COMPANY RESEARCH AND ANALYSIS REPORT

Cross Marketing Group Inc.

3675

TSE Mothers

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FISCO Ltd. Analyst
Kimiteru Miyata

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

Likely shortfall in FY12/17 due to a special factor, though still possesses robust growth potential with healthy core business and advances in building the business foundation

Cross Marketing Group Inc. <3675> can trace its roots to Cross Marketing Inc., an online research company that was founded in April 2003. In May 2006, Cross Marketing entered into a capital and business alliance with EC Navi (currently VOYAGE GROUP, Inc. <3688>). In October 2008, Cross Marketing listed its shares on the Mothers section of the Tokyo Stock Exchange and subsequently broadened the business foundation. It was the latest arrival in the marketing research industry at the time of its founding, but is now one of the top players in the industry. In 2013, a decade after the company's establishment, Cross Marketing converted to a holding company, Cross Marketing Group, in what it refers to as its second founding. The Group has accelerated business expansion with the aim of becoming Asia's No.1 marketing group. While it is likely to miss goals in the current medium-term management plan mainly due to one-time factors, its core business is healthy and development of operations to support a presence as Asia's No.1 firm is steadily advancing. These results should become increasingly apparent.

The Group had originally projected FY12/17 earnings of ¥17,350mn in revenue (+8.6% YoY) and ¥1,382mn in ordinary profit (+9.1%) driven by upbeat trends in domestic research and IT solutions business. However, it lowered the ordinary profit target to ¥1,071mn (-15.5%) at the 2Q FY12/17 announcement. The downward revision primarily stemmed from ¥264mn in amortization of goodwill and a ¥216mn impairment loss related to the additional payment contract for share acquisition because of stronger-than-anticipated earnings at Kadence International Business Research Pte. Ltd. (hereafter Kadence), which it acquired in 2014.

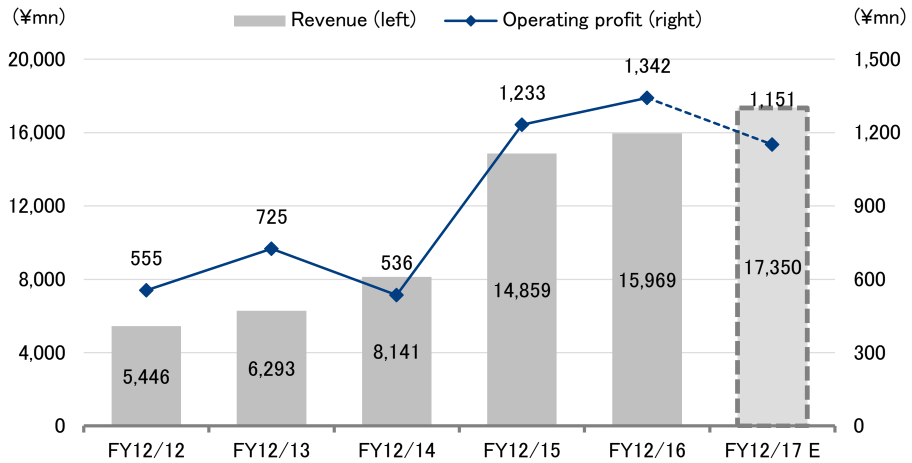
We expect the Group to miss goals from the medium-term business plan of ¥17,985mn in revenue and ¥1,500mn in ordinary profit for FY12/17 because of the downward revision. Nevertheless, core business is upbeat and the Group is aggressively expanding in targeted business fields and areas and building a foundation to support a position as Asia's No.1 player. We hence think it can sustain robust growth potential.

The Group revised its dividend policy from "incrementally raising consolidated dividend payout ratio with a goal of 20%" to "targeting the dividend at a payout ratio of about 15%" in light of its vibrant capital demand, business investment plan, and other factors in FY12/16. While the dividend payout ratio is likely to increase to 50.6% in FY12/17 because of an anticipated net loss, the Group intends to keep the dividend at the period-start estimate of ¥6.5 because the reason for the loss (Kadence) is a one-time factor.

Key Points

- Major marketing research firm rapidly expanding from online research to marketing solutions
- Targeted growth driven by M&A and overseas initiatives, but lowered FY12/17 forecast due to a one-time factor; core business remains healthy
- Steadily building a foundation as Asia's No.1 marketing group and likely to sustain double-digit growth

Results trends



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

Company profile

Aggressively broadening business fields and areas with online research at the core

1. Business overview

The Group's business areas are research, IT solutions, and other businesses. In research, it handles the full range of marketing research, including offline research, with emphasis on core online research. It offers a one-stop service for all types of surveys, including quantitative and qualitative surveys and online and offline surveys. In IT solutions, it plans, develops, and operates mobile systems and dispatches engineers. In other businesses, it conducts web/mobile marketing, UI and UX consulting, and other web marketing as well as promotion business related to marketing assistance. The Group has substantially broadened business scope from marketing research to marketing solutions with online research at the core.

The Group is proactively expanding into new geographical markets with the aim of becoming Asia's No.1 marketing group. At the end of FY12/16, the Group was made up of 5 affiliate companies and 29 group companies including 6 companies in the domestic research business, 19 companies in the overseas research business, 3 companies in the IT solutions business, and one in the other businesses segment. With facilities in Japan and more than 20 offices in 10 other countries in Europe, the Americas, and Asia, it has 758 employees in Japan and 656 overseas.

