment in FY12/14



*1 SEM (Search Engine Marketing): Search engine marketing is a means of increasing the number of visitors to a website through search engines. Among such means are search engine optimization (SEO), listing ads, and ads connected to keywords

*2 DSP (Demand Side Platform): A demand-side platform is a next-generation platform for ad distribution that maximizes advertising effectiveness by such means as distributing display ads to target segments of an audience data base.

○Internet Advertising segment

The Internet Advertising segment is divided between the media rep business and the agency business, which account for approximately 30% and 70% of the segment sales, respectively.

The media rep business has a customer base of approximately 3,000 mid-size and SME-sized advertising agencies, to whom the company sells Internet advertising media acquired through business alliances and so forth. The agency business includes SEM"*1 services such as listing advertising, as well as Web production and DSP"*2 advertising and the affiliate advertising business of GMO INNOVATORS Inc., which became a consolidated group company in July 2013.

○Media & Content Development segment

This segment includes the Japanese search engine service business of JWord Inc., which became a consolidated group company in March 2013, the social game business, the smartphone media business of GMO mobile, Inc. and the free magazine business (book planning, production, and publication) of GMO Concierge (Hong Kong), which became a consolidated group company in October 2013.

○Solution segment

The main business of this segment is that of GMO Solution Partner. The main services include support in attracting website visitors and website construction and management support for e-commerce websites. Marketing support services include the Japanese search keyword service JWord, search engine optimization (SEO) services, and MAP search optimization services.

Business Trends

FY12/14 results surpassed the company's plan

(1) Overview of FY12/14 full-year operating results

GMO AD Partners announced its consolidated operating results for FY12/14 on February 5, 2015. Sales grew by 25.5% y-o-y to ¥23,742mn, operating profit declined by 0.6% to ¥656mn, recurring profit declined by 0.5% to ¥650mn, and net profit increased by 132.5% to ¥420mn. These results surpassed the revised figures for sales and profits announced in December 2014.

Consolidated Operating Results for FY12/14

(¥mn)

	FY12/13		FY12/14			
	Result	Margin	Company plan	Result	Margin	y-o-y
Sales	18,923	-	23,500	23,742	-	25.5%
Cost of sales	14,567	77.0%	-	17,162	72.3%	17.8%
SG&A cost	3,696	19.5%	-	5,923	25.0%	60.3%
Operating profit	659	3.5%	630	656	2.8%	-0.6%
Recurring profit	653	3.5%	630	650	2.7%	-0.5%
Net profit	180	1.0%	400	420	1.8%	132.5%

Note: The company guidance is the revised figures announced in December 2014.

Sales saw a double-digit increase. This was mainly due to brisk activity in social ads, as well as added sales from subsidiaries newly consolidated within the past year, such as GMO Solution Partner and GMO Concierge. These increases were partially offset by a decline in managed placement in the media rep business.

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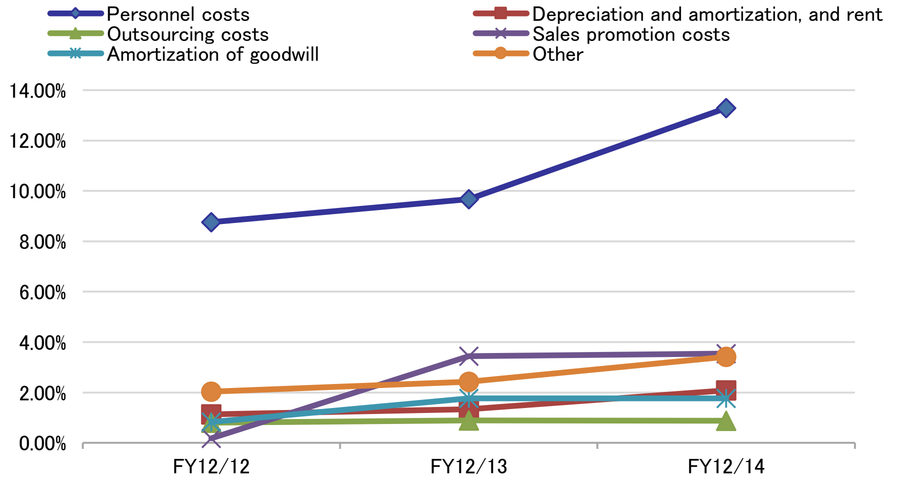
Despite the double-digit increase in sales, operating profit stagnated because of the impact of changes in the market environment and a decline in managed placement in the media rep business, a temporary decline in ad placements by major clients in the agency business, and other factors.

