COMPANY RESEARCH AND ANALYSIS REPORT

Cross Marketing Group Inc.

3675

TSE Mothers

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Index

Summary

Business expansion drives continued top-line growth in FY12/17, but one-time costs weigh down operating profit

Cross Marketing Group Inc. <3675> is comprised of three businesses: research, IT solutions, and other businesses. The mainstay research business offers a one-stop service for various marketing research services based primarily on online research. The IT solutions business does mobile system planning, development, and operations, and also dispatches engineering personnel. Under other businesses, the Group runs a promotion services business to provide marketing support. Despite being a late-comer to the industry when it was founded in 2003, Cross Marketing Inc. has since become one of the largest companies in the marketing research industry. In 2013, as it approached the 10-year anniversary of its founding, the Group undertook what it called a “second founding” by reorganizing as a holding company; it is currently active in M&A and is also expanding overseas.

The Group’s mainstay research business is distinguished by a support structure in which sales staff, researchers, directors, and all other personnel who interact with clients work to resolve issues in a unified manner. Further distinguishing the Group from competitors is the experience of its researchers in providing the right proposals and plans to address the client’s situation, and its ability to offer a one-stop, comprehensive marketing solutions service that makes use of the Group’s IT solutions capabilities. The Group is also highly regarded for its marketing research process, which features the largest number of registered monitors in Japan, screen design that makes it easier for respondents to answer questions, and delivery options to achieve accurate target selection.

Over the years, the Group has come to a number of major turning points that have served as springboards for growth. The first turning point was its business and capital alliance with VOYAGE GROUP Inc. (then known as EC Navi) in 2006. Through this alliance, it gained access to VOYAGE GROUP’s large monitor base of 700,000+ people (at that time), while it also was able to establish partnerships with top-class marketing research companies. The second major turning point was its listing on the Mothers Section of the Tokyo Stock Exchange in 2008. By increasing its capital base and its name recognition, the stock exchange listing facilitated the rapid expansion of the scope of the Group’s business and led to business alliances with major research companies that, because it included reciprocal-use of each other’s monitors, gave the Group the largest monitor base in the industry. The Group is now at its third major turning point. Since switching to a holding company structure in 2013, the Group has been able to accelerate M&A activity and overseas expansion efforts and aims to use this as its springboard to become the top marketing group in Asia.

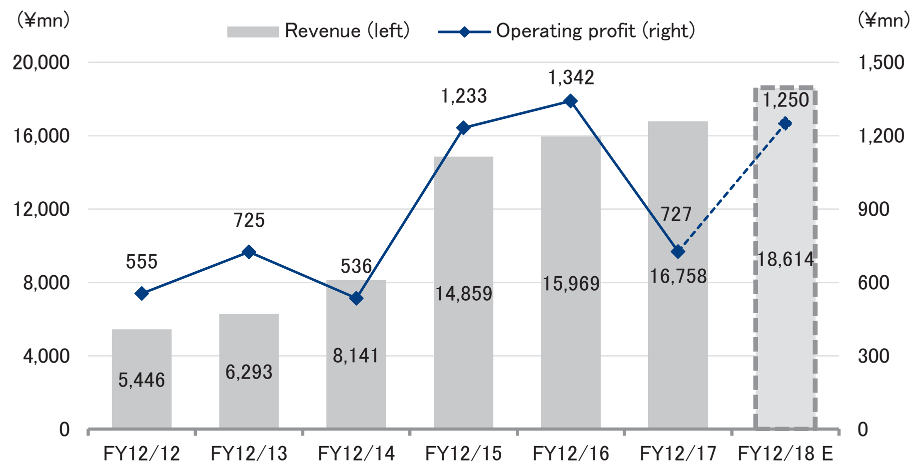
For FY12/17, the Group reported revenue of ¥16,758mn (+4.9% year on year (YoY)), operating profit of ¥727mn (-45.9%), ordinary profit of ¥597mn (-52.9%), and net loss attributable to owners of parent of ¥703mn (versus a profit of ¥837mn for the previous year). Aided by a favorable operating environment characterized by rising and more diverse consumption spending and good corporate earnings, the Group logged solid top-line growth. Operating profit and ordinary profit were down, however, hurt by lagging productivity as overtime work was restricted and one-time charges for goodwill amortization and impairment losses, and a net loss attributable to owners of parent was recorded. The Group’s proactive stance on M&A largely contributed to costs during the year as growth seemed to reach a temporary plateau. We would note, however, that even though a net loss was reported for the period the Group maintained its dividend per share under its policy of maintaining stable returns to shareholders.

