COMPANY RESEARCH AND ANALYSIS REPORT

# UT Group Co., Ltd.

## 2146

TSE JASDAQ

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# Summary

## Aiming to become a leading Japanese company in the employment services industry

**1. Business areas**

UT Group <2146> primarily operates a manufacturing dispatch and outsourcing services business and also dispatches design and development engineers, construction engineers, and software development outsourcing engineers. Its major customer industries for manufacturing dispatch and outsourcing services are semiconductors and electronic devices, environment and energy, and automotive, and UT Group is the industry leader in manufacturing dispatch and outsourcing service employee volume for the semiconductor industry, which generates half of its sales in this area, with Panasonic <6752>, Sony <6758>, and ROHM <6963> group as key customers. UT Group has been an industry pioneer in hiring dispatch workers for unlimited-time employment, ability-based wages, and other practices and possesses the industry's top retention rate. It has steadily expanded with a unique business model of "outsourcing entire processes (start-to-finish)" that differentiate it from other firms.

**2. Financial results trends**

UT Group reported FY3/17 results with ¥57,588mn in sales (+30.7% YoY), ¥3,413mn in operating profit (+38.7%), ¥3,341mn in ordinary profit (+38.0%), and ¥2,033mn in net profit attributable to owners of parent (+35.8%). Sales and profits increased by double digits as it posted gains in a 7th straight fiscal year. Sales set a new all-time high, exceeding the previous peak from FY3/08. While UT Group started the fiscal year with a conservative plan that factored in impact from the Kumamoto earthquake, actual setback from the earthquake was temporary. Key sources of robust earnings beyond guidance were 1) favorable effects for UT Group from the Revised Worker Dispatching Law implemented in September 2015, 2) vibrant demand in mainstay customer industries, such as new vehicles and next-generation smartphones, and 3) selective acceptance of higher-priced and higher-margin deals. UT Group had 472 customer plant sites (up by 16 plants YoY) and an all-time high of 15,488 technology employees (with a breakdown of 14,123 people in manufacturing dispatch and outsourcing and 1,365 people in engineer dispatch) at the end of the fiscal year. It achieved healthy results with a foundation for hiring 750 people per month nationwide and selective orders acceptance and steadily expanded engineer dispatch business through growth at existing subsidiaries.

UT Group forecasts for double-digit sales and profit growth in FY3/18 to ¥70,000mn in sales (+21.6% YoY), ¥4,200mn in operating profit (+23.0%), ¥4,100mn in ordinary profit (+22.7%), and ¥2,800mn in net profit attributable to owners of parent (+37.7%). The plan takes into account extensive demand for personnel in many fields because of ongoing labor shortages and likely continuation of positive impact from legislative revisions. While UT Group projects just over 20% YoY increases in sales and operating profit, we think it presents relatively firm numerical goals and might have room to overshoot, just as in FY3/17. We base this view on 1) stronger favorable effects from the Revised Worker Dispatching Law implemented in September 2015 than anticipated, 2) the increase in technology employees by about 4,500 people at the start of the fiscal year and prospect of attaining sales on track with the budget if all of these members are active, and 3) vibrant demand in mainstay customer industries, such as new vehicles and next-generation smartphones. Additionally, UT Group announced that it will move restructuring assistance solutions out of the manufacturing dispatch and outsourcing business as a separate business and disclose information in three business categories from FY3/18.

### 3. Medium-Term Business Plan

The new Medium-Term Business Plan announced in July 2015 (covering FY3/17-21) presents a new vision of "creating jobs nationwide in Japan" as a second "founding phase" in line with a group mission of "creating vigorous workplaces empowering workers," along with goals of 29,000 technicians, ¥145,000mn in sales, ¥10,000mn in EBITDA, and ¥8,200mn in operating profit in FY3/21. UT Group aims to become a leading company in Japan's employment service industry. It updated management indicators in FY3/17 based on conducting aggressive M&A with commitments to an EBITDA growth rate of at least 30% (average growth rate for the five-year plan), a total return ratio of at least 30%, and a gross D/E ratio* of 1.0 or less (by FY3/21).

* Indicates the ratio of interest-bearing debt to capital as the source of corporate capital. Financial standing is typically healthy when this value is one or less.

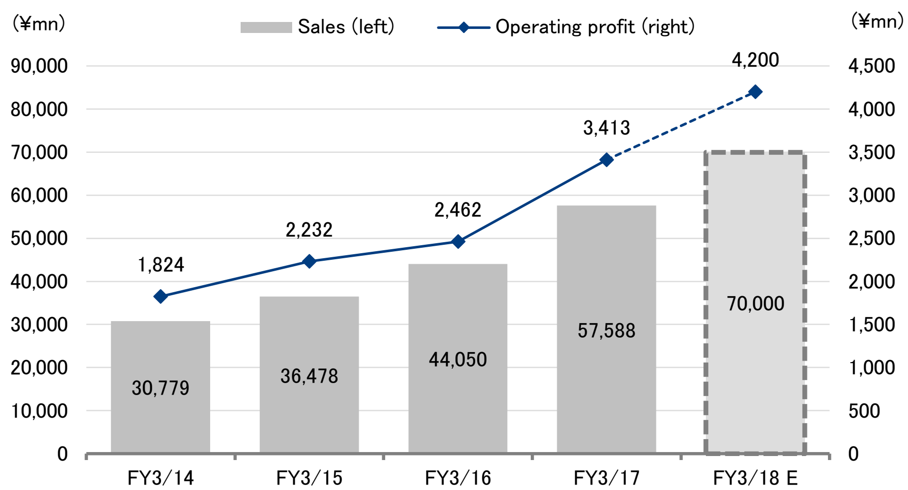
### 4. Shareholder returns

For shareholder returns, UT Group has committed to a total return ratio of at least 30% and uses of the PEG ratio (forward PER ÷ annual EPS growth rate) value for decisions as its basic policy. It decided to buy up to 500,000 shares of its own stock with a budget of ¥610mn in FY3/18 (during May 12, 2017 to August 11, 2017). It also plans to retire all of the purchased shares. UT Group intends to implement profit allocation with a total return ratio of at least 30% based on a combination of dividends and share buybacks taking into account earnings and stock market trends, in line with the revised commitment in the new Medium-Term Business Plan.