The cost of sales ratio improved, partly because of the contribution from GMO Solution Partner, but SG&A costs surged from 19.5% to 25.0%, which was a major factor driving down the operating margin. Looking at a breakdown of SG&A costs, personnel costs increased sharply from 9.6% in FY12/13 to 13.3%, which was the main factor driving up the SG&A margin.

The main factor behind the significant increase in net profit was the recording of extraordinary gains from a gain on change in equity of ¥54mn following the merger of a consolidated subsidiary and a gain on sales of an affiliates' stocks of ¥62mn. A further factor was a decline in the effective tax rate as losses carried forward were continued due to the merger of the subsidiary.

Breakdown of SG&A costs and margin



Note: Rent includes leasing fees

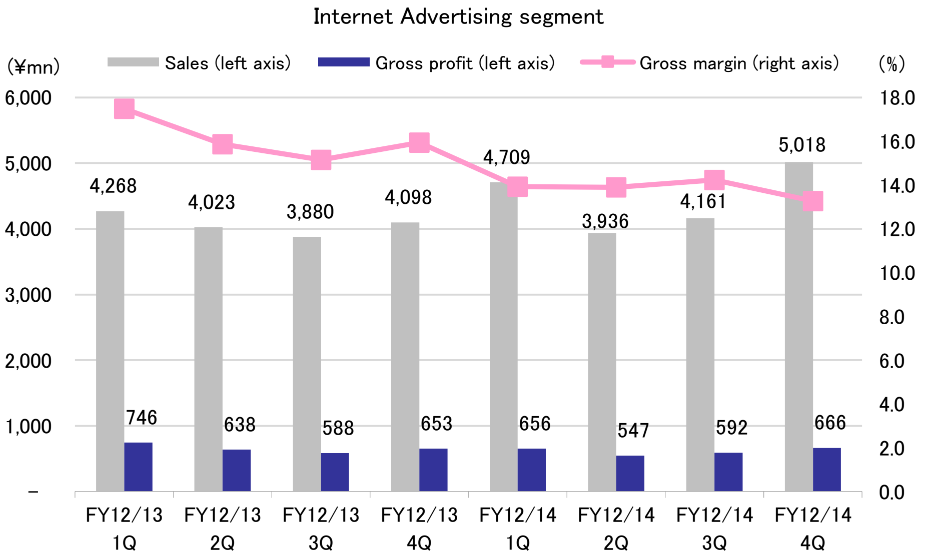
Signs of recovering momentum in the core Internet Advertising segment

(2) Business trends by segment

○Internet Advertising segment

In the Internet Advertising segment, sales rose 9.5% y-o-y to ¥17,823mn and gross profit declined 6.3% to ¥2,463mn. Although a decline in managed placement sales was covered by brisk sales on social advertising, smartphone advertising, and affiliate advertising, and so forth, the gross margin declined due to a fall in sales in the media rep business, which weighed on earnings, and a temporary decline in advertisements by major clients in the agency business. Moreover, from 1Q FY12/15 onwards, the company is projecting a recovery in profitability, partly due to redistributing its personnel deployment.