2. History

The Group can trace its roots to Cross Marketing Inc., an online research company that was founded in April 2003 by Miki Igarashi, the current representative director, president and CEO. In May 2006, Cross Marketing entered into a capital and business alliance with EC Navi (currently VOYAGE GROUP, Inc.: the operator of ad platform and point media businesses). In March 2007, it entered in capital and business alliances with Dentsu Research Inc. (currently DENTSU MACROMILL INSIGHT, INC.) and Research Panel, Inc. In October 2008, Cross Marketing listed its shares on the Mothers section of the Tokyo Stock Exchange and subsequently broadened business from online research to marketing research and marketing solutions. In February 2011, it formed alliance with Rakuten Research, Inc. and others to jointly develop a monitor database. In August 2011, it acquired Index Inc.'s mobile solutions business (currently the IT solutions business). In 2013, a decade after the company's establishment, Cross Marketing converted to a holding company, Cross Marketing Group, in what it refers to as its second founding. The Group is accelerating M&A and new business and overseas initiatives with the aim of becoming Asia's No.1 marketing group.

Major player in the marketing research industry with stable growth

3. Industry environment

Market research is broadly divided into online research and offline research depending on whether it is conducted on the Internet or in the real world. The methods are also separated into panel research and ad hoc research. Panel research collects data from a fixed target group over an extended amount of time periodically and in defined locations. The household survey of 9,000 households conducted by the Ministry of Internal Affairs and Communications is a good example. Ad hoc research, in contrast, is one-off research that designs a questionnaire and other materials each time for a region or target group to fulfill a purpose. While both approaches require considerable time and effort, ad hoc research must be customized in each case and is even more laborious. The market research industry in Japan is steadily growing with increased and more diversified consumption, though offline research has been flat and online research is driving the growth.

Online research expanded along with growing utilization of the Internet from 2000. Key differences with offline research are the short number of days in which survey results can be obtained, easier processing of response data because it is already digitalized, lower costs for printing, mailing, and survey staff, reduction of response gifts, ability to conduct surveys of a few hundred thousand people in a short period, and ability to survey rare targets. Online research excels in speed, cost, and scale, and these attributes have rapidly driven usage.

Three major firms dominate the marketing research industry – Macromill Inc. <3978> (whose fiscal year ends in June), INTAGE HOLDINGS Inc. <4326> (whose fiscal year ends in March), and Cross Marketing Group (whose fiscal year ends in December). Sales in the most recent fiscal years for these firms were ¥35,514mn, ¥31,433mn, and ¥15,959mn respectively.

Growing offline business too by leveraging strength in mainstay online research

4. Research business

(1) Research business

The Group's research business posted ¥13,372mn in revenue (+3.6% YoY) and ¥2,256mn in operating profit (-5.0%) in FY12/16. Revenue consisted of ¥9,213mn from Japan (+10.5%) and ¥4,160mn from overseas (-8.9%), putting the domestic and overseas ratios at 7:3.

Marketing research conducted by the Group adheres to the following steps – 1) speak to the client about the survey background and purpose and prepare the method to achieve the survey goal, 2) support survey form planning and design and confirm the survey form's purpose, 3) handle fieldwork in the various processes to improve quality, 4) implement suitable planning and conduct compilation and analysis, 5) prepare a report with detailed analysis of the survey results, and 6) conduct discussions to lead action for solutions.

Mainstay online research service consists of the following detailed flow. First, 1) receive a research request from the client and develop a questionnaire program that reflects plan content. Host the materials on the questionnaire server. In the survey itself, 2) conduct advance screening to extract registered monitors suited to giving responses, 3) request e-mail distribution of questionnaire notification to affiliate Research Panel Inc. and Research Panel notifies registered monitors and recruits questionnaire respondents from registered monitors, and 4) pay an honorarium (operating company points) to registered monitors who respond to the questionnaire via Research Panel and the questionnaire survey finishes after collecting required sample volume. 5) Data cleaning is implemented with a system check and then visual checking by dedicated staff to remove contradictory or improper replies. After the survey, 6) results are compiled and delivered to the customer and various statistical analysis reports may be prepared if requested by the client. Finally, 7) pay Research Panel for use of its registered monitors.

Main services in the research business

Research type	Research method	Service content
Quantitative research	Online research	Original questionnaire program that meets customer needs is created on the Internet and registered monitors fill out the questionnaire
	Mailing research	Questionnaires are mailed to research participants and then collected. Results are compiled and analyzed.
	Phone research	Research staff interview research participants by phone and questionnaire results are compiled and analyzed
	CLT research	Research participants gather at a designated venue for questionnaire and interview surveys. Results are compiled and analyzed. People walking in the area by the venue are selected as participants in some cases.
	Mobile research	Original questionnaire program that meets customer needs is created on the mobile Internet and registered monitors fill out the questionnaire
	Home use test	Send products to the research participant's home to obtain product evaluation in a questionnaire after test use or tasting. Involve product delivery, questionnaire collection, and compilation and analysis of results.
Qualitative research	Focus group interview	Gather at group (normally 5-8 people) and conduct an interview of research participants by a moderator in a panel discussion format
	In-depth interview	One-to-one interview of research participants by a moderator
	Home visit	Visit research participants at home or work to conduct questionnaires and interviews
	Shop along	Accompany research participants on shopping trips to conduct questionnaires and interviews
	Eye-tracking survey	Measure "view movement" by research participants using a special eye-tracking system
Others	Overseas survey	Surveys in 85 countries – mainly developed countries (US and Europe), BRICS, Southeast Asia, and Oceania
	ID – POS data	Various types of research using ID-attached POS data at supermarkets, drugstores, and convenience stores

Source: Prepared by FISCO from the Company's securities report

(2) Registered monitors

Quality and quantity of registered monitors is the most important factor for the Group's business. For quantity, it has a very large number of active registered monitors at 1.44mn people. Monitor registration by VOYAGE GROUP encourages members of EC Navi, VOYAGE GROUP's comprehensive online shopping site, to register at Research Panel. In addition, the Group has an agreement with Credit Saison Co., Ltd. wherein Credit Saison members who wish to participate in surveys are recruited through a service operated by Research Panel called Eikyufumetsu Research. Registered monitors are recruited from VOYAGE GROUP, Credit Saison, and other membership sites and managed by affiliated Research Panel. The Group has also built a network for mutual use of registered monitors with other online research firms. This arrangement provides access to 2.31mn active registered monitors. The Group's accessible active registered monitors hence amount to 3.75mn people, an extremely large number.