For FY12/18, the Group is forecasting revenue of ¥18,614mn (+11.1% YoY), operating profit of ¥1,250mn (+72.1%), ordinary profit of ¥1,172mn (+95.6%), and net profit attributable to owners of parent of ¥600mn (versus a loss of ¥703mn for the previous year). The bullish outlook is based primarily on expectations of a strong recovery in sales and earnings in its mainstay domestic research business, but management believes this forecast is extremely realistic. Having booked a number of one-time charges during FY12/17, the Group plans to release a new medium-term business plan sometime this summer, after it has accessed recent business trends.

Key Points

- Major marketing research firm expanding its business areas from online research to marketing solutions
- Looking to growth through M&A and overseas expansion; maintained dividend in FY12/17 despite a net loss as this was due to one-time factors
- All areas of earnings expected to bounce back to previous levels in FY12/18 as one-time factors drop out and mainstay business logs solid gains

Results trends



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

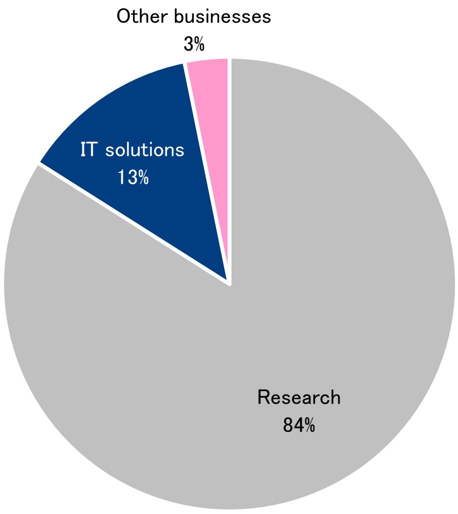
Company profile

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

1. Business overview

The Group is comprised of three businesses: research, IT solutions, and other businesses. Its original business was marketing research based primarily on online surveys, but over the years, it has developed a full range of services covering all areas of marketing research with quantitative and qualitative studies; most of the research is based on online surveys, but offline surveys and other types of research are done as well. The IT solution business does mobile system planning, development, and operations, and also dispatches engineering personnel. Other businesses include a promotion services business for marketing support. With these service lines, the Group has greatly expanded its business interests from online survey-based marketing research to marketing solutions. The Group is also actively working to expand its geographic footprint with the aim of eventually becoming the leading marketing company in Asia. As of the end of FY12/17, the Group had a total of more than 20 offices in 11 countries as well as 29 subsidiaries and 3 affiliated companies.

SALES BREAKDOWN BY SEGMENT (FY12/17)



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

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 into capital and business alliances with major research companies such as Dentsu Research Inc. (currently DENTSU MACROMILL INSIGHT, INC.) and Video Research Ltd. 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 an 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. Despite having been a late starter, the Group is now counted among the research industries leading companies.

3. Industry environment

Marketing 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 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 marketing research industry in Japan is steadily growing with increased and more diversified consumption and strong corporate earnings.

Online research expanded along with growing utilization of the Internet from 2000. Key differences compared to 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. We note that there are three largest firms dominating the marketing research industry: Macromill, Inc. <3978> (with fiscal year ending in June), INTAGE HOLDINGS Inc. <4326> (fiscal year ending in March), and Cross Marketing Group (fiscal year ending in December).

Growing offline research business too by leveraging strength in mainstay online research

4. Research business

(1) Research business

Marketing research conducted by the Group adheres to the following steps: 1) Listen 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 purpose of the survey, 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 which lead solutions.