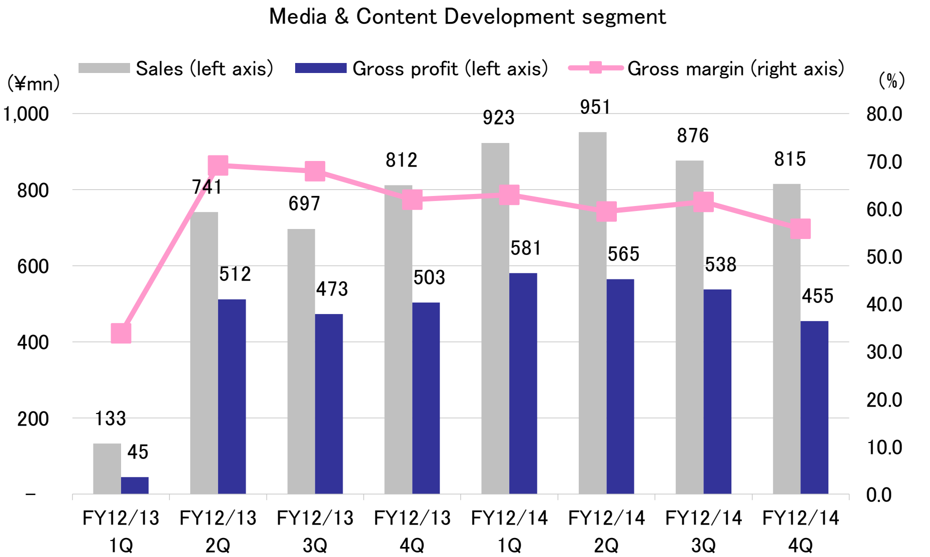
However, on a quarterly basis, sales and profits began to increase again from Q3 onward, and in Q4 sales recovered their momentum to rise 22.4% y-o-y, partly because of an increase in placements by major clients.



○Media & Content Development segment

In the Media & Content Development segment, both sales and income increased significantly, with sales increasing 49.4% y-o-y to ¥3,563mn and gross profit climbing 39.4% to ¥2,139mn. The main factor driving the increases was the first full-year contribution in FY12/14 of JWord, which was consolidated in March 2013, and GMO Concierge, which was consolidated in October 2013. Furthermore, in app development, the company boosted sales from the news site app Yomerumo by enhancing its functionality.

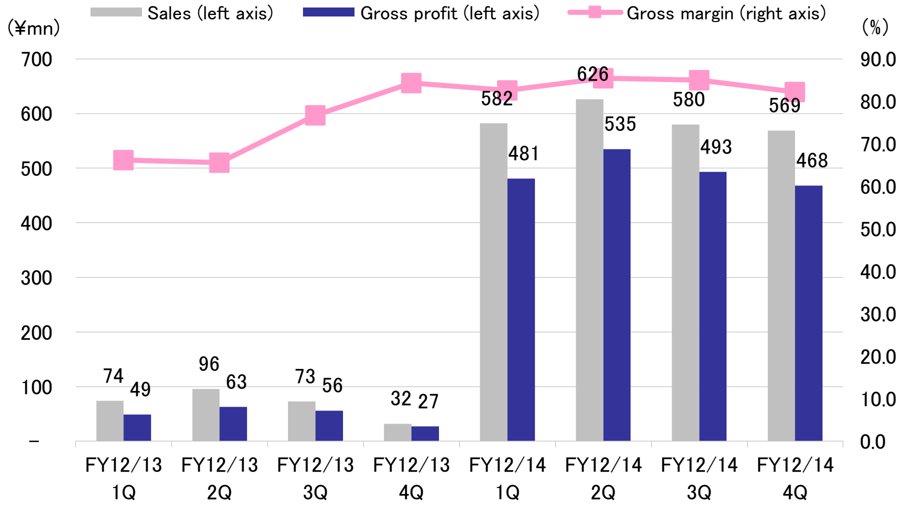
Moreover, the results of JWord, which accounts for the majority of this segment, have seen sales and profits level with the previous fiscal year due to delays in restructure the sales system. The sales system of JWord are centered on a push-type sales through agencies including GMO Solution Partner. Some agencies, however, have been affected by a temporary dip in performance of the agency organization structure, such as an increase in retirements and other such factors. As a result, on a quarterly basis, Q4 sales were lackluster, increasing only 0.3% y-o-y, while gross profit declined 9.5%.



○Solution segment

In the Solution segment, sales increased 8.6 times y-o-y to ¥2,356mn, and gross profit increased 10.1 times to ¥1,977mn. The main factor in the increase was the contribution of GMO Solution Partner, which was consolidated in January 2014. Within the earning structure of GMO Solution Partner, the majority of expenses are the personnel cost component of SG&A costs (around 200 telephone sales staff).

