GMO AD Partners
4784 TSE JASDAQ

17-May.-16

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FISCO Ltd. Analyst
Yuzuru Sato

## Launching a string of ad technology offerings

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. The company's policies intend to accelerate profit growth by strengthening the group management function and speeding up management decision-making within each business.

In FY12/15 (January through December 2015), sales rose 18.4% to ¥28,111mn, while operating profit was down 54.6% to ¥297mn. The sales gain reflected sustained double-digit growth in the Agency segment, which focuses on ad operations. The earnings downturn was due largely to lower proceeds from key Media & Ad Tech segment offerings that were set for upgrades or changes. Another factor was heavy investments in human resources. That said, both sales and operating profit were higher than projected.

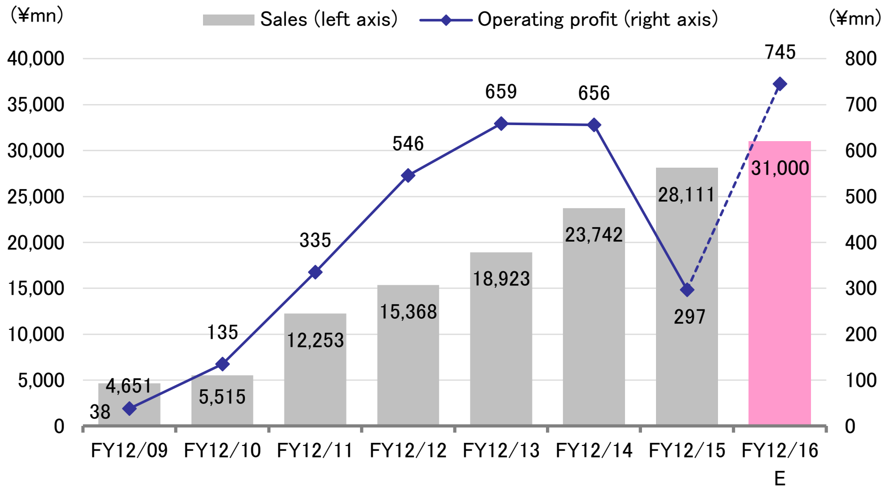
For FY12/16, the company expects that spending on human resources in the ad tech field in FY12/15 will drive a record performance. It projects a 10.3% y-o-y increase in sales to ¥31,000mn and a 150.8% gain in operating profit to ¥745mn. In the Media & Ad Tech segment, GMO AD Marketing Inc., GMO mobile Inc., and Adcloud Inc. merged in January 2016. The goals were to enhance operational agility and bolster profitability by integrating development, operations, and sales. Investments in new proprietary offerings have begun to bear fruit. One of these products is AkaNe, a smartphone ad network service for native advertising. Another is TAXEL, a content recommendation widget that is designed to maximize media user migration and advertising earnings. Such offerings are in the spotlight for their potential to drive profit growth.

Management has rolled out a policy to reinforce shareholder returns. From FY12/16, it lifted its consolidated payout ratio target from 35% to 50%. The resulting dividend projection for FY12/16 is a record ¥10.00 per share. The company's shareholder benefits system is unchanged. Under the program, shareholders on June 30 and December 31 will continue to receive (1) a cash-back payment of share purchase commission fees on the purchase of GMO AD Partners shares if purchased at GMO CLICK Securities, Inc. and (2) cash-back payment of share trade commission fees at GMO CLICK Securities up to a limit of ¥3,000 occurring within the target period.

## Check Point

- The company looks set to post record sales, operating profit, and recurring profit
- Fruits of investment include releases of ad tech offerings and LINE corporate account management service
- Targeting 50% payout ratio from FY12/16