## Key Points

- Reported higher sales and profits for a seventh straight year and all-time high net sales in FY3/17
- Dual customer strategy addressing companies (major manufacturing-related customer firms) and individuals (job seekers and employees)
- Likely to post upbeat results again in FY3/18 with tailwind from the Revised Worker Dispatching Law and other legislation

Business trends




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

# Corporate overview

## After the financial crisis (Lehman Shock), it decided to return to dispatching technicians in the manufacturing industry

### 1. Corporate overview

With a group mission of “creating vigorous workplaces empowering workers,” UT Group primarily operates a manufacturing dispatch and outsourcing service business with human resources for in-house work, mainly in domestic and semiconductors and electronic devices, environment and energy, and automotive industries, and also dispatches engineers. It is the industry leader in manufacturing dispatch and outsourcing service employee volume for the mainstay semiconductor industry with Panasonic, Sony, and other key customers. The engineer business dispatches engineers mainly to domestic customers for software outsourced development and machinery, electric equipment, and electronics design and development. UT Group has been an industry pioneer in dispatch workers for unlimited-time employment, ability-based wages, and other practices and possesses the industry’s top retention rate. It has steadily expanded with a unique business model of “outsourcing entire processes (start-to-finish)” that differentiates it from other firms.

### 2. History

The group was founded in April 1995 based on the philosophy of President, Representative Director & CEO Yoichi Wakayama of contributing to both people looking for a job and companies wanting people. The group’s corporate history can be categorized into three periods: (1) its founding period from 1995 to 2001, (2) its first growth period from 2001 to 2009, and c) its second growth period from 2010 to present.

#### (1) The founding period (1995 to 2001)

The origins of the group were the founding in April 1995 in Yokohama of Aim CIC Company for the business of contractual on-site work. In July 1996, Aim CIC was renamed Nihon Aim Co., Ltd. Since its founding, it has focused on the manufacturing field, and one after another it adopted employment systems that ran contrary to the prevailing wisdom in the industry at that time, such as permanent employment, 100% employee participation in social insurance and a skill-based wage system. In such ways, it was successfully able to increase its employee retention rate and production efficiency. Furthermore, it created an independent business model in which instead of dispatching individuals, it dispatches entire teams to provide its start-to-finish outsourced production service in which the team is responsible for an entire process, and implemented various reforms of employees’ ways of working. These initiatives helped to improve the management efficiency at its corporate clients, which further increased client numbers, and established the business foundations for its first growth stage.

**(2) First growth stage (2001 to 2009)**

Due to the collapse of the IT bubble, the performance of companies in the manufacturing industry, which are the group's clients, deteriorated, and so inevitably the group's results also worsened. In this situation, it decided to convert to a niche, growth strategy of specializing in the semiconductor field which requires high-level expertise and is appropriate for outsourcing work on the unit of an entire process. In October 2002, it established the Semiconductor Market Development Team (currently the Tsukuba Training Center), which promotes the start-to-finish outsourced production service for semiconductor device manufacturers and carries out planning to improve the abilities of functional employees specializing in the semiconductor business. These efforts bore fruit and up to 2007 prior to the Lehman Brothers' collapse, it had established its position as No.1 in the manufacturing outsourcing industry in terms of number of manufacturing outsourced and dispatched employees to the semiconductor-related industry. In April 2006, in order to advance into the semiconductor device design business, it made a subsidiary of ARTISTA Co., Ltd. (merged with Comm Leading Co., Ltd. in December 2011), thereby entering into the design and development engineers dispatch business.

Further, in April 2007 it established a joint holding company called United Technology Holdings Co., Ltd. (name changed to UT Holdings Co., Ltd. in January 2009; changed to UT Group in July 2015) with Apex Inc., which sells used semiconductor manufacturing equipment and provides technical services. Next, in June 2007, Nihon Aim Co., Ltd. (name changed to UT Aim Co., Ltd in July 2012) made a subsidiary of Micro Engineering Inc., which manufactures and sells semiconductor manufacturing equipment, thereby entering into the business of manufacturing and selling semiconductor equipment and accelerating its strategy of expanding the scope of its semiconductor business.

However, it had to abandon its expansion of its semiconductor business due to the deterioration of the performance of companies in the semiconductor industry following the worldwide recession triggered by the Lehman Brothers' collapse. In June 2009, it sold Micro Engineering and then in November it sold Apex, and decided to return to the engineer business in the manufacturing field, which had been its business domain since its founding. In December 2003, the group's predecessor Nihon Aim listed on the over-the-counter market, with one of its objectives being "to create a company that could have its employees as the top shareholder." Incidentally, this was the first IPO of an outsourcing company, and its formation of an employee shareholder plan was also a first for the manufacturing outsourcing industry.

**(3) Second growth stage (2010 to the present)**

From the group's decision to return to its original business of manufacturing outsourcing, in addition to cultivating further transactions in its main manufacturing dispatch and outsourcing services business and expanding into client growth fields, such as the environment and energy field, the automobile-related field, and the housing field, it aimed to develop its business foundations by expanding its engineer business (dispatch of design and construction engineers). In this way, it implemented a market leader strategy of escaping from a reliance on semiconductors and becoming the No.1 outsourcing company, at the same time as implementing financial restructuring. Even though its business environment was working against it, such as the shift of the manufacturing industry overseas due to the Great East Japan Earthquake and the strong yen, the 2012 problem* worked to the advantage of the group thanks to its policy of permanent employment, and its number of client plants increased, its results recovered, and its expansion trend accelerated.

* The 2012 problem that affected the group was that in conjunction with the rapid expansion in production following the Lehman Brothers' collapse, from 2009 the re-utilization of dispatch workers started once again in the manufacturing industry. But then the temporary employment periods of the dispatched workers that started at that time all came to an end at the same time in 2012. Manufacturing companies, which are the group's main clients, were required to decide whether to directly employ their dispatch workers and workers on a fixed-term employment contract, or to switch to outsourcing. Since then, the shift toward outsourcing has accelerated even outside of the semiconductor industry.

In order to expand its business foundations, in January 2010 the group established Comm Leading Co., Ltd. (design and development engineers dispatch business)*1, and then in March it established Comm Agent Co., Ltd. (distribution and retail dispatch business)*2. In addition, in July 2013, it acquired 81% of the shares of Panasonic Battery Engineering Co., Ltd. and made it into a subsidiary (at the same time, its name was changed to UT Pabec Co., Ltd.). Further, in March 2015, with the objective of expanding its engineer business even further, it made a subsidiary of System Revolution, which operates a software development business*3. Management positioned 2015, the 20th anniversary of the company's founding, as a new founding year and presented a new vision of "creating jobs nationwide in Japan" in July 2015. It also renamed itself from UT Holdings to UT Group and updated the brand mark*4.