For quality, Research Panel annually updates member registered information to ensure data reliability and constantly keeps the latest information on basic attributes related to registered monitors. It also checks the content of survey responses for individual registered monitors and actively manages the quality of registered monitors, such as eliminating registration in the case of inappropriate responses. Additionally, it extracts registered monitors for specific features, such as consumer goods ownership and assets, and places them in categories (car owner, mobile phone owner, asset owner, etc.). This method facilitates highly accurate and effective surveys without having to define survey conditions each time. Skepticism about reliability in the industry's early years has almost entirely disappeared now thanks to cumulative efforts with these measures.

(3) Coverage ranges from online research to marketing research

The Group steadily broadened business scope from Internet to offline research leveraging online research knowhow and infrastructure explained above. Offline research offers quantitative surveys using questionnaires and interviews with research participants gathered at a venue and qualitative surveys via interviews of research participants in a panel discussion format. Furthermore, the Group supplies various research services that combine IT technology with existing survey methods. These capabilities have enabled it to build an extensive track record in a broad range of industries, including food products, beverages, cosmetics, pharmaceuticals, automotive, research firms, advertising and mass media, financial and insurance services, wholesale and retail, and services. The Group can also accommodate various themes, such as consumer activity, concept tests, product evaluation, packaging tests, advertising effect measurement, advertising evaluation, usage patterns, commercial zones and areas, brand evaluation, and customer satisfaction (CS).

Industry examples

Industry	Examples
Food and soft drink manufacturers	Concept acceptability survey for a new flavor, new product tasting evaluation survey
Chemicals, textiles, pharmaceuticals, and cosmetics manufacturers	Fashion brand recognition survey, skincare cosmetic naming survey
Automakers	Automotive purchasing behavior survey and customer satisfaction benchmark survey
Financial, insurance, and securities	Credit card usage survey and website usability survey
Research companies and institutions	Worker awareness survey, senior PC usage survey
Advertising agencies	New product notification commercial effect measurement survey, media contact questionnaire survey

Source: Prepared by FISCO from the Company's securities report

Few companies offer integrated service through marketing solutions

5. IT solutions business and other businesses

(1) IT solutions business

The IT solutions business booked ¥1,907mn in net sales (+11.9% YoY) and ¥175mn in operating profit (-8.8%) in FY12/16. The Group delivers one-stop service of all functions required in mobile and smartphone services from marketing to planning, development, operation, and promotion. Specifically, it handles website construction, smartphone app development, tool and package provision, surveys and analysis, operation outsourcing, construction and operation of infrastructure and server, web promotions, and security measures.

The Group has experience building and operating systems for financial institution apps and settlement and point management that require robust performance, large-scale systems with a million members, and other systems. It also conducts development to support the latest features in steadily advancing mobile equipment. Furthermore, it is capable of linking a smooth PDCA cycle to results aided by research and analysis that leverages the strength of having a marketing research company in the group.

Main services in the IT solutions business

Service	Content
Website (PC /smartphone) construction	Services ranging from site strategy proposals to system development, site design, and maintenance and operation
Smartphone app development	Planning and development of iPhone and Android native apps supporting a broad array of applications from entertainment to business
Tool and package supply	Provision of various tools and packages to support web strategies that meet customer needs
Research and analysis	Hypothesis assessment and improvement proposals based on website research and analysis that aims to contribute to enhanced customer KPI
Operation outsourcing	Consignments of website operations, such as content updates, email magazine distribution, user support, and site inspection
Infrastructure and server construction and operation	Construction, operation, and hosting of an infrastructure environment that supports large-scale, concentrated access
Web promotion	Provision of optimal promotion measures for purpose (customer draw and member acquisition) and platform attributes
Security measures	Comprehensive security measures for site operation, such as personal information protection and site vulnerability checks

Source: Prepared by FISCO from the Company's securities report

(2) Other businesses

Other businesses reported ¥690mn in revenue (+172.4% YoY) and ¥74mn in operating profit (vs. a ¥56mn operating loss) in FY12/16. This segment covers web marketing business and promotions business. Web marketing service analyzes web and smartphone site UI/UX utilizing the USERDRIVE site analysis tool that provides visualization through bitmap images and video of activity by users visiting the website and offers consulting for improvements. Promotions business delivers promotions and other marketing assistance services.

Business model

Positive stance of business field and area expansion responsible for low profit margin

1. Earnings structure

In the income breakdown, survey form and other material production and researchers who handle proposals and analysis are booked as production costs, and sales and headquarters (common areas) come under SG&A expenses. The Group can boost sales and gross profit by raising productivity with an effective balance of skills and people in production and accumulation of knowhow and human resources in researchers. For sales, meanwhile, having more staff lifts orders. Indirect costs should be tailored to the corporate scale.

Comparison of recent operating margins among major industry firms shows Macromill at 19.2%, INTAGE at 8.9%, and Cross Marketing Group at 8.4%. Macromill is highly efficient because of the large percentage of online research. INTAGE has lower profit margin than Macromill because it mainly conducts offline and panel research. Cross Marketing Group, meanwhile, should generate operating margin close to Macromill because it started as an online research specialist, but is actually around the INTAGE level. We attribute lower margin to shrinkage in the online research ratio of overall business due to broadening of scope to cover from the full range of marketing research to marketing solutions and modest cost build-up because of overlapping functions amid rapid advances in M&A, new business development, and overseas initiatives in recent years. While the former change is unavoidable, it might be the right timing to assess operations and pursue synergies and profits for the latter. We believe the Group has a similar view.