Full-Year Consolidated Sales and Operating Profit

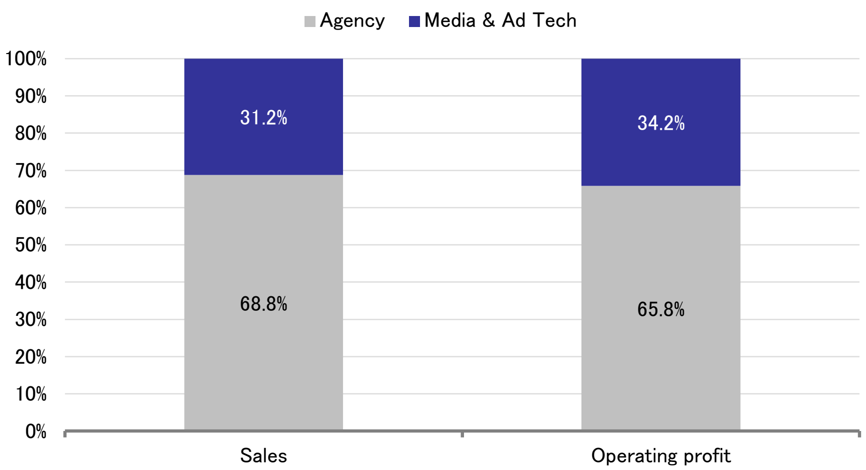



## Company Profile

### Comprising the Agency and Media & Ad Tech Segments

The company comprises the Agency and Media & Ad Tech segments. The former accounted for 68.8% of sales and 65.8% of operating profit in FY12/15. Details of each segment are as follows.

Sales and Operating Profit by Segment (FY12/15)



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○ **Agency segment**

The three companies constituting the Agency segment are GMO NIKKO, Inc. in the agency field, GMO Solution Partner Inc. in the solutions field, and GMO INNOVATORS Inc. in the new business field. The core sales generator in this segment is GMO NIKKO, which is a comprehensive online advertising agency with strengths in selling listing and other operational advertisements and providing consulting. GMO Solution Partner offers services to attract customers to corporate websites. GMO INNOVATORS focuses on affiliate services.

○ **Media & Ad Tech segment**

The Media & Ad Tech segment encompasses three companies. These are GMO AD Marketing in the ad tech field, JWord Inc. in the data technology field, and GMO Concierge Co. Ltd. in the new business field. The most important of these three companies is GMO AD Marketing, which is the fruit of mergers in January 2016 with GMO mobile, and Adcloud, which became a group company in July 2015. GMO AD Marketing engages in development, operations, and sales in the ad tech field and also maintains a media sales business. JWord runs the JWord Japanese keyword service and offers social games. GMO Concierge issues free magazines to Japanese nationals residing in China and offers consulting services to companies entering China.

**Group Companies**

| Company name | Ownership | Business |
|---|---|---|
| Agency segment | | |
| GMO NIKKO | 99.69% | Agency business for listing and other advertising |
| GMO Solution Partner | 100.00% | Web promotions and marketing support business |
| GMO INNOVATORS | 90.00% | Online advertising business handling affiliate and listing ads, etc. |
| Media & Ad Tech segment | | |
| GMO AD Marketing | 99.40% | Engages in media rep and ad tech businesses |
| JWord | 72.42% | Internet search service business |
| GMO Concierge | 100.00% | Consulting services for companies entering China and free magazine business |

# ■ Business Trends

## Continuing to post record sales on favorable Agency segment performance

### (1) Overview of FY12/15 operating results

GMO AD Partners announced consolidated results for FY12/15 on February 8. Sales for the year increased 18.4% to ¥28,111mn and operating profit fell 54.6% to ¥297mn, while recurring profit was down 40.2% to ¥389mn. The company posted a net loss of ¥100mn (from a net profit of ¥420mn a year earlier). Sales were a record for a second consecutive year, reflecting a favorable performance of the Agency segment, centered on listing and other operational advertising. Operating profit was down owing to lower sales of the company's PC offerings amid a shift to smartphones. Another factor was heavy human resources investments and increased hiring expenses in the ad tech field. The net loss stemmed from ¥210mn in extraordinary losses, including impairment losses. Management's initial projections had assumed that revenues would rise and earnings would drop for the term from heavy human resources investments, but sales, operating profit, and recurring profit were higher than expected. The company filled 96 of 102 new positions in the ad tech field, so hiring went as planned.