Solution segment



The Company is Maintaining a Sound Financial Structure and Expects to Improve Profitability Going Forward

(3) Financial Status

Total assets at the end of FY12/14 stood at ¥10,220mn, up ¥1,770mn from the end of the previous fiscal year. The increase mainly reflected the consolidation of GMO Solution Partner. In current assets, cash and cash equivalents and deposit paid in subsidiaries and affiliates increased ¥752mn from the end of the previous fiscal year, while accounts receivable increased ¥1,018mn in line with the increase in sales up to the end of the fiscal year. In fixed assets, goodwill declined ¥440mn.

On the other hand, liabilities were ¥5,099mn, up ¥1,314mn from the end of the previous fiscal year. The increase mainly reflected an increase of ¥735mn in accounts payable, and increases of ¥240mn in interest-bearing debt and ¥188mn in accrued consumption taxes. Net assets increased ¥456mn to ¥5,121mn atop increases in capital surplus and retained earnings.

Looking at key performance indicators, the liquidity ratio, an indicator of security, stood at 147.7%, above the 100% reference point. Although the equity ratio had declined slightly, at 46.3% it is also not at a problem level. Net cash (cash and cash equivalents and deposit paid in subsidiaries and affiliates - interest-bearing debt) stood at ¥2,624mn, up ¥512mn. These and other indicators suggest that the company is maintaining a sound financial status.

Looking at profitability, the company's aggressive M&A activity over the past year or two has caused ROA and the operating margin to display a slight declining trend. Now, the company is expected to improve its profitability by using the management resources of the subsidiaries acquired through these M&As and increasing the ratio of sales of its own high-value-added products.

Consolidated Balance Sheet

(¥mn)

	FY12/10	FY12/11	FY12/12	FY12/13	FY12/14	Change
Current assets	4,473	4,696	4,912	5,422	7,310	1,887
(Cash and cash equivalents and deposit paid in subsidiaries and affiliates)	2,955	2,832	2,985	2,621	3,374	752
Fixed assets	1,306	1,391	1,815	3,027	2,910	-117
Total assets	5,780	6,088	6,727	8,449	10,220	1,770
Current liabilities	1,812	1,976	2,471	3,618	4,950	1,332
Fixed liabilities	292	258	93	166	148	-17
(Interest-bearing debt)	-	-	-	509	750	240
Total liabilities	2,104	2,235	2,565	3,784	5,099	1,314
Shareholders' equity	3,632	3,826	4,071	4,138	4,643	504
Accumulated other comprehensive income	41	21	34	74	85	11
Net assets	3,675	3,853	4,162	4,664	5,121	456
Total liabilities and net assets	5,780	6,088	6,727	8,449	10,220	1,770
(Security)						
Current ratio	246.9%	237.6%	198.8%	149.9%	147.7%	
Equity ratio	63.6%	63.2%	61.0%	49.9%	46.3%	
D/E ratio	0.0%	0.0%	0.0%	12.1%	15.9%	
(Profitability)						
ROA (ratio of recurring profit to total assets)	5.3%	7.3%	11.9%	8.6%	7.0%	
ROE (return on equity)	3.5%	6.3%	9.0%	4.3%	9.4%	
Operating profit margin	2.5%	2.7%	3.6%	3.5%	2.8%	

Forecasts

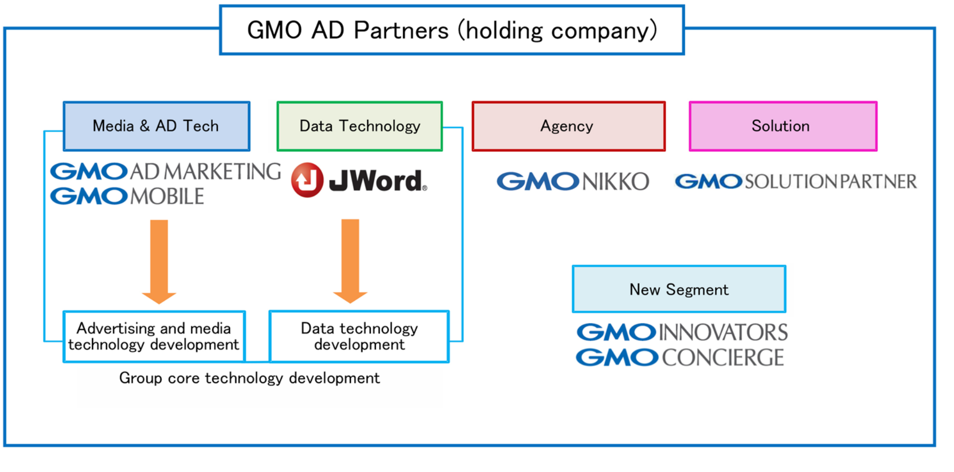
2015 a year for building base to support growth acceleration

(1) FY12/15 plan

The company has positioned 2015 as a year for preparing the base for accelerating group from FY12/16 onward, aiming to "evolve into a technology-oriented Internet advertising corporate group."