Looking at financial indicators, ROA and ROE, which depict asset profitability, have been improving since the bottom in FY12/14. While ROE recovered in this period (five fiscal years), the same is not true for ROA. ROE benefited from leverage. ROA, however, has not recovered in terms of operating margin and total asset turnover. Lack of rebound in these values stems from heavy SG&A expenses and insufficient sales relative to increase in goodwill and other fixed costs. The Group does not require immediate reforms or improvements because of its robust stability and excess income. However, it might be better to take a more cautious stance toward forward-looking investments that involve fixed costs and other spending.

Financial indicators

(%, times, ¥mn)

		FY12/12	FY12/13	FY12/14	FY12/15	FY12/16
1-1.	ROA	18.7	20.4	8.9	13.8	13.5
2.	Operating margin	10.2	11.5	6.5	8.3	8.4
3.	Total asset turnover rate	1.8	1.8	1.4	1.7	1.6
2-1.	ROE	16.5	19.6	9.6	17.6	20.5
2.	Net margin	5.7	7.0	3.0	3.8	5.2
3.	Total asset turnover rate	1.8	1.8	1.4	1.7	1.6
4.	Leverage	1.6	1.6	2.3	2.8	2.4
3-1.	Net margin	5.7	7.0	3.0	3.8	5.2
2.	Gross margin	36.8	40.2	31.2	42.5	40.9
3.	SG&A expenses ratio	26.6	28.6	31.2	34.2	32.5
4.	Operating margin	10.2	11.5	6.5	8.3	8.4
5.	Financial income ratio	0.0	-0.0	-0.1	-0.1	-0.2
6.	Pretax margin	10.6	11.8	6.2	7.7	8.7
7.	Tax rate	45.2	39.2	40.0	50.0	41.0
4-1.	Gross capital turnover rate	1.84	1.77	1.37	1.67	1.60
2.	Financial asset turnover rate	2.23	2.23	2.12	2.57	2.27
3.	Investment asset turnover rate	129.92	100.36	35.09	43.41	45.82
4.	Equipment asset turnover rate	11.40	9.37	4.36	5.33	6.24
6-1.	Sales growth	23.1	15.6	29.4	82.5	7.5
2.	Operating profit growth	27.3	30.8	-27.5	134.3	8.9
3.	Total asset growth	9.1	29.9	96.2	26.7	-0.4
4.	Shareholders' equity growth	10.4	23.8	7.1	40.4	19.8
7-1.	Shareholders' equity ratio	64.7	61.6	33.6	37.3	44.8
2.	Quick assets ratio	193.1	152.2	73.8	131.5	150.0
3.	Current ratio	207.8	172.4	95.9	157.0	177.4
4.	Fixed ratio	52.1	62.0	140.1	95.5	75.9
5.	Interest-bearing debt reliance	4.2	3.4	33.9	28.5	24.2
6.	Turnover difference funds	-518	-796	-902	-1,945	-2,188
7.	Net working capital	559	880	1,282	2,250	2,580
8.	Surplus liquidity	962	779	1,407	2,384	2,160
9.	Net cash	831	645	-1,264	-453	-245
10.	Interest coverage ratio	168.2	344.0	77.8	47.0	40.5

Note: Asset profitability is calculated by dividing assets by the period-end average. Equipment assets = fixed assets, Financial assets = Total assets – inventory assets – equipment assets
Source: Prepared by FISCO from the Company's financial results

Strengths are online research quality and integrated services through marketing solutions

2. Strengths and weaknesses

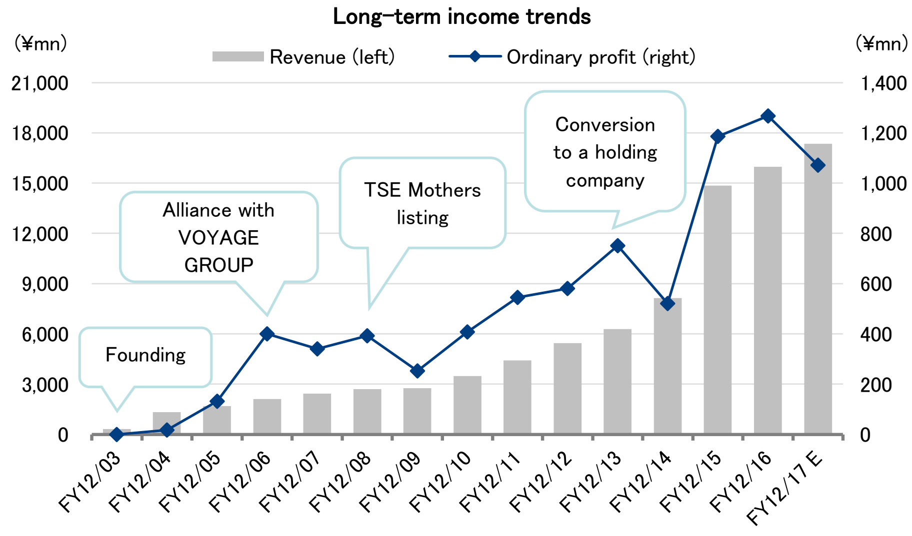
Key features of the Group's research are support operations in which sales staff, researchers, directors, and others who interact with customers resolve issues in a unified manner, screen development that takes into account lightening response burden and distribution settings for suitable target selection, high quality with highly accurate data cleaning, quick response with screen formulation, distribution, and data delivery using a high-performance questionnaire system, top-level registered monitor numbers for Japan, and surveys that address rare groups (rather than just basic attributes).

While services do not vary much among competitors, we think above-mentioned features plus experience of researchers to provide suitable proposals and designs to issues and proposals of total marketing solutions using group IT solution functions offer differentiation to customers.