The Group's 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 planned content. Host the materials on the questionnaire server. In the survey itself, 2) conduct preliminary screening to extract registered monitors suited to giving responses, 3) request e-mail distribution of questionnaire notification to affiliate Research Panel Inc., who 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 the required sample volume. Then, 5) data cleaning is implemented with a system check and visual check 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 questionnaires 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 in a mobile format for the 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. Involves product delivery, questionnaire collection, and compilation and analysis of results
Qualitative research	Focus group interview	Gather a group (normally 5-8 people) and interview of research participants conducted 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 to the Group's marketing research business. In terms of quantity, at 1.44mn people, the Group has a very large number of active registered monitors. Registered monitors are recruited from the membership roles of websites run by VOYAGE GROUP, Credit Saison Co., Ltd. <8253>, and others, with this process being handled by Research Panel (a Cross Marketing Group affiliate). In the case of VOYAGE GROUP, members of its EC Navi website (a comprehensive shopping website) are invited to register at Research Panel. In the case of Credit Saison, Credit Saison website members who wish to participate in surveys are asked to sign up as registered monitors with Eikyufumetsu Research, which is operated by Research Panel. The Group also has a reciprocal agreement that gives it access to the networks of registered monitors of other marketing research firms, which have a combined total of more than 2.31mn active monitors. This means the Group could potentially make use of a total of 3.75mn active monitors, which is more than enough in terms of quantity.

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 and there has been sufficient securing of quality.

(3) Coverage ranges from online research to marketing research and now aiming for overseas

The Group steadily broadened business scope from Internet to offline research leveraging online research know-how and the 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). Furthermore, Japanese companies are increasing their expansion overseas to places like countries in the rest of Asia, and the Group has accelerated its Asian expansion with overseas sales already accounting for 30% of total sales and rapidly chasing domestic sales.

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 cosmetics naming survey
Automakers	Automotive purchasing behavior survey, customer satisfaction benchmark survey
Financial, insurance, securities	Credit card usage survey, website usability survey
Research companies and institutions	Worker awareness survey, survey for PC usage among seniors
Advertising agencies	New product debut 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

The Group's IT solutions business offers one-stop service for all essential functions in mobile and smartphone services, from marketing to planning, development, operation, and promotion. More specifically, the IT solutions business provides website construction, smartphone app development, various tools and software packages, surveys and analysis, operations outsourcing, construction and operation of infrastructure and server, online 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 client companies' marketing strategies aided by research and analysis capabilities obtained by leveraging 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 KPIs
Operations outsourcing	Consignment 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

Under other businesses, the Group operates promotion and other support services for marketing. The main business here is D&M, Inc., which operates a promotion services business. Sales in this area have been rising.

Business model

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

1. Earnings structure

Taking a close look at sources of earnings, we note that costs of researchers and web directors fall under cost of sales while selling and overhead costs (common-use areas of the headquarters building) are booked under SG&A expenses. With regard to the flow of business and the function of individual departments, after the sales team brings in a project, research department staff put together a proposal for a specific research approach and work out the details of the research methodology. The director is the individual who, depending on the size of the research and scope of the project, will design and oversee the research process, collect the data, and turn the results into a research product with the creation of a research report. Simplifying the contributions to earnings, one might say that the Group should be able to increase both sales and gross profit by increasing productivity through a proper balancing of the skills of the director and other research personnel, and by building up the expertise and size of the research department staff. On the other hand, increasing the size of the sales team would lead to more orders, and indirect costs need to be properly matched to the size of operations.

Looking at the operating profit margins reported by the leading firms in the industry for the most recent fiscal year, we find Macromill with an operating profit margin of 19.2%, INTAGE 8.9%, and Cross Marketing Group 4.3%. Macromill is highly efficient because a large percent of its research is based on online research. INTAGE's margins are lower than Macromill because INTAGE mainly conducts offline and panel research and these are rather labor-intensive services. Having started as an online research specialist, the Group should be able to generate roughly the same operating margin Macromill. It is not even close, however, because the proportion of revenues coming from online research have gotten smaller and smaller over the years as the Group has branched out from its original roots in online marketing research and expanded the scope of its business to cover all types of marketing research and marketing solutions services. This trend has only accelerated in recent years as the Group has steadily added costs as more and more functions have started to overlap as it has made acquisitions, developed new businesses, and established operations overseas. While the former changes are unavoidable from a strategic standpoint, in the case of the later, we agree with management that now is probably a good time to stop to assess operations, pursue synergies, and focus on profits. One additional note, it should be remembered that the Group's operating profit margin in FY12/17 was lower than it normally is owing to a number of one-time charges.