*1 In July 2012, its name was changed to UT Leading Co., Ltd., and in October 2015, it was renamed again as UT Technology.

*2 In April 2012, its name was changed to UT icom Co., Ltd., and at the same time it launched a manufacturing dispatch and outsourcing business. But then in June 2012, it spun-off the distribution and retail dispatch business and established UT Agent Co., Ltd. In April 2013, UT Agent transferred its business to UT icom (UT icom was merged with UT Aim in April 2014).

*3 The acquisition cost was ¥1,000mn. Renamed UT System in October 2015.

*4 Developed with an image of robust human resources, teamwork, and growth.

**Company History**

| Date | Company history |
|---|---|
| April 1995 | Aim CIC Company was founded for the business of dispatching personnel for in-plant work |
| July 1996 | Aim CIC was renamed Nihon Aim Co., Ltd. |
| October 2002 | The Semiconductor Market Development Team was established (currently the Tsukuba Training Center) |
| December 2003 | Nihon Aim was listed on the over-the-counter market (JASDAQ) |
| April 2006 | ARTISTA Co., Ltd. was made a subsidiary in order to enter into the design and development engineer dispatch business |
| April 2007 | Nihon Aim and Apex Inc. jointly transferred shares to establish United Technology Holdings Co., Ltd. (currently UT Group Co., Ltd.) as a pure shareholding company. It was listed in the JASDAQ market (Nihon Aim became unlisted) |
| January 2009 | United Technology Holdings was renamed UT Holdings Co., Ltd. |
| November 2009 | All shares of Apex were acquired by HACHITOKU Co., Ltd. |
| January 2010 | Comm Leading Co., Ltd. was established in order to strengthen the group's design and development engineers dispatch business |
| March 2010 | Comm Agent Co., Ltd. was established in order to enter into the distribution and retail dispatch business |
| January 2011 | ARTISTA and Comm Leading were combined to form Comm Leading |
| April 2012 | The name of Comm Agent Co., Ltd. was changed to UT icom Co., Ltd. and a manufacturing dispatch and outsourcing business was launched.<br>UT Career Co., Ltd. was established (entered into the outplacement business).<br>UT Construction Network Co., Ltd. was established in order to enter into the construction engineer dispatch business. |
| June 2012 | The distribution and retail dispatch business of UT icom Co., Ltd. was spun-off and UT Agent Co., Ltd. was established |
| July 2012 | To enhance the UT Group's brand power, some subsidiaries were renamed to make corporate names of all subsidiaries start with UT |
| October 2012 | UT Life Support was established in order to expand welfare services to employees |
| July 2013 | 81% of shares of Panasonic Battery Engineering Co., Ltd. were acquired to make it a subsidiary that was renamed UT Pabec Co., Ltd. |
| May 2015 | System Revolution Co., Ltd. was made into a subsidiary |
| July 2015 | UT Holdings Co., Ltd. was renamed UT Group Co., Ltd. |
| October 2015 | Renamed UT Leading as UT Technology Co., Ltd., UT Construction Network as UT Construction Co., Ltd., and System Revolution as UT System Co., Ltd. |
| May 2016 | Acquired shares in Atex Co., Ltd. and converted it to a subsidiary |
| December 2016 | Acquired shares in Forward Co., Ltd. and converted it to a subsidiary |
| January 2017 | Opened the UT Advanced Career Center, a training facility for engineers |
| March 2017 | Acquired shares in Tight Work Co., Ltd. and converted it to a subsidiary |
| April 2017 | Merged Atex into UT Technology and Forward into UT System. Acquired shares in Lei Hau'oli Co., Ltd. and made it a subsidiary |

Source: Prepared by FISCO from the Company website and press releases

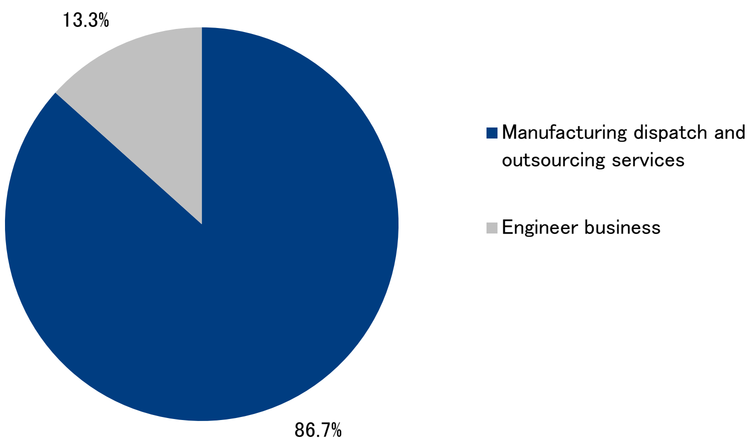
# Business overview

## Mainly operates a manufacturing dispatch and outsourcing services business and also dispatches engineers

● Description of businesses

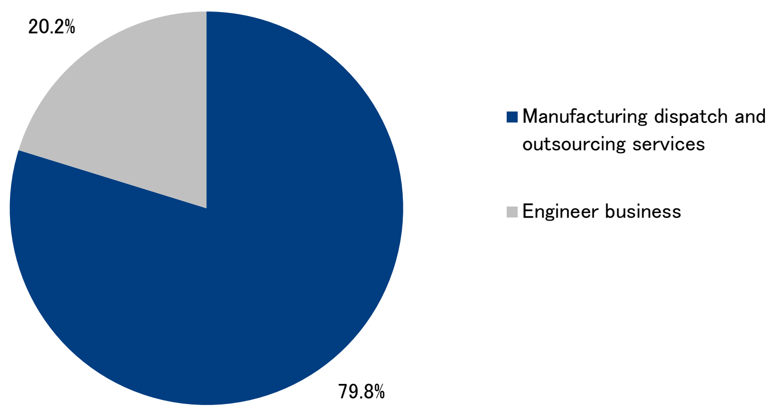
The UT Group consists of UT Group, which oversees group companies as a pure holding company, 10 consolidated subsidiaries, and two other companies. It disclosed results in two segments – manufacturing dispatch and outsourcing and engineer dispatch. Sales ratios in FY3/17 were the manufacturing dispatch and outsourcing business at 86.7% and the engineer business at 13.3%. Engineer dispatch business is divided further into design engineer dispatch (6.8% of overall sales), construction engineer dispatch (3.8%), and software development engineer dispatch (2.8%). Operating profit ratios were manufacturing dispatch and outsourcing at 79.8% and engineer dispatch at 20.2%. Engineer dispatch business has relatively higher profitability.