Weaknesses (or challenges), meanwhile, are difficulty improving profit margin because of growth in labor-intensive services with the increase in offline research, positioning as a newcomer (partly due to the TSE Mothers listing), and especially low overseas recognition. We expect progress in dealing with domestic issues over time. On the overseas front, the Group aims to raise recognition through brand integration to Kadence, which was acquired in 2014.

Turning points – Alliance with VOYAGE, Mothers listing, and conversion to a holding company

3. Turning points



Source: Prepared by FISCO from the Company's materials

Cross Marketing was founded relatively late in 2003 and was viewed as the latest arrival in the online research industry at the time. However, it has successfully grown into a company that leads the marketing research industry.

The first turning point was the business and capital alliance with VOYAGE GROUP (then EC Navi) in 2006. Cross Marketing invested in Research Panel, which was part of VOYAGE GROUP, and thereby obtained access to its large monitor base of 700,000 people (at the time). This event served as a catalyst for alliances with top-class research firms Dentsu Research (currently DENTSU MACROMILL INSIGHT) and Research Panel and significant expansion of business scope. Dentsu Research was a peer, but lacked an online research capability then and wanted to utilize the Group's services in a complementary manner. This relationship brought "indirect sales." The Group relied on "indirect sales" as an important growth driver in the initial phase amid limited interest from other firms in such business.

The TSE Mothers IPO listing in 2008 was the second major turning point. Cross Marketing received requests for a wide range of research after obtaining funds and increased recognition through the listing. It aggressively pursued "direct sales" after the IPO in part because of the small scale of the online research market. Rapid expansion of business scope required retention of multifaceted, diverse, and a large number of monitors and customization of research designs. For the former, Cross Marketing arranged business alliances with peers that possessed large-scale monitor groups, such as Rakuten Research and NetMile Incorporated, and secured access to industry-leading monitor volume via mutual utilization of monitors. This enabled Cross Marketing to handle surveys requiring very large sample volume and rare surveys, fueling further growth. For the latter, it developed pyxis2, which facilitates creation and customization of questionnaire screens without expert knowledge, and built an operation center at a remote site to control costs. These efforts reduced costs and provided customers with easy-to-use tools.

The third turning point was the switch to a holding company in 2013. M&A and overseas initiatives accelerated under this format. However, while this was an important step in broadening business scope, it also added more factors that affect earnings, such as forex impact. Newcomer firms, particularly in the IT industry, accumulate subsidiaries via M&A and other activities in some cases. This raises issues related to retaining the subsidiary or absorbing it internally as well as management structures and governance. But this turning point was vital in order to achieve breakthroughs for the next growth phase. While Cross Marketing has successfully dealt with various matters at each of the turning points thus far, the main challenge is improving business efficiency and establishing effective management operations and governance in response to the increase in subsidiaries.

Business trends

Kadence extraordinary costs and losses weighed on 1H FY12/17 results

1. 1H FY12/17 results

The Group reported 1H FY12/17 results with ¥8,141mn in revenue (+11.5% YoY), ¥411mn in operating profit (-4.1%), ¥340mn in ordinary profit (-7.8%), and a ¥184mn net loss attributable to owners of parent (vs. a ¥141mn profit in the previous year). We think core business was generally upbeat.

The research business posted ¥6,916mn in net sales (+12.8%) and ¥1,041mn in operating profit (+8.5%). Revenue breakdown indicates ¥4,448mn (+3.1%) in domestic research and ¥2,468mn (+36.0%) in overseas research. Domestic sales remained healthy primarily at mainstay Cross Marketing. Overseas growth leaders were the UK operation that booked a major order as well as upbeat trends at operations in the US and Indonesia. Operating profit strengthened on improved productivity in Japan and higher sales in overseas business. Also, Shopper's Eye Inc., which was added to consolidated results in 3Q FY12/16, is fully contributing to income in FY12/17.

The IT solutions business booked ¥1,011mn in revenue (+1.0% YoY) and ¥65mn in operating profit (+24.6%). Aggressive sales efforts at Cross Propworks Inc., an outsourcing services firm, Cross J Tech Inc., an engineer dispatching services firm, and Cross Communication Inc., a mobile website services firm, steadily increased orders. This segment generated higher operating profit even with ramp-up of hiring aimed at growth over the medium term.

Other businesses reported ¥297mn in revenue (+4.5% YoY) and ¥32mn in operating profit (+122%). D&M, Inc., which handles promotions business, continued upbeat growth with enhanced recruitment of new customers. UNCOVER TRUTH Inc., which runs the web marketing business from 3Q FY12/16, changed from being a consolidated subsidiary to an equity-method affiliate.

1H FY12/17 results

(¥mn)

	FY12/16			FY12/17			
	1H	Ratio	Progress	1H	Ratio	Change	Progress
Revenue	7,299	100.0%	45.7%	8,141	100.0%	11.5%	46.9%
Gross profit	2,907	39.8%	44.5%	3,394	41.7%	16.7%	-
SG&A	2,479	34.0%	47.7%	2,982	36.6%	20.3%	-
Operating profit	429	5.9%	32.0%	411	5.0%	-4.1%	35.7%
Ordinary profit	369	5.0%	29.1%	340	4.2%	-7.8%	31.7%
Net profit attributable to owners of parent	141	1.9%	16.8%	-184	-2.3%	-	-73.4%

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

FY12/17 revenue by business segment

(¥mn)

1Q	FY12/16	(Ratio)	FY12/17	(Ratio)	Change
Research	3,310	85.4%	3,772	87.4%	13.9%
IT solutions	498	12.8%	484	11.2%	-2.6%
Other	137	3.5%	159	3.7%	16.5%
Adjustment	-70	-1.8%	-101	-2.4%	45.8%
Total	3,875	100.0%	4,314	100.0%	11.3%