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**Consolidated Operating Results for FY12/15**

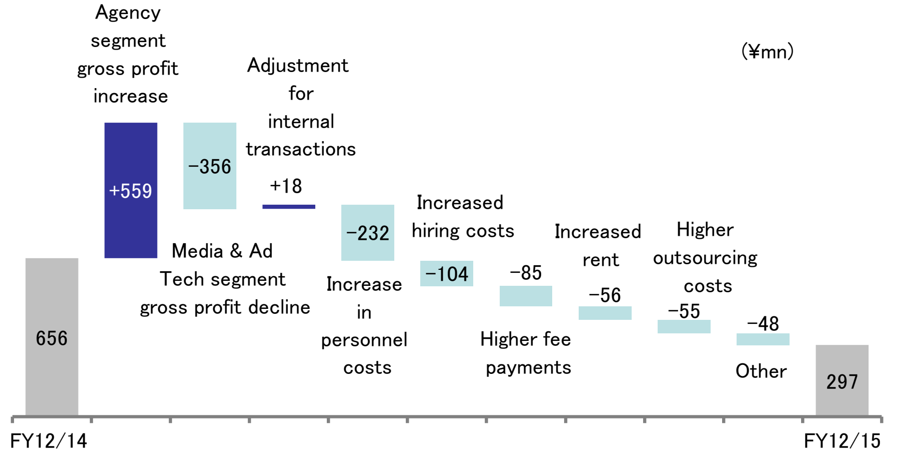
(¥mn)

| | FY12/14 | | FY12/15 | | | | |
|---|---|---|---|---|---|---|---|
| | Result | Margin | Original plan | Revised plan | Result | Margin | y-o-y |
| Sales | 23,742 | - | 26,000 | 28,000 | 28,111 | - | 18.4% |
| Cost of sales | 17,162 | 72.3% | - | - | 21,309 | 75.8% | 24.2% |
| SG&A cost | 5,923 | 25.0% | - | - | 6,503 | 23.1% | 9.8% |
| Operating profit | 656 | 2.8% | 240 | 250 | 297 | 1.1% | -54.6% |
| Recurring profit | 650 | 2.7% | 240 | 320 | 389 | 1.4% | -40.2% |
| Net profit | 420 | 1.8% | 0 | -120 | -100 | -0.4% | - |

Note: Figures for the revised plan were announced in December 2015.

The main factor behind the reduced operating profit was that although the Agency segment boosted its gross profit by ¥559mn, the gross profit of the Media & Ad Tech segment declined by ¥356mn, while personnel expenses and hiring costs rose ¥232mn and ¥104mn, respectively. Segment trends were as follows.

**Factors in operating profit changes**




**(2) Business trends by segment**

○ **Agency segment**

Sales in this segment rose 27.3% to ¥20,777mn, with operating profit increasing 6.5% to ¥644mn. Twitter, Facebook, and other social network site advertising and listing advertising were up amid an expansion in the Internet advertising market. The company also did well in deepening ties with existing customers while cultivating new ones, reflecting heavier investments in human resources. Although earnings were down y-o-y in 2Q, revenues and earnings picked up again from 3Q.

In October 2015, Yahoo Japan (4689) upgraded GMO NIKKO's rating as a Yahoo! Marketing Solutions official agency from three stars a year earlier to four, which is second from the top ranking, in recognition of efforts to roll out proposals that match customer needs. Among around 800 official agencies, only three companies have Yahoo Japan's five-star certification, while three have four stars, placing GMO NIKKO among the top six.