Sales percentages by business (FY3/17)




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

Profit composition by business (FY3/17)



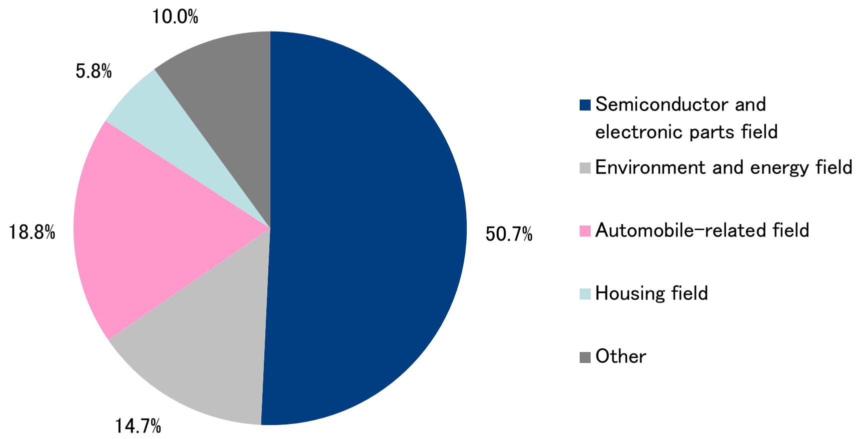

Source: Prepared by FISCO from the Company's financial results

**(1) Manufacturing dispatch and outsourcing services business**

It dispatches human resources and handles outsourcing of in-plant work mainly for Japanese manufacturers. Rather than dispatching individuals for work outsourced to it, UT Group mainly organizes experienced employees into teams, establishes a chain of command, and carries out the work on the unit of an entire process (start-to-finish outsourcing). The group's employees that carry out the outsourcing work are called technicians and their employment formats are divided into permanent employees transferred to locations nationwide (approximately 70% of all employees) and contract employees.

Its main users are manufacturing companies in industries including semiconductor, electronics, environment and energy, automotive, and construction and building materials. Specifically, its main clients include the Sony Group, the Panasonic Group, and the Toshiba <6502> Group. Consolidated subsidiaries UT Aim, UT Pabec, Tight Work Co., Ltd. and UTHP Co., Ltd. carry out this business. As of the end of March 2017, it dispatched technicians to 472 plants (vs. 456 plants at end-FY3/16) and employed 14,123 technicians (vs. 10,022 technicians). Percentages of sales by industry were semiconductors and electronic devices at 50.7%, environment and energy at 14.7%, automotive at 18.8%, housing at 5.8%, and others at 10.0%.

Sales composition by areas in the manufacturing dispatch and outsourcing business (FY3/17)

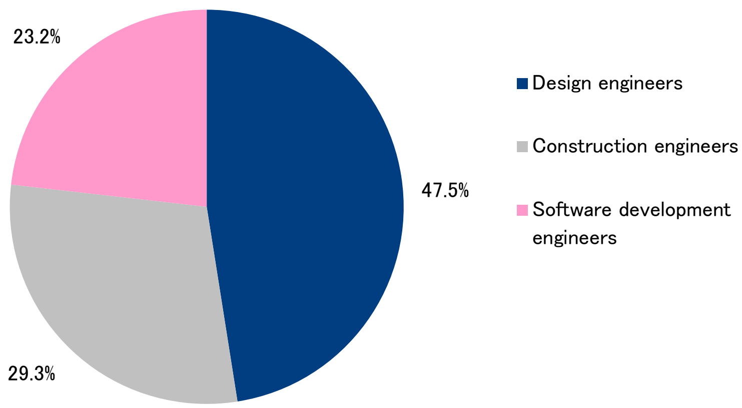



Source: Prepared by FISCO from the Company's results briefing materials

### (2) Engineer business

The business involves software outsourced development; machinery, electrical, and electronic design development (including design work using 3D CAD); and the dispatch of construction engineers. Software development is carried out by UT Technology Co., Ltd. and UT System, while the dispatch of engineers for machinery, electrical, and electronic design development is handled by UT Technology. The construction engineer dispatch business is carried out by UT Construction Co., Ltd. Main clients for software development and dispatch of engineers for machinery, electrical, and electronic design development are major electronics manufacturers. Clients in the construction engineer dispatch business include major construction companies, primarily super general contractors. The sales composition by areas in the engineering dispatch business is design engineers 47.5%, construction engineers 29.3% and software development engineers 23.2%. As of the end of March 2017, the group employed 1,365 engineers in this business (vs. 904 at the end of FY3/16).

Sales composition by areas in the engineering dispatch business (FY3/17)




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

# Financial results trends

## Reported higher sales and profits for a seventh straight year and all-time high net sales in FY3/17

### 1. Overview of the FY3/17 results

UT Group reported FY3/17 results with ¥57,588mn in sales (+30.7% YoY), ¥3,413mn in operating profit (+38.7%), ¥3,341mn in ordinary profit (+38.0%), and ¥2,033mn in net profit attributable to owners of parent (+35.8%). Sales and profits increased by double digits as it posted gains in a 7th straight fiscal year. Sales set a new all-time high, exceeding the previous peak from FY3/08. While UT Group initially started the fiscal year with a conservative plan that factored in impact from the Kumamoto earthquake, actual setback from the earthquake was temporary. Key sources of robust earnings beyond guidance were 1) favorable effects for UT Group from the Revised Worker Dispatching Law implemented in September 2015, 2) vibrant demand in mainstay customer industries, such as new vehicles and next-generation smartphones, and 3) selective acceptance of higher-priced and higher-margin deals. UT Group had 472 customer plant sites (up by 16 plants YoY) and an all-time high of 15,488 technology employees (with a breakdown of 14,123 people in manufacturing dispatch and outsourcing and 1,365 people in engineer dispatch) at the end of the fiscal year. It achieved healthy results with a foundation for hiring 750 people per month nationwide and selective orders acceptance and steadily expanded engineer dispatch business through growth at existing subsidiaries.