2Q	FY12/16	(Ratio)	FY12/17	(Ratio)	(Change rate)
Research	2,825	82.5%	3,261	85.2%	15.4%
IT solutions	504	14.7%	527	13.8%	4.5%
Other	150	4.4%	166	4.3%	10.3%
Adjustment	-55	-1.6%	-127	-3.3%	128.9%
Total	3,424	100.0%	3,827	100.0%	11.8%

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

FY12/17 profit by business segment

(¥mn)

1Q	FY12/16	(Margin)	FY12/17	(Margin)	Change
Research	582	17.6%	871	23.1%	49.7%
IT solutions	29	5.8%	28	5.9%	-2.1%
Other	24	17.8%	31	19.4%	27.2%
Adjustment	-276	-	-342	-	24.1%
Total	359	9.3%	588	13.6%	63.7%

2Q	FY12/16	(Margin)	FY12/17	(Margin)	Change
Research	378	13.4%	170	5.2%	-55.0%
IT solutions	23	4.6%	37	7.0%	57.8%
Other	-10	-6.6%	1	0.7%	-112.0%
Adjustment	-322	-	-385	-	19.6%
Total	70	2.0%	-177	-4.6%	-

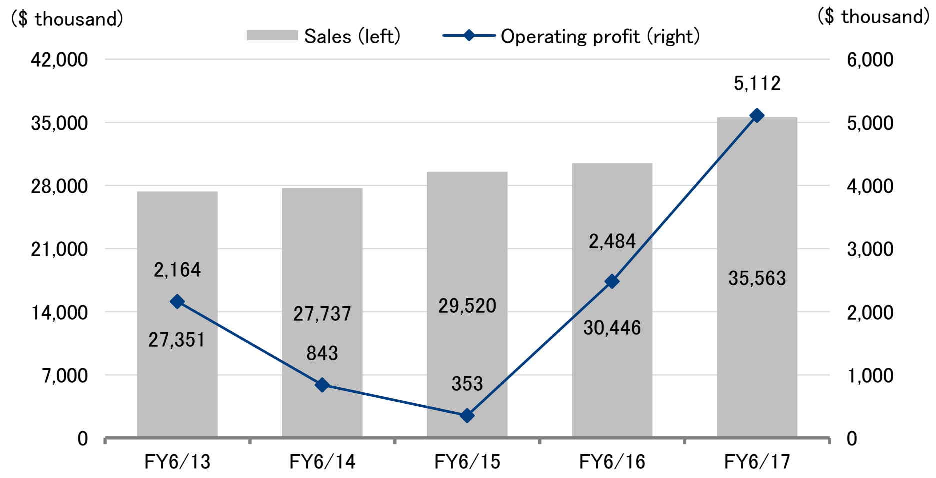
Source: Prepared by FISCO from the Company's financial results and other materials

While core business is generally upbeat, the Group missed targets of ¥8,307mn in revenue, ¥566mn in operating profit, ¥557mn in ordinary profit, and ¥311mn in net profit attributable to owners of parent.

The main reason for the shortfall was an extra payment based on an earn-out clause in the purchase contract for Kadence shares. This contract linked the final purchase price to earnings for three fiscal years (FY6/15-17). The Group made an initial payment of $14mn and agreed to an extra amount tied to subsequent earnings that could be as low as zero and up to $15mn. Recent recovery in economic conditions and enhanced sales activities fueled robust earnings in Kadence's third year with the Group, and this resulted in an extra payment of $10mn. We think there might have been some room for negotiation, but the Group appears to have given priority to management speed. The contract included this special clause to prevent a mismatch of a confident seller seeking a high price (former Kadence owner) and a buyer interested in an attractive price considering risk (Cross Marketing Group).

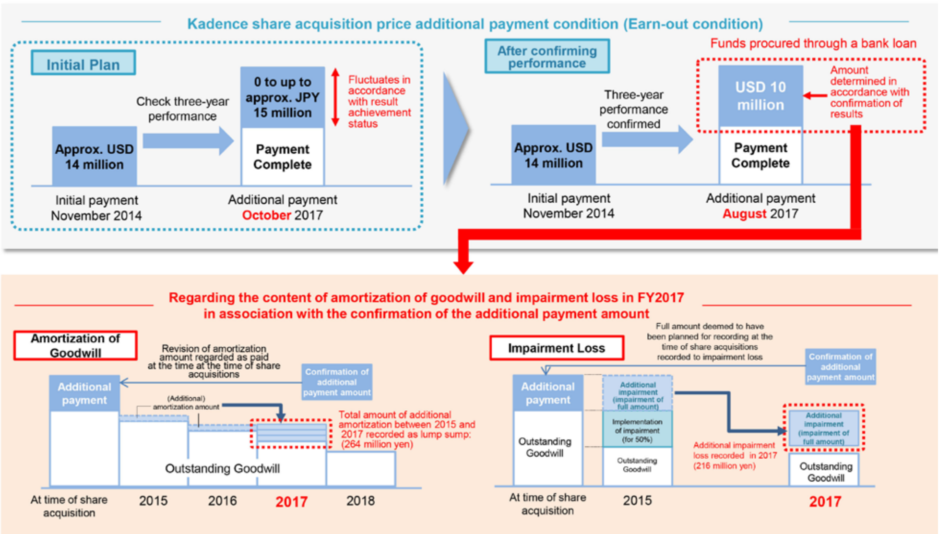
Strong earnings improvement in Kadence's third year forced retroactive recalculation of the share purchase because of the impact of the additional payment. Extra amortization of goodwill occurred for each period since the purchase, and the Group allocated goodwill collectively for the three years totaling ¥264mn in FY12/17. Impairment losses, meanwhile, stem from goodwill for sites that booked impairment losses during the same period (Indonesia and Vietnam). The Group booked ¥216mn in extraordinary losses to cover the full value of additional impairment losses in FY12/17.