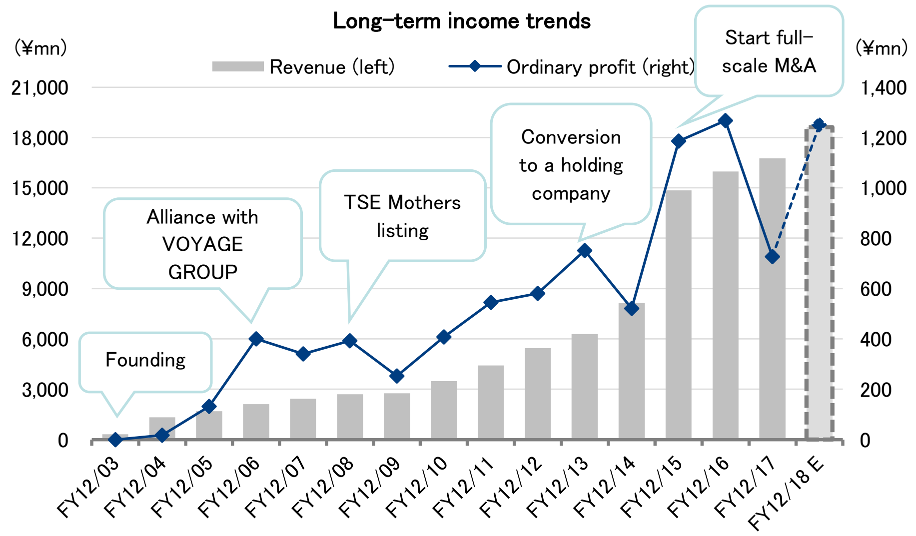
2. Strengths and weaknesses

The most distinguishing feature of the Group's research is its support structure that brings together all sales staff, researchers, directors, and others who interact with clients to resolve issues in a unified manner. It is also distinguished by its screen designs that make it easier for respondents to answer questions: delivery options to achieve accurate target selection: accurate and high-quality data cleaning: quick response with screen formulation, distribution, and data delivery using a high-performance questionnaire system; industry-leading number of registered monitors in Japan: and surveys that are capable of targeting not only basic categories but small, unique groups as well. While its services might not vary much from competitors, the Group's support structure together with the experience of its researchers in designing the right proposal to address the client's situation and its ability to provide comprehensive marketing solutions that draw on internal IT solutions capabilities appear to effectively distinguish the Group from its competitors in the eyes of clients.

Weaknesses (or challenges), meanwhile, are difficulty improving its 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 low overseas recognition. We expect progress in dealing with domestic issues through consolidation of subsidiaries. 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 GROUP, TSE Mothers listing, and conversion to a holding company

3. Turning points



Source: Prepared by FISCO from Company materials

Cross Marketing was founded 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. We see the Group's growth story as being marked by three major turning points thus far.

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 Video Research 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 IPO on the TSE Mothers Section 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 owing to the direct sales required retention of a multifaceted, diverse, and 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 volumes 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 curve costs. These efforts reduced costs and provided customers with easy-to-use tools.

The Group came to its third major turning point in 2013 when it switched to a holding company structure that allowed it to accelerate M&A activity and overseas expansion efforts in pursuit of its goal of becoming the top marketing group in Asia. To be sure, the M&A and overseas expansion was essential to expand the scope of the Group's business, but it came at the cost of added volatility in earnings stemming from exchange rate fluctuations and higher fixed costs. Among young companies in recent years, we find many with a long list of subsidiaries as a result of M&A, especially in the IT industry. These acquisitions are not without their own set of problems, though, especially when it comes to governance. The third major turning point the Group has reached is not just about increasing the number of its subsidiaries, it is about getting a better grip on business efficiency and oversight so that it has a group of profitable and growing subsidiaries that will drive its next phase of growth. Accordingly, we are hoping that the next medium-term business plan will provide a roadmap that will show how management intends to get through the third turning point and continue growing the business.

Business trends

Business expansion drives continued top-line growth in FY12/17, but one-time costs weigh down operating profit

1. FY12/17 results

For FY12/17, the Group reported revenue of ¥16,758mn (+4.9% YoY), operating profit of ¥727mn (-45.9%), ordinary profit of ¥597mn (-52.9%), and net loss attributable to owners of parent of ¥703mn (versus a profit of ¥837mn for the previous year). Aided by a favorable operating environment characterized by including rising and more diverse consumption spending and good corporate earnings, the domestic marketing research industry enjoyed steady growth. The Group was no exception, making progress winning new clients and strengthening relationships with existing clients as it promoted its comprehensive marketing research service, and powering its way to a fourth straight year of positive top-line growth. Unfortunately, productivity suffered as a result of restrictions on overtime hours worked and the Group incurred substantial one-time charges for goodwill amortization and impairment losses, pushing down operating profit and ordinary profit and leading to a net loss. In short, growth appears to have plateaued in FY12/17 as a result of its focus on investing for future growth.