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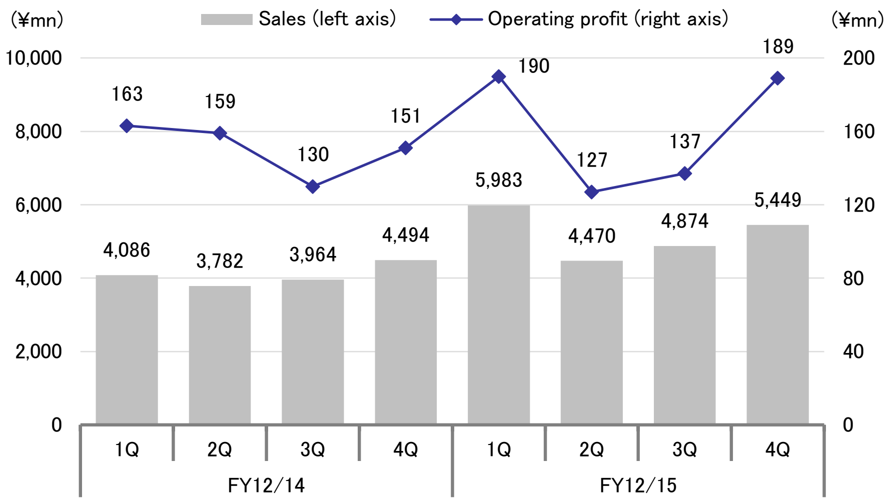
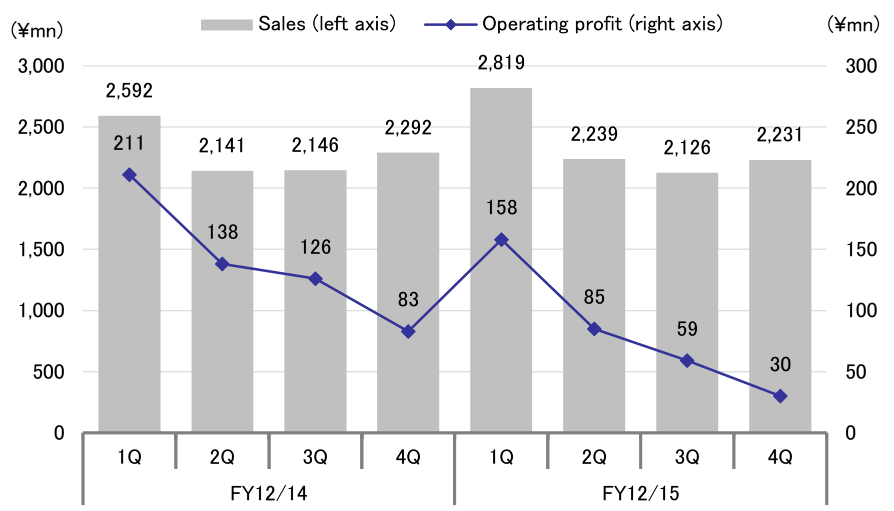
Agency segment quarterly results




○ **Media & Ad Tech segment**

Sales of this segment increased 2.7% to ¥9,417mn. Operating profit was down 40.3%, however, to ¥334mn. In the Internet advertising market, demand surged away from managed placement ads to ad tech brokered operational ads. Although the company enjoyed steady growth with ad tech offerings, its media sales and sales of existing PC offerings continued to decline, so the overall pace of sales growth slowed in this segment. On the operating profit front, it is worth noting that the downturn in FY12/15 was because the year was a strategic, transitional stage on the path to growth. This reflected heavy investments in human resources in the ad tech field and a focus on investing in developing new ad tech offerings. While operating profit has continued to decline on a quarterly basis, the company deployed a string of offerings that it newly developed internally from 4Q, which should drive sales of new products and contribute to an earnings turnaround.

Media & Ad Tech segment quarterly results



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## Net cash position improved, for a sound financial position

**(3) Financial status**

At the end of FY12/15, total assets were ¥10,734mn, up ¥513mn from a year earlier. In current assets, the main factors in this change were a ¥440mn increase in cash and cash equivalents and deposit paid in subsidiaries and affiliates, while accounts receivable were up ¥189mn. In fixed assets, goodwill declined ¥290mn, while there were rises of ¥206mn in investment securities, ¥77mn in software, and ¥45mn in deferred tax assets.

Liabilities were ¥5,766mn, up ¥667mn from the close of the previous year. The principal factors in terms of current liabilities were increases of ¥200mn in interest-bearing debt, ¥128mn in accounts payable, and ¥96mn in income taxes payable. Fixed liabilities were down ¥14mn.

Net assets were down ¥153mn to ¥4,967mn. Although unrealized gains on other securities were up ¥114mn, retained earnings were down ¥248mn owing to the net loss and dividend payments.

In terms of key performance indicators, while the equity ratio and interest-bearing debt ratio were both slightly down from a year earlier, the net cash position (cash and cash equivalents and deposit paid in subsidiaries and affiliates—interest-bearing debt) improved, so in our view the company maintained a healthy financial position. At the same time, the return on assets and operating margin declined for the third straight year. As mentioned earlier, the main likely factors in that were lower sales of the company's highly profitable products, as well as heavy investments in human resources to drive growth in the ad tech field. We look for a recovery in profitability from FY12/16.