**FY3/17 results review**

(¥mn)

| | FY3/16 | | FY3/17 | | | | |
|---|---|---|---|---|---|---|---|
| | Results | Ratio (to sales) | Period-start forecast | Results | Ratio (to sales) | Change versus the forecast (%) | Change YoY (%) |
| Sales | 44,050 | 100.0% | 47,840 | 57,588 | 100.0% | 20.4% | 30.7% |
| Cost of sales | 35,303 | 80.1% | 38,660 | 46,126 | 80.1% | 19.3% | 30.7% |
| Gross profit | 8,747 | 19.9% | 9,180 | 11,462 | 19.9% | 24.9% | 31.0% |
| SG&A expenses | 6,284 | 14.3% | 6,650 | 8,048 | 14.0% | 21.0% | 28.1% |
| Operating profit | 2,462 | 5.6% | 2,530 | 3,413 | 5.9% | 34.9% | 38.7% |
| Ordinary profit | 2,421 | 5.5% | 2,430 | 3,341 | 5.8% | 37.5% | 38.0% |
| Net profit attributable to owners of parent | 1,497 | 3.4% | 1,620 | 2,033 | 3.5% | 25.5% | 35.8% |

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

Key sales drivers were 1) upbeat expansion of manufacturing dispatch and outsourcing services business thanks to a steady rise in technician employee volume through establishment of a hiring program for 750 people per month and higher contracted plant volume and 2) strong growth in engineering business at over 30% led by growth at existing subsidiaries and the addition of UT System acquired as a subsidiary. Gross profit accompanying higher sales climbed 31.0% YoY to ¥11,462mn, and gross margin remained high at 19.9%. SG&A expenses, meanwhile, increased sharply with a 28.1% rise to ¥8,048mn, mainly due to a steep expansion of hiring costs from aggressive hiring activity that factored in large back-order volume for FY3/18 in addition to increased indirect costs in the Staffing Division accompanying the expansion of business. UT Group hence posted a double-digit rise in operating profit, and operating margin improved by 0.3ppt from 5.6% to 5.9%.

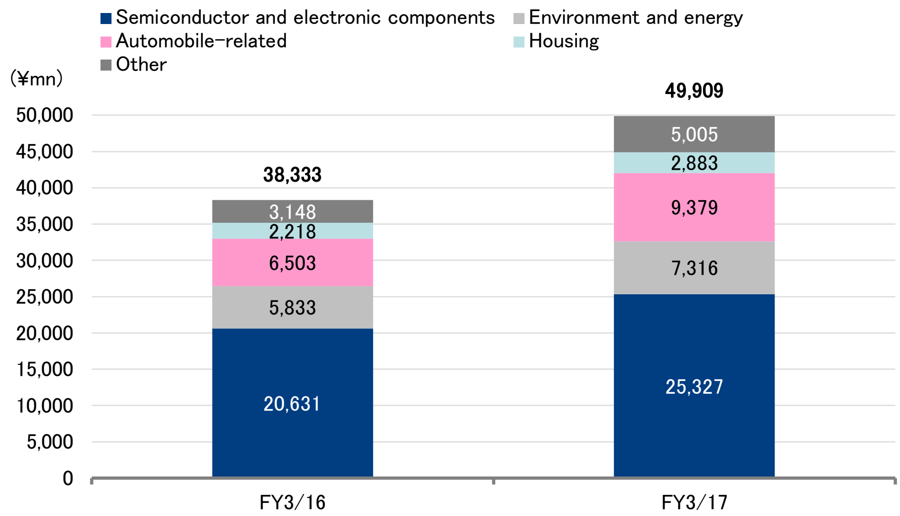
Sales and all profit categories surpassed period-start guidance (¥47,840mn in sales, ¥2,530mn in operating profit, ¥2,430mn in ordinary profit, and ¥1,620mn in net profit attributable to owners of parent). Main upside sources were stronger tailwind in manufacturing dispatch and outsourcing business from the Revised Worker Dispatching Law than expected, upbeat trends in smartphone, vehicle electronic parts, and automotive businesses, and healthy demand for non-experienced people in the engineer dispatch business amid labor shortfall.

We review conditions for the business segments.

### (1) Manufacturing dispatch and outsourcing services business

This business posted major increases in sales and operating profit with gains of 30.2% YoY to ¥49,909mn and 53.2% to ¥2,271mn, respectively. The number of technical employees increased by 40.9% to 14,123 at period-end with support from establishment of a program for hiring 750 people per month and rising demand mainly in electronic devices for smartphones and vehicle electronic parts and automotive industries. Viewed by industry, sales rose at robust pace in the areas of semiconductors and electronic devices, environment and energy. Automotive-related fields grew significantly, increasing by 44.2% from the previous fiscal year and expanding their share of sales composition. Segment profit margin climbed from 3.9% to 4.6% owing to selective acceptance of higher-margin deals and results from sales activities aimed at raising in-house share.

Manufacturing dispatch and outsourcing sales



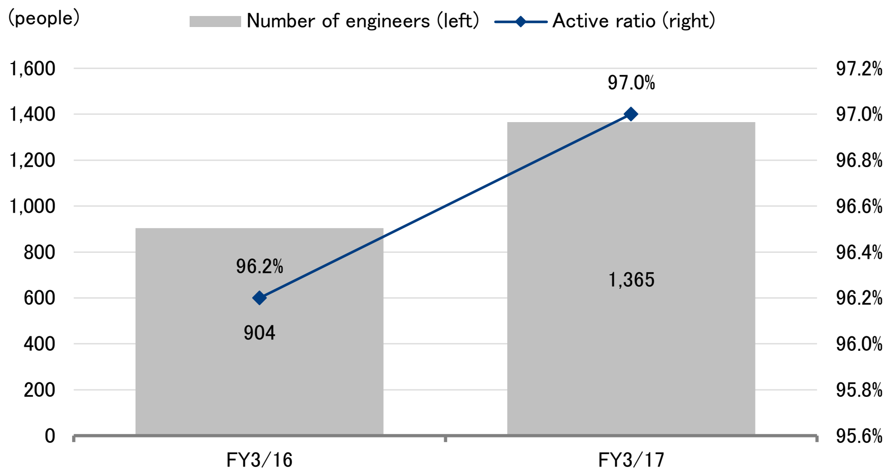

Source: Prepared by FISCO from the Company's results briefing materials

### (2) Engineer business

This business reported major increases in sales and operating profit with gains of 34.9% YoY to ¥7,688mn and 49.5% to ¥575mn, respectively. Key drivers were upbeat expansion at subsidiaries, such as UT Technology, UT Construction and UT System. The number of engineer employees for the engineer business expanded by 461 people from the end of the previous fiscal year to 1,365 people, including a boost from One UT* (career change within the group; added 130 people).