Trends in Kadence Group results



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

Contract content and background to the extra charges



Source: The Company's results briefing materials

Compared to 1H forecast, domestic research missed by ¥523mn in revenue and ¥253mn in gross profit because of delayed budget utilization at some major customers, while overseas research overshot by ¥379mn in sales and ¥142mn in gross profit thanks to a large deal in the UK and more improvement than expected in Indonesian and Vietnamese businesses. IT solutions posted upbeat orders, but encountered shortfalls of ¥82mn in sales because of delays in some deliveries to 2H or later, similar to domestic research. Combined gross profit for IT solutions and other businesses missed by ¥36mn. Nevertheless, cost control provided ¥211mn in savings and operating profit totaled ¥631mn, beating the period-start target (¥566mn) by ¥65mn.

Actual operating profit, however, was ¥411mn, missing by ¥155mn, owing to ¥220mn in amortization of goodwill for the extra acquisition payment. Furthermore, net income missed the period-start target (¥311mn profit) by ¥495mn at a ¥184mn loss because of the ¥216mn in impairment losses from the extra payment and ¥62mn in new impairment losses due to weakness at Kadence Hong Kong.

Kadence-related additional depreciation costs and impairment losses affect the fiscal situation too

2. Fiscal situation

Looking at the fiscal situation in 2Q FY12/17, the Group reported ¥10,142mn in total assets (+¥210mn vs. end-FY12/16) with ¥6,238mn in current assets (-¥319mn), which mainly consisted of ¥2,714mn in cash and deposits and ¥2,603mn in notes and accounts receivable-trade, and ¥3,904mn in non-current assets (+¥529mn), which primarily included ¥277mn in property, plant and equipment, ¥224mn in software, ¥2,206mn in goodwill, and ¥548mn in deposits. While goodwill increased ¥502mn versus end-FY12/16, the source was the additional payment for Kadence. Cash and deposits rose by ¥554mn owing to expansion of operating cash flow on upbeat core business.

In liabilities, current liabilities totaled ¥4,426mn (+¥729mn), which mainly consists of ¥1,241mn in accounts payable – trade and ¥1,448mn in unpaid amounts, and non-current liabilities stood at ¥1,549mn (-¥213mn), which primarily covers ¥1,298mn in long-term loans payable and ¥118mn in asset disposal debts. The Group reduced short-term and long-term loans by ¥422mn because of repayments supported by robust operating cash flow. The ¥989mn rise in unpaid amounts occurred due to not having made the Kadence-related extra payment as of end-2Q.

Net assets declined ¥307mn to ¥4,167mn based on these changes. Legal retained earnings dropped ¥243mn to ¥3,066mn as a result of the ¥184mn net loss attributable to owners of parent in 2Q FY12/17.

Simplified balance sheet

(¥mn)

	FY12/16	FY12/17 1H	Change
Current assets	6,557	6,238	-319
Cash and deposits	2,160	2,714	554
Notes and accounts receivable-trade	3,386	2,603	-782
Non-current assets	3,375	3,904	529
Property, plant and equipment	457	440	-17
Goodwill	1,703	2,206	502
Affiliate company shares	227	182	-45
Total assets	9,932	10,142	210
Current liabilities	3,697	4,426	729
Accounts payable – trade	1,198	1,241	43
Short-term payable and other short-term borrowings	895	686	-209
Unpaid amounts	459	1,448	989
Non-current liabilities	1,762	1,549	-213
Long-term loans payable	1,510	1,298	-213
Total liabilities	5,459	5,976	517
Net assets	4,474	4,167	-307
Legal retained earnings	3,309	3,066	-243

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

2H FY12/17 as the timing to restart growth

3. FY12/17 outlook

For FY12/17, the Group expects ¥17,350mn in revenue (+8.6% YoY), ¥1,151mn in operating profit (-14.2%), ¥1,071mn in ordinary profit (-15.5%), and ¥251mn in net profit attributable to owners of parent (-70.0%). By segment, it forecasts revenue at ¥9,890mn in domestic research (+7.3%), ¥4,715mn in overseas research (+13.3%), ¥2,055mn in IT solutions, and ¥690mn in other businesses (+0.1%).

While the Group retained the FY12/17 revenue target, it lowered operating profit by ¥249mn, ordinary profit by ¥311mn, and net profit by ¥574mn. These adjustment factors in delayed income until 2H or later because of slower budget utilization at some major customers in 1H, advances in hiring that had been behind schedule, and the extra payment for the Kadence purchase.

The new outlook adopts targets that require some effort given 1H momentum. However, we think the Group is capable of reaching updated guidance in light of upbeat trends in research and IT solutions, OP from actual business exceeding forecast in 1H, the prospect of improved gross margin due to higher productivity in domestic research and gross profit from increased revenue in overseas research, and the absence of deals with a possibility of extra payments along the lines of Kadence. We will be looking for progress toward the next phase of growth.

Forecasts for FY12/17

(¥mn)

	FY12/16			FY12/17		
	Result	Ratio to sales	Change rate	Forecast	Ratio to sales	Change rate
Revenue	15,969	100.0%	7.5%	17,350	100.0%	8.6%
Operating profit	1,342	8.4%	8.9%	1,151	6.6%	-14.2%
Ordinary profit	1,267	7.9%	6.9%	1,071	6.2%	-15.5%
Net profit	837	5.2%	49.8%	251	1.4%	-70.0%

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

Segment forecasts for FY12/17

(¥mn)

	FY12/16			FY12/17		
	Results	Ratio to sales	Change rate	Forecast	Ratio to sales	Change rate
Research	13,372	83.7%	3.6%	14,605	84.2%	9.2%
IT solutions	1,907	11.9%	11.9%	2,055	11.8%	7.8%
Other	690	4.3%	172.4%	690	4.0%	0.1%
Total	15,969	100.0%	7.5%	17,350	100.0%	8.6%

Source: Prepared by FISCO from the Company's materials

Medium-term management plan

Aiming to become the No.1 marketing group in Asia with aggressive expansion and high value-added services

1. Medium-term management plan approach

Since its founding, the Group has developed various marketing research services with the aim of giving customers information needed to make decisions. It continues to bolster mainstay marketing research and is also pursuing opportunities in mobile and smartphone fields, the promotions field, and overseas markets (particularly Asia).