**Consolidated Balance Sheet**

(¥mn)

| | FY12/12 | FY12/13 | FY12/14 | FY12/15 | Change |
|---|---|---|---|---|---|
| Current assets | 4,912 | 5,422 | 7,510 | 7,994 | 484 |
| (Cash and cash equivalents and deposit paid in subsidiaries and affiliates) | 2,985 | 2,621 | 3,374 | 3,815 | 440 |
| Fixed assets | 1,815 | 3,027 | 2,710 | 2,739 | 29 |
| Total assets | 6,727 | 8,449 | 10,220 | 10,734 | 513 |
| Current liabilities | 2,471 | 3,618 | 4,950 | 5,631 | 681 |
| (Interest-bearing debt) | - | 509 | 750 | 950 | 200 |
| Fixed liabilities | 93 | 166 | 148 | 134 | -14 |
| Total liabilities | 2,565 | 3,784 | 5,099 | 5,766 | 667 |
| Net assets | 4,162 | 4,664 | 5,121 | 4,967 | -153 |
| (Security) | | | | | |
| Equity ratio | 61.0% | 49.9% | 46.3% | 43.0% | |
| Interest-bearing debt ratio | - | 12.1% | 15.9% | 20.6% | |
| (Profitability) | | | | | |
| ROA (ratio of recurring profit to total assets) | 11.9% | 8.6% | 7.0% | 3.7% | |
| ROE (return on equity) | 9.0% | 4.3% | 9.4% | -2.2% | |
| Operating profit margin | 3.6% | 3.5% | 2.8% | 1.1% | |

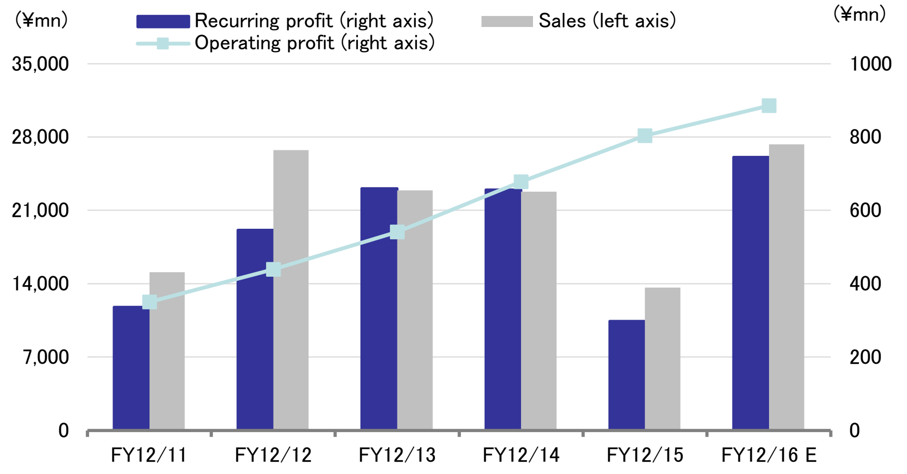
## Forecasts

### Set to post record sales and recurring profit

**(1) Forecast for FY12/16**

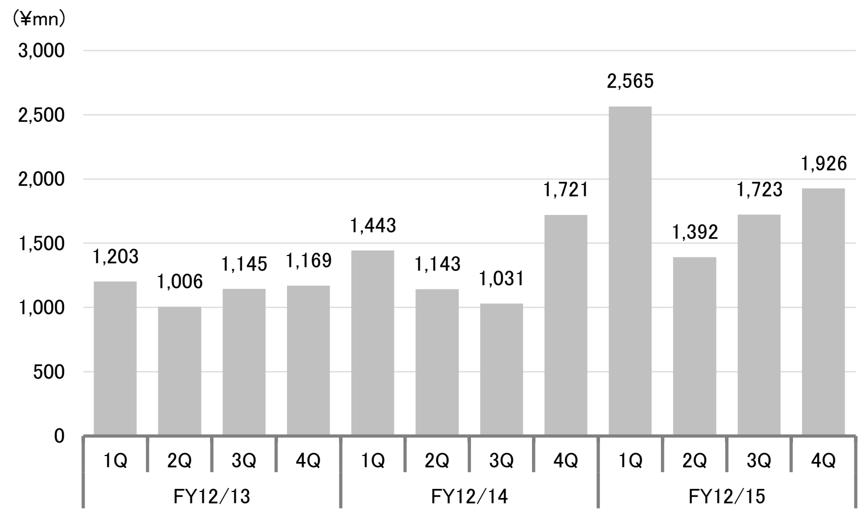
For FY12/16, GMO AD Partners targets a 10.3% increase in consolidated sales to ¥31,000mn. It also expects operating profit to plunge ¥150.8% to ¥745mn, recurring profit to jump 100.5% to ¥780mn, and net income attributable to owners of the parent to be ¥330mn (from a net loss of ¥100mn). Management thus seeks to post record sales for a second consecutive year, with operating and recurring profit reaching new highs for the first time in three and four years, respectively.