* Unique program in which the UT Group works jointly to support employee career advances and new challenges. Anybody can enter the program regardless of age or work experience. Participants learn specialty knowledge and skills while working. There are currently two courses running – Construction Engineer and Design and Development Engineer.

Number of engineers and active ratio trends for the engineer business




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

## Moderate upward trend in the shareholders' equity ratio, financial status is strong

### 2. Financial position and management indicators

Total asset value increased ¥6,005mn YoY to ¥23,144mn at end-March 2017. Current assets climbed by ¥4,710mn with additions of ¥1,958mn in cash and deposits and ¥2,579mn in notes receivables and accounts receivables. Fixed assets expanded by ¥1,301mn because of higher goodwill associated with three new subsidiaries in FY3/17.

Liabilities, meanwhile, increased by ¥4,517mn compared to the end of the previous fiscal year to ¥17,409mn, mainly on higher current liabilities, such as unpaid costs, unpaid consumption taxes, deposits, and unpaid amounts, linked to business expansion. Loans (short-term and long-term loans) rose by ¥950mn. Furthermore, net assets grew by ¥1,487mn YoY to ¥5,735mn, including a ¥1,246mn rise in surplus profit from net profit attributable to owners of parent and other factors.

Next, we review cash flow trends. Cash and cash equivalents increased ¥1,958mn from the end of the previous fiscal period to ¥8,470mn at end-FY3/17. Operating cash flow had a surplus of ¥3,107mn, despite booking ¥496mn in corporate tax and other payments and a ¥1,997mn rise in accounts receivable value, thanks to booking ¥3,154mn in net profit prior to taxes and other adjustments. Investment cash flow posted a deficit of ¥1,052mn due to ¥820mn in payments for purchase of subsidiary shares associated with change in scope of consolidation. Financing cash flow had a deficit of ¥147mn, even with ¥2,800mn in income from long-term loans, due to ¥1,911mn in spending to repay long-term loans, ¥749mn in outlays to acquire treasury shares, and ¥410mn in outlays to repay corporate bonds.

In soundness-related business indicators, while the liquidity ratio worsened, this was a temporary impact at the end of the fiscal year, and improved capital and interest-bearing debt ratios (YoY) reflect changes in composition of the balance sheet accompanying income growth. In profitability-related indicators, operating margin and other indicators improved and financial conditions are healthy.

Consolidated balance sheet, business indicators and cash flow statement

(¥mn)

| | FY3/16 | FY3/17 | Change |
|---|---|---|---|
| Current assets | 13,863 | 18,574 | 4,710 |
| (Cash and deposits) | 6,511 | 8,470 | 1,958 |
| Fixed assets | 3,262 | 4,564 | 1,301 |
| Total assets | 17,139 | 23,144 | 6,005 |
| Current liabilities | 7,835 | 11,896 | 4,061 |
| Fixed liabilities | 5,056 | 5,513 | 456 |
| (Interest-bearing debt) | 7,409 | 7,056 | 950 |
| Total liabilities | 12,891 | 17,409 | 4,517 |
| Net assets | 4,248 | 5,735 | 1,487 |
| (Stability) | | | |
| Liquidity ratio | 176.9% | 156.1% | -20.8pt |
| Shareholders' equity ratio | 23.9% | 24.2% | 0.3pt |
| D/E ratio | 143.7% | 123.0% | -20.7pt |
| (Profitability) | | | |
| ROA | 14.4% | 16.6% | 2.2pt |
| ROE | 39.3% | 41.9% | 2.6pt |
| Operating margin | 5.6% | 5.9% | 0.3pt |
| Operating CF | 517 | 3,107 | 2,589 |
| Investment CF | -334 | -1,052 | -717 |
| Financing CF | -789 | -147 | 641 |
| Balance of cash and cash equivalents | 6,511 | 8,470 | 1,958 |

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

# Strengths and business risks

## Strengthened human resource cultivation and training programs and has the industry's highest retention rate

### 1. Strengths and competition

The group's strengths are its systems of permanent employment and 100% employee participation in social insurance. In addition, by introducing Job Grade, which is a skill evaluation system on 25 levels; Entry System, in which employees can fairly become candidates for management; and an Employee Stock Ownership Plan (ESOP), it has achieved the lowest employee turnover rate in its industry (specifically, its current turnover rate is around 3%, falling by about 1 percentage point compared to the previous fiscal year and significantly below the industry average of 7 to 8%). Additionally, UT Group has robust personnel education and training programs, such as One UT, a job-change program within the group that supports career enhancement from manufacturing operator to engineer, the Super Manager School executive training program, and MTM Training, a management and leadership program. We think its ability to maintain high-quality employees contributes to upbeat assessments from customers. Further, another one of its strengths seems to be that it can contribute to the improved management efficiency of its clients through the format of its outsourcing contracts, in which a team provides a start-to-finish outsourced production service.

The group is leveraging its strengths to differentiate itself from competitors in the semiconductor field, which is where its main clients are located, and has established an unshakeable position as the No.1 company in the manufacturing outsourcing industry in terms of the number of manufacturing outsourced and dispatched employees. On the other hand, competition is fierce for manufacturing outsourcing in growth fields like automobiles, where the group has been aiming to expand its business to escape from its reliance on the semiconductor field through developing a market leader strategy. But despite this competition, the group is steadily increasing client numbers through leveraging its strengths. Specific competitors in this field include Nikken Total Sourcing Inc., NISSO, Outsourcing <2427>, and World Holdings <2429>.

### 2. Business risks

The group's business risks can be summarized into two points; a) its high reliance on the manufacturing and semiconductor-related industries and b) securing human resources.

As the group's clients are in the manufacturing industry, they are likely to be affected by fluctuations in the macro economy, like a strong yen and the domestic economic climate. Further, while the percentage of sales from the semiconductor field is declining due to the progress the group is making in its strategy of escaping from its reliance on the semiconductor-related field, this business still provides around 40% of sales, so the group could be affected by changes in the performance of its semiconductor-related corporate clients.