First, in January the company shifted to a pure holding company structure. This will concentrate its group strategy drafting functions and management functions, allowing agile and efficient management in each of its business fields, and increasing the speed of management responses.

The company intends to develop its business by categorizing it into four new operating domains: Media & Ad Tech, Data Technology, Agency, and Solution, as well as New Segment. Management of the operations previously conducted by GMO AD Partners is transferred to the newly split-off company GMO AD MARKETING, Inc.



In the Media & Ad Tech domain, GMO AD MARKETING and GMO Mobile will conduct product and service development centered on development of next-generation supply-side platforms (SSPs) and media. In the Data Technology domain, the company will utilize the machine-learning research of JWord and the data assets of the entire group. In the Agency domain, the company will promote its data strategy centered on the private DMP of GMO NIKKO, Inc. and an industry-specialized sales strategy, aiming to develop Japanese nationwide clients. In the Solution domain, GMO Solution Partner will take steps to improve customer retention by increasing customer satisfaction. At the same time, the company intends to develop new customers.

Furthermore, to accelerate its growth, the company will make strategic investments totaling ¥560mn in the Media & Ad Tech domain and Agency domain in 2015, aiming to bolster human resources and strengthen development of in-house products and services. The specific details of the investment are as follows.

○Media & Ad Tech domain

The company will bolster the number of development engineers and sales staff in the Media & Ad Tech domain, to upgrade development and sales framework for new products and services. First, in the domain of smartphone advertising, where the market is expanding rapidly, the company aims to develop a highly competitive SSP"*1 and establish itself as the leader in Japan for the number of distributions in the medium term. Currently, major Japanese clients have not fully exploited the medium of smartphone advertising because of concerns over brand safety*2. The company plans to increase its SSP share by providing a mechanism that can distribute safely and improving functionality, such as user-friendliness. The strategy is to expand the company's own products and services, such as DSP advertising, by increasing the number of companies (advertising media) adopting SSP.

In media development, the company will take steps to increase the number of unique users*3 of its news curation website, Yomerumo, by enhancing the content function, and aggressively stepping up promotion activities such as television commercials and Internet advertising to increase recognition. By increasing the number of unique users, we see the company expanding its network and thereby increasing sales of its in-house products and services.

○Agency domain

In the Agency domain, the company will undertake a large scale increase in personnel for advertising operation consultancy, sales, and engineering operations, to strengthen its sales framework centered on private DMPs*4. The sales force of the company's agency business operator, GMO NIKKO, is smaller than that of other major companies in the same industry, and human resource expansion has become an issue for further sales and profit growth.

Moreover, in the private DMP service, which the company launched in autumn of 2014, some of the company's existing clients have already decided to use the service. The service offered by the company is characterized by a user interface that strongly emphasizes ease of use, real time links to Internet advertisement distribution, and a concentration of the GMO Internet Group's high-level big data processing technology expertise.

Private DMP products and services assist with retention of existing customers. The company's strategy is therefore to promote sale development focusing on existing major customers and industries, where the company has a relatively strong market share, and to acquire more Japanese clients with nationwide scale.

*1 SSP (Supply Side Platform):
An ad distribution system that operates by real-time bidding, where the engine is embedded in the media side. Basically, the scheme displays the advertisement displaying the highest price from among the advertisers, who are buyers, in the advertising frame of the media. More than 10 companies have developed SSP engines, such as Google's AdSense, and are providing services. Conversely, engines on the advertiser side are referred to as demand-side platforms (DSP).

*2 Brand Safety:
Maintenance of brand value. If an advertiser's brand is displayed through ad networks, DSPs and other means on media that goes against public order and morals, there is a risk that the brand value could be damaged. Ensuring brand safety is therefore an important issue among advertisers and advertising agencies.