Consolidated Operating Results



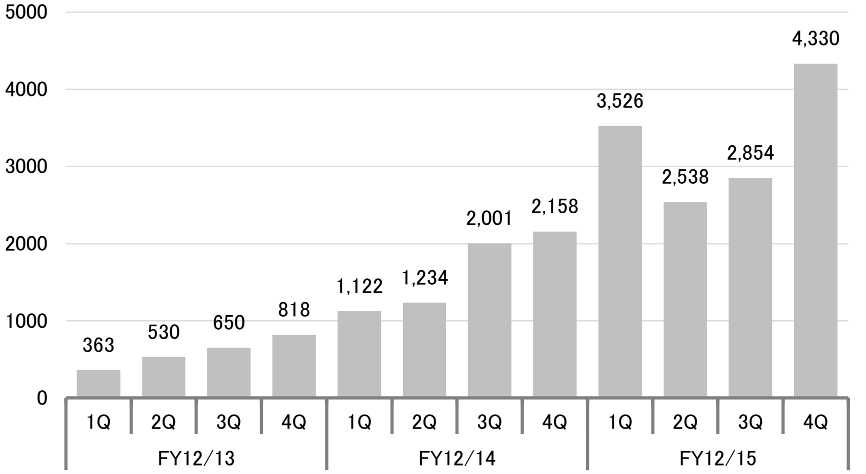

The Internet advertising market should continue to perform well amid the spread of smartphones and growth in social media advertising, and the company will push ahead in such growth areas. Quarterly ad network advertising sales have enjoyed double-digit growth since 2015. We believe that the human resources investments made last fiscal year has started to bear fruit, and anticipate further expansion in 2016. Social media advertising sales growth remains high, and is roughly doubling the quarterly growth of the previous term, so expansion should be great this period.

Sales of Ad Network



■ Forecasts

Social advertising sales index




Note: FY12/12 Q4 = 100

In January 2016, the company integrated GMO AD Marketing, GMO mobile, and Adcloud to accelerate the pace of expansion in the ad tech field. Management anticipates that bringing together development, operations, and sales organizations should generate close communications between people in those areas and boost development efficiency even further. It also hopes to cut back office and other expenses to improve cost efficiencies and enhance profitability.

On the cost front, personnel expenses will probably rise this fiscal year, as the company plans to hire another 60 people or so, although hiring costs and sales promotion expenditure are expected to decline. To bolster profitability, management plans to keep pushing ahead with new media development and services development through collaboration between internal development units and external partners.

## Starting to offer message management feature to corporate customers of LINE Business Connect

**(2) Noteworthy new products**

The company began releasing a string of new products amid a focus on development in the ad tech field. Following is a simple introduction to key offerings.

**○ AkaNe by GMO**
AkeNe is an ad network service that specializes in the native ad domain for smartphones. GMO AD Marketing began offering its service in November 2015. To date, the company already supplied ADResult for SmartPhone as an ad tech offering for smartphones. The company undertook a major revamp to reinforce the ad serving performance of that service, expand scale in the native ad domain and bolster the ad format by shifting the service infrastructure to the adcloud network ASP developed and supplied by Adcloud, which became a group company in July 2015.

The resulting functionality additions are frequency management*1 for each delivery user, creative optimization and automated bidding price optimization for each serving medium, and automated budget allocation optimization according to ad prices for each serving time zone. The company will collaborate with DMPs*2 to manage delivery setting details and accommodate video ad formats, which have become a center of attention.

*1 A measure of the frequency of users' specific online ad contacts within certain time frames.

*2 DMP is short for Data Management Platform, which centrally manages and analyzes data accumulated online for more effective ad serving and Web marketing programs. A private DMP is a platform that companies use to combine and harness their accumulated marketing data with audience information.

○ **TAXEL by GMO**
TAXEL is a service for website and other media operators. It automatically analyzes the interest, behavior, and content attributes of users viewing media, presenting related articles to encourage users to travel around the site. TAXEL functions as a contents recommendation widget*1 to optimize advertising income. GMO AD Marketing began providing this service in January 2016.