The group's source of revenues is its human resources and securing them is its biggest challenge. It may not be able to secure the engineers it requires due to conditions in the labor market. Or if its employee retention rate declines, this may have a negative impact on earnings due to an increase in hiring expenses. In addition, its hiring system in its main manufacturing dispatch and outsourcing services business is founded upon hiring locally in each region, so if it has difficulties hiring in one region, it will have to hire from other regions and will incur relocation expenses, which may cause profitability to decline.

# Business outlook

## Conservative FY3/18 guidance, possibility of attaining medium-term plan targets

### ● FY3/18 outlook

UT Group aims for double-digit sales and profit increases in FY3/18, with sales up 21.6% YoY to ¥70,000mn, operating profit up 23.0% to ¥4,200mn, ordinary profit up 22.7% to ¥4,100mn and net profit attributable to owners of parent up37.7% to ¥2,800mn.

**Overview of FY3/18 guidance**

(¥mn)

| | FY3/17 | | FY3/18 | | |
|---|---|---|---|---|---|
| | Results | Ratio (to sales) | Period-start guidance | Ratio (to sales) | Change YoY (%) |
| Sales | 57,588 | 100.0% | 70,000 | 100.0% | 21.6% |
| Operating profit | 3,413 | 5.9% | 4,200 | 6.0% | 23.0% |
| Ordinary profit | 3,341 | 5.8% | 4,100 | 5.9% | 22.7% |
| Net profit attributable to owners of parent | 2,033 | 3.4% | 2,800 | 4.0% | 37.7% |

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

UT Group prepared a conservative plan in FY3/17 that factored in impacts (¥200mn on sales and operating profit) from increase in waiting person due to the Kumamoto earthquake that occurred in April 2016, but the actual impact ended up being temporary.

Significant personnel demand exists in many fields because of sustained labor shortages in FY3/18. Furthermore, UT Group explains that the Revised Worker Dispatching Law, Revised Labor Contracts Law, and other legislative revisions should continue to work well for it. The Revised Worker Dispatching Law that took effect in September 2015 reinforced regulations on dispatching firms, such as revisions to past restrictions on the working period. In UT Group's case with permanent employees, time limits do not apply to dispatches without a fixed term and customer demand is growing. Similarly, the Revised Labor Contracts Law implemented in April 2013 is boosting demand for dispatching as a replacement because it strengthens regulations on fixed-term contract employees. Societal needs for non-fixed term dispatch have risen sharply due to these legislative revisions. Smaller dispatching firms unable to provide this support are being weeded out. We expect this trend to continue at least over the next few years and thereby provide a tailwind to UT Group.

UT Group announced its intention to utilize three business segments from FY3/18 with the former manufacturing dispatch and outsourcing business split into the manufacturing business for manufacturing personnel dispatch and outsourcing and the solutions business for restructuring assistance and the engineering dispatch business as the engineering business. The first aim is separation of solutions business, which inherently differs from dispatching business, from manufacturing dispatch business as a more clearly defined segment. Promotion of structural reforms by transferring employees from customer firms to UT Group and giving them options for job type changes during the three-year guarantee program is a type of customer BPO and has been distinctly divided from dispatch business. The second aim is removal of "dispatch" from segment names. This seeks to eliminate an issue for employees who have a negative sentiment toward "dispatching."

For business strategy, UT Group announced measures from the standpoint of broadening the career platform for employments and expanding services for customer firms through organic collaboration of business segments, rather than taking a segment-based approach. These measures adhered to the two major customer strategies from the medium-term business plan covered below.

**(1) Reinforcement of the career platform**

UT Group seeks to become "the company most selected by working people" with the following initiatives.

**a) Adding attractive work locations**

UT Group will develop work locations suited to team dispatches so that new university graduates, non-experienced people, and other employees can work in a division with attractive conditions for a short period. Specifically, it will strive to broaden transactions with automakers, electric equipment firms, and other large companies. It will also foster solidarity through expansion of the number of dispatch workers per plant and thereby offer workplace environments where people can work with a sense of security.

**b) Promoting of value enhancement for working people**

UT Group will pursue establishment of a career-consulting framework that makes career formation an important indicator for managers. It intends to bolster job-training programs by actively utilizing engineer cultivation facilities, such as UTACC* opened in FY3/17. It will also aim to improve the added value of working people through job transfers within the group and introductions to customer companies.

* UT Advanced Career Center: This facility cultivates engineers who can work effectively at work sites and assists in employee career formation.

**(2) Expansion of corporate services**

UT Group wants to "provide broad value to manufacturing companies" with the following efforts.

**a) Strengthening support for large-scale requirements**

A major strength is UT Group's large-scale mobilization of personnel on a nationwide basis. Management intends to enhance hiring capacity from 750 people per month in FY3/17 to 1,000 people per month in FY3/18.

**b) Recruiting restructuring demand**

As solutions business, UT Group has a track record of transferring about 1,000 people cumulatively from five companies over the past five years. It will continue to pursue opportunities, including large-scale projects, with an in-house solution approach that combines acceptance of full-time employee transfers and outsourcing of entire processes. This business cannot take place unless solid trust relationships exist with customer companies and employees. UT Group has sufficiently formed trust relationships via its track record in manufacturing dispatch business, supporting high expectations.

**c) Developing business in the lower-priced segment**

UT Group wants to develop business in the lower-priced segment using the technical intern program to introduce overseas personnel and provide related management services. For the time being, it will continue moving forward utilizing human resources from Southeast Asia, including Vietnam.

**d) Expanding engineer dispatch business**

UT Group intends to strengthen training programs and enhance supply capabilities. It will offer diverse paths to becoming IT engineers by hiring new graduates, recruiting non-experienced people and encouraging manufacturing dispatch engineers to make a job change and reinforce its training utilizing UTACC. Additionally, it will review M&A deals as needed in hiring engineering.

We think guidance is conservative and UT Group is capable of realizing the medium-term plan goals explained below because of 1) stronger favorable effects from the Revised Worker Dispatching Law implemented in September 2015 than anticipated, 2) the increase in technology employees by about 4,500 people at the start of the fiscal year and prospect of attaining sales on track with the budget if all of these members are active, 3) vibrant demand in mainstay customer industries, such as new vehicles and next-generation smartphones, and 4) selective acceptance of higher-priced and higher-margin orders.