The Group is currently implementing a medium-term business plan that seeks to aggressively expand business fields and areas aimed at further broadening its scope. It is accelerating various initiatives as a group because of the prospect of steady implementation leading to new value creation for the group.

In domestic research, it is targeting steady growth through utilization of the latest technologies mainly in core online research. It is building operations to deliver one-stop access to all services related to marketing research and pursuing provision of higher value-added services, such as comprehensive proposals and planning, as a marketing research partner. In overseas research, it is assembling a network that covers all of Asia and promoting support for overseas initiatives by Japanese and US/European global firms.

In IT solutions, it hopes to realize steady growth in existing businesses and invest in new services. It is boosting development, production, and operation of application and pursuing aggressive sales efforts to new and existing customers amid the market's shift to smartphones. In other businesses, D&M aims to provide cutting-edge marketing services that utilize consumer data.

The Group aims to become Asia's No.1 marketing group with comprehensive capabilities in all businesses and the Kadence acquisition in November 2014.

Likely to miss goals from the current medium-term plan, though content is positive

2. Review of the FY12/15-17 medium-term management plan

The medium-term business plan announced in 2014 called for ¥17,895mn in revenue and ¥1,500mn in ordinary profit in FY12/17. However, the Group already started final-year FY12/17 with targets below these levels at ¥17,350mn in revenue and ¥1,400mn in ordinary profit and then further reduced ordinary profit to ¥1,071mn because of the occurrence during this fiscal year of special amortization of goodwill and impairment related to Kadence.

Profit from actual business, meanwhile, should be very close to the medium-term plan goal. We think this is progress on track with the plan. Furthermore, the Group is aggressively expanding its business fields and areas and building the foundation to become Asia's No.1 firm as it intended. These aspects indicate that main business growth is continuing.

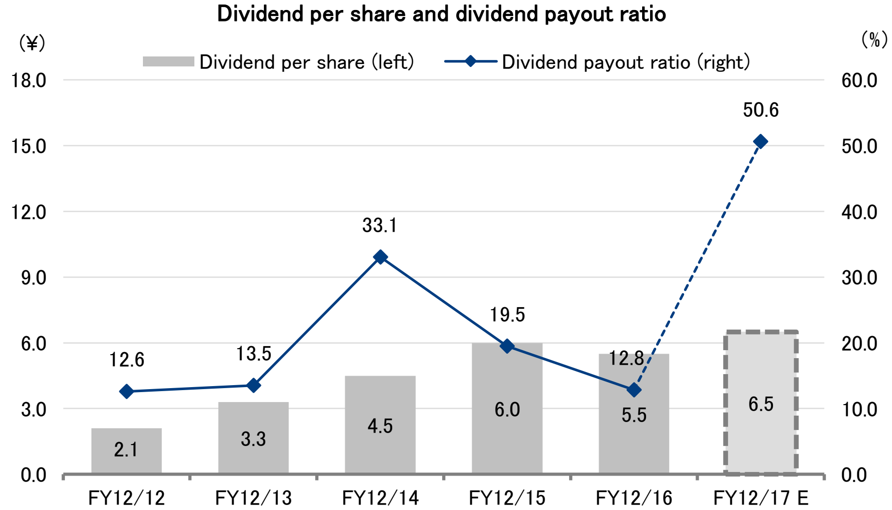
Some concerns exist as well. One is overly rapid expansion via M&A deals and new business and overseas initiatives during the turning point of conversion to a holding company in 2013. Given this situation, we will be looking for improved efficiency by raising productivity by reorganizing overlap while still broadening scope in Japan. Meanwhile, the impact on the overseas business from the extra payment to purchase Kadence shares in 2Q FY12/17 was enough to create a negative surprise for investors. However, earnings have improved in this business and the issue that hurt overall earnings was simply the contract. The fundamentals picture is positive. The Group needs to continue the upbeat trend and executives are tightening the grip on this operation.

Domestic businesses are healthy and still have room for better productivity. Kadence profits are rising in overseas markets. The Group is making advances in marketing solutions and establishment of a base to become Asia's No.1 firm. We believe the Group can continue to pursue double-digit growth over the medium term in light of these trends.

Shareholder return policy

The Group revised its dividend policy from "incrementally raising consolidated dividend payout ratio with a goal of 20%" to "targeting the dividend at a payout ratio of about 15%" of business profit excluding extraordinary income/loss in light of its vibrant capital demand, business investment plan, and other factors in FY12/16. This policy resulted in a dividend reduction in FY12/16. While the dividend payout ratio is likely to increase to 50.6% in FY12/17, the Group intends to keep the dividend at the period-start estimate of ¥6.5 (¥3.25 interim dividend) because the reason for the loss (extra payment from the contract with Kadence) is a one-time factor and actual business earnings beat the period-start view. The Group does not have a shareholder gift program.

Dividend per share and dividend payout ratio



* The Group conducted a 2-for-1 stock split on February 18, 2013, and a 3-for-1 stock split on June 1, 2014. Dividends per share for prior years are adjusted for these stock splits retrospectively.
Source: Prepared by FISCO from the Company's financial results

Disclaimer