TAXEL analyzes the attributes of contents that users have accessed, and automatically analyzes it in a combination data including analyzes of user interests and behavior, and topicality in social media. It draws on a proprietary algorithm to recommend content that optimally increases traffic within a site. The recommendations can also be put together with native advertisements to make it possible to maximize profits.

*1 A tool incorporated in media to display recommended contents to users.

○ **Video-based contents marketing service**
In January 2016, GMO TECH, Inc. (6026) and GMO NIKKO jointly launched a video-based contents marketing service. The service integrates everything from video contents planning and production to uploading to sites and measuring impact. The service aims to engage with prospective customers that the company has been unable to reach before, making it possible to effectively attract customers to websites. The service should be effective in promoting purchases and increasing awareness while appealing to a wide range of prospective customers.

The advanced capabilities of smartphones make it easy for people to view video contents wherever they are, increasing the importance of video advertising in web marketing strategies as each year passes. Japan's video advertising market has tripled since 2013 to around ¥13.2bn, and this figure is expected to increase fivefold to ¥64bn by 2017. The company accordingly aims to reinforce its efforts in video advertising.

○ **Message management feature for corporate customers of LINE Business Connect**
In February 2016, GMO MARS, a comprehensively managed ad platform of GMO NIKKO, began supplying a messaging management feature to corporate customers using the LINE Business Connect service, which LINE offers to corporations.

By using this feature, companies can extensively segment users accessing official LINE accounts by age and gender and in terms of questionnaire responses. This enables companies to distribute LINE messages that match objectives and targets. There are more than 58 million registered LINE users in Japan*2, so as exchanging LINE information becomes the norm, email opening rates have dwindled with more and more companies using LINE in their promotions. GMO AD Partners aims to capture such demand growth. The target customers for the feature include existing GMO MARS customers, as well as new customers using LINE Business Connect. While more and more companies are offering similar services, GMO AD Partners looks to cultivate customers by leveraging its strengths in supplying comprehensive online advertising services. Since March 1, this feature has been offered under the name of GMO MARS LINE BC with the brand integration of GMO MARS.

*2 Source: LINE media materials for October 2015 to March 2016

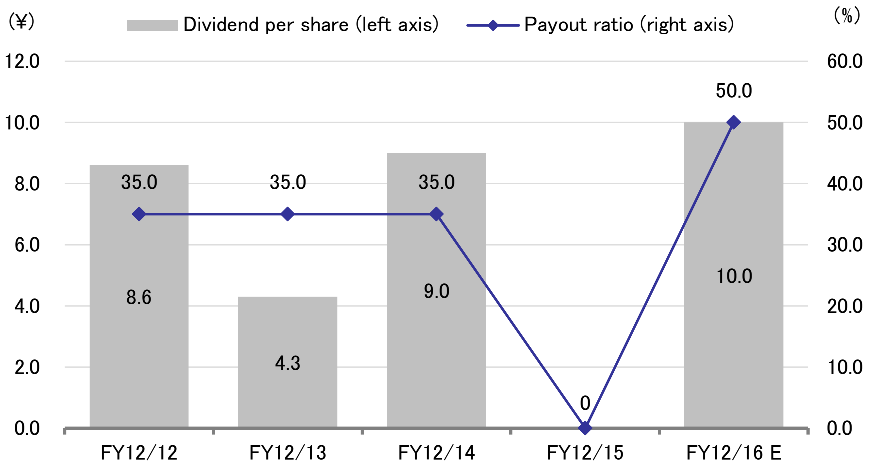
## Policy on Shareholder Returns

### Targeting a dividend payout ratio of 50% from FY12/16

The company has deployed a policy to reinforce shareholder returns. Management revised this policy, raising its dividend payout ratio target from FY12/16 to 50%, from 35% previously. The company thus plans a dividend per share payment of ¥10.00 for FY12/16. Dividends could rise as earnings continue to expand. Although dividend payments are currently once annually, as of the end of December, management revised the articles of incorporation in March 2015 to enable quarterly payments. Management merits praise for its active commitment to shareholder returns.

The company's shareholder benefits system is unchanged. Under the program, shareholders on June 30 and December 31 will continue to receive (1) a cash-back payment of share purchase commission fees on the purchase of GMO AD Partners shares if purchased at GMO CLICK Securities and (2) cash-back payment of share trade commission fees at GMO CLICK Securities up to a limit of ¥3,000 occurring within the target period.

Dividend per Share and Payout Ratio



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