FY12/17 results

	FY12/16 (¥mn)	Ratio (%)	FY12/17 (¥mn)	Ratio (%)	Change (%)
Revenue	15,969	100.0	16,758	100.0	4.9
Gross profit	6,539	40.9	6,623	39.5	1.3
SG&A expenses	5,197	32.5	5,896	35.2	13.4
Operating profit	1,342	8.4	727	4.3	-45.9
Ordinary profit	1,267	7.9	597	3.6	-52.9
Net profit (loss) attributable to owners of parent	837	5.2	-703	-4.2	-

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

FY12/17 sales by business segment

	FY12/16 (¥mn)	Ratio (%)	FY12/17 (¥mn)	Ratio (%)	Change (%)
Research	13,372	83.7	14,058	83.9	5.1
Domestic research	9,213	57.7	9,075	54.2	-1.5
Overseas research	4,160	26.1	4,983	29.7	19.8
IT solutions	1,907	11.9	2,147	12.8	12.6
Other businesses	690	4.3	553	3.3	-19.8

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

FY12/17 profit by business segment

	FY12/16 (¥mn)	Profit margin (%)	FY12/17 (¥mn)	Profit margin (%)	Change (%)
Research	2,256	16.9	1,881	13.4	-16.7
IT solutions	175	9.2	254	11.8	45.1
Other businesses	74	10.8	30	5.6	-59.8
Adjustment	-1,164	-	-1,438	-	-

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

Breaking down results by segment, we find the research business reporting sales of ¥14,058mn (+5.1% YoY) and operating profit of ¥1,881mn (-16.7%). The domestic research business was able to boost productivity to some extent with the help of workflow reforms and stricter time management, but the productivity gains were less than expected. Sales in the overseas business sharply increased as a large project received by Kadence added to sales throughout the year, allowing the research business as a whole to report positive growth in sales over the previous year. Segment operating profit still finished down, however, as the workflow reforms enacted required the hiring of additional staff and additional goodwill amortization charges for past years were booked in connection with Kadence.

What was different from most years is workflow reforms actually led to an increase in staffing levels; additional goodwill amortization for past years also had to be booked in connection with Kadence. As part of the workflow reforms, overtime hours worked by employees were cut by more than 30%. This led to the hiring of additional employees but it took time to bring the newcomers up to speed and prepare a sales management system as was clearly evident from the substantial impact on domestic research sales. As will be detailed later in this report, the terms of contract under which the Group acquired Kadence were such that it was necessary to book another ¥220mn in goodwill amortization to cover past years. Together with the cost of new hires, this resulted in a jump in one-time costs booked in FY12/17.

For FY12/17, the IT solutions business reported sales of ¥2,147mn (+12.6% YoY) and operating profit of ¥254mn (+45.1%). Cross Communication Inc., the mainstay subsidiary for planning, development, and operation of mobile and smartphone websites, systems, and apps, saw a strong and steady order stream for smartphone apps and other development work from financial institutions that easily brought in enough to cover the added cost of new hires. Along with the increase in development projects, client company needs for one-stop IT solutions led to strong growth at Cross Propworks Inc., an outsourcing services business, as well as for the engineer dispatch service operated by Cross J Tech Inc.

Other businesses reported sales of ¥553mn (-19.8% YoY) and operating profit of ¥30mn (-59.8%). The drop in sales and earnings at this segment was driven primarily by the dropout of contributions from UNCOVER TRUTH, an online marketing service provider that went from being a consolidated subsidiary to an equity-method affiliate. The promotion services business headed by D&M enjoyed double-digit growth in sales, though earnings finished down for the year (but in line with the plan), as it expanded staff and made other investments in human resources to support growth in the future.

Regarding operating profit, the Group saw strong results in the overseas research business and IT solutions business, with this effectively covering the downturn in the domestic research business. This stands in contrast to the previous year (FY12/16), when it was the domestic research business that was doing well and offset the downturn in the struggling overseas research business, and also shows the Group's portfolio of businesses working effectively to offset downturns at individual businesses.