*3 Unique users:
Refers to the actual number of users of a website or web service.

*4 Private DMP
(Data Management Platform):
A service that analyses data such as customer information and Internet browsing history held by companies to categorize users into segments, then makes the results available for use in a range of marketing strategies.

Smooth start in January – February, with the pace of increasing mid-career hires in focus

(2) Forecast for FY12/15

In its forecast for FY12/15 the company is projecting sales to increase 9.5% y-o-y to ¥26,000mn, operating profit to decline 63.4% to ¥240mn, recurring profit to decline 63.1% to ¥240mn, and net profit to come in at zero.

Sales are projected to increase across all business domains, but profits will be weighed down by increases in personnel costs, hiring costs, and marketing costs, all due to strategic investments. Ignoring the strategic investments, operating profit would be forecast to increase 21.9% to ¥800mn. Furthermore, the gap between recurring profit and net profit is due to the effect of the consolidation adjustments account, and no particular extraordinary losses and so forth are expected.

The company appears to be making a good start in January-March. In particular, advertising placements by major clients have increased significantly after declining in FY12/14., and are contributing to higher sales. Depending on the pace of personnel increases, we believe that the company can achieve its guidance.

Policy on Shareholder Returns

Dividend payout ratio target of 35%, increase of ¥4.71 per share for FY12/14

The company's policy on shareholder returns is to target a dividend payout ratio of 35%. The dividend for FY12/14 was ¥9.01 (dividend payout ratio: 35%), an increase of ¥4.71 from FY12/13. The dividend for FY12/15 has yet to be decided; however it is possible that if the company performs as planned, no dividend will be paid.

The company also has a shareholder benefits system. Under the program, shareholders registered as holding at least 1 unit of shares (100 shares) on the record dates of June 30 and December 31 receive (1) a cash-back payment of share purchase commission fees on the purchase of GMO AD Partners shares from GMO CLICK Securities, Inc. and (2) cash-back payment of share trade commission fees from GMO CLICK Securities up to a limit of ¥3,000 occurring within the target period.

Consolidated Income Statement

(¥mn)

	FY12/11	FY12/12	FY12/13	FY12/14	FY12/15 E
Sales	12,253	15,368	18,923	23,742	26,000
(y-o-y)	122.2%	25.4%	23.1%	25.5%	9.5%
Cost of sales	10,221	12,712	14,567	17,162	-
Cost of sales ratio	83.4%	82.7%	77.0%	72.3%	-
SG&A cost	1,696	2,109	3,696	5,923	-
SG&A cost ratio	13.8%	13.7%	19.5%	25.0%	-
Operating profit	335	546	659	656	240
(y-o-y)	148.1%	62.8%	20.8%	-0.6%	-63.4%
Margin	2.7%	3.6%	3.5%	2.8%	0.9%
Non-operating income	96	224	19	50	-
Non-operating expenses	1	6	25	56	-
Recurring profit	430	764	653	650	240
(y-o-y)	40.9%	77.5%	-14.5%	-0.5%	-63.1%
Margin	3.5%	5.0%	3.5%	2.7%	0.9%
Extraordinary gains	14	0	14	117	-
Extraordinary losses	10	23	66	86	-
Pretax profit	434	741	601	681	-
(y-o-y)	67.8%	70.5%	-18.8%	13.3%	-
Margin	3.5%	4.8%	3.2%	2.9%	-
Income taxes	196	391	372	205	-
(Effective tax rate)	45.2%	52.8%	61.8%	30.2%	-
Minority interest	-	-7	49	56	-
Net profit	238	357	180	420	0
(y-o-y)	82.9%	50.3%	-49.5%	132.5%	-
Margin	1.9%	2.3%	1.0%	1.8%	-
Key performance indicators					
Depreciation and amortization	37	54	96	185	
Amortization of goodwill	100	127	334	418	
Number of shares issued (thousand)	14,794	14,697	14,709	16,330	16,341
Earnings per share (¥)	16.10	24.47	12.15	25.47	-
Dividend per share (¥)	5.75	8.60	4.30	9.01	-
Net assets per share (¥)	260.08	279.33	285.29	289.36	-
Dividend payout ratio (%)	35.7	35.1	35.0	35.0	-

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