# Longer-term management strategy

## Aims to expand into a leading company in Japan’s employment service industry by FY3/21

UT Group announced in July 2015 the new Medium-Term Business Plan period covering the five years from FY3/17 to FY3/21. The plan presents a new vision of “creating jobs nationwide in Japan” as a second “founding phase” in line with a group mission of “creating vigorous workplaces empowering workers,” along with goals of 29,000 employees, ¥145,000mn in sales, ¥10,000mn in EBITDA, and ¥8,200mn in operating profit in FY3/21. UT Group aims to become a leading company in Japan’s employment service industry.

While UT Group had committed to “an EPS growth rate of at least 30%” and “total return ratio of at least 50%” in the existing Medium-Term Business Plan, it revised indicators this time based on conducting aggressive M&A to commitments of an EBITDA growth rate of at least 30% (average growth rate for the five-year plan), a total return ratio of at least 30%, and a gross D/E ratio of 1.0 or less (by FY3/21). To achieve these goals, it formulated specific policies and strategies aimed at its two main clienteles - dispatched workers/employees and user companies.

**1. Policy and strategy for employees and job applicants**

UT Group implements a strategy based on themes of reliability, bonding, and empowerment for employees and job applicants. It offers “reliability” by raising its share at customer sites and thereby giving employees a secure job environment. It supports “bonding” by seeking to raise the retention rate with extensive career counseling and other measures and providing work that enables employees to feel connected with peers, the company, and local society via their jobs. It facilitates “empowerment” by supplying an environment that lets employees feel growth through work with a target of lifting the average annual salary by 20% within five years via provision of education and training programs and opportunities.

### 2. Policy and strategy for customer companies

UT Group carries out a strategy for themes of matching, risk management, and assistance in human resource strategy formulation. As "matching," it proposes utilization of human resources that delivers volume, quality, and speed to customer companies by strengthening responsiveness to change and sales capabilities. For "risk management," it complies with the worker dispatch law, Labor Contract Act, and other worker-related laws and reduces risk related to amended laws. UT Group also strives to lower labor management risk and reputation risk at customer companies by ensuring compliance. For "human resource strategy formulation assistance," it is expanding tools, holding seminars, consulting on use of non-regular labor resources, giving proposals for utilization of foreign workers, and broadening the service menu in other ways to discover and resolve issues in human resource utilization at customer sites.

### 3. Medium-term business plan and comparison of results and forecasts

Results in FY3/17, the first fiscal year of the medium-term business plan, were at the upper end of the target range. QT Group presented FY3/18 forecast values at weaker levels than the medium-term plan view. We find this stance conservative as explained in the full-year outlook section and see possible upside and attainment of medium-term plan goals.

**Medium-Term Business Plan**

(¥mn)

| | FY3/16 Results | FY3/17 | | | FY3/18 | | |
|---|---|---|---|---|---|---|---|
| | | Medium-Term Business Plan | Results | Change YoY (%) | Medium-Term Business Plan | Forecast | Change YoY (%) |
| Sales | 44,050 | 45,000~62,000 | 57,588 | 30.7% | 84,000 | 70,000 | 21.6% |
| EBITDA | 2,574 | 2,900~4,000 | 3,652 | 41.9% | 5,300 | 4,380 | 19.9% |
| Operating profit | 2,462 | 2,700~3,500 | 3,413 | 38.7% | 4,400 | 4,200 | 23.0% |
| Net profit attributable to owners of parent | 1,497 | 1,700~2,200 | 2,033 | 35.8% | 2,900 | 2,800 | 37.7% |
| EPS (¥) | 40.40 | 47.00~61.00 | 57.19 | 41.6% | 79.00 | 78.98 | 38.1% |
| Technician and engineering employees (people) | 10,926 | 11,600~14,700 | 15,488 | 41.8% | 18,500 | - | - |

Source: Prepared by FISCO from the Company's Medium-Term Business Plan, financial results and results briefing materials

# Shareholder return policy

## Changed the commitment for the total return ratio to 30% or more from FY3/17

For shareholder returns, UT Group has committed to a total return ratio (the sum of dividends paid and share buybacks as a ratio of consolidated net income; ratio of shareholder returns to net profit) of at least 30% and use of the PEG ratio* value for decisions regarding shareholder returns as its basic policy.

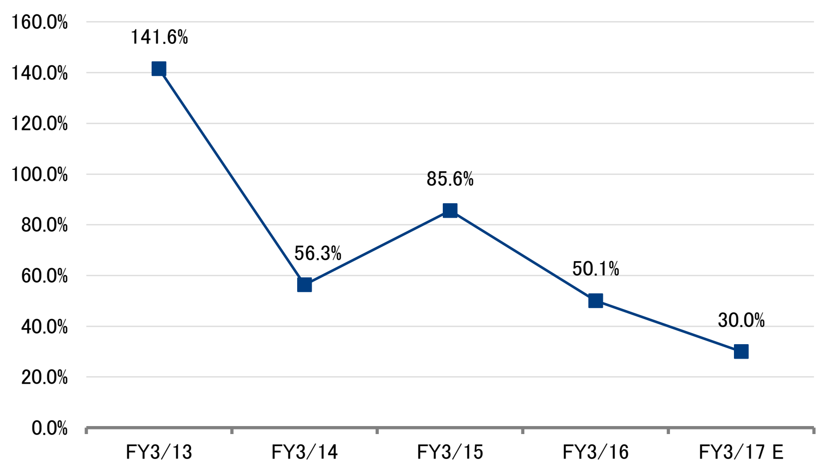
* Price Earnings Growth Ratio = PER ÷ annual EPS growth rate

UT Group comprehensively reaches conclusions on shareholder returns policy in line with the following basic policy stance and also striking balance with investments.

If the PEG ratio is between 1 and 2, management deems that investors are undervaluing the shares and comprehensively considers dividends and share buybacks in this phase. For example, it is implementing share buybacks this fiscal year with shares trading at about 1x, which is considered inexpensive.

If PEG ratio is above 2, management deems that investors are sufficiently assessing the shares at this level and fundamentally relies on dividends. Given this policy, it decided to buy up to 500,000 shares of its own stock (1.42% of outstanding shares excluding treasury shares) with a budget of ¥610mn in FY3/18 (during May 12, 2017 to August 11, 2017). UT Group intends to implement profit allocation with a total return ratio of at least 30% based on a combination of dividends and share buybacks, taking into account earnings and stock market trends, in line with the revised commitment in the new Medium-Term Business Plan.

Total return ratio trend




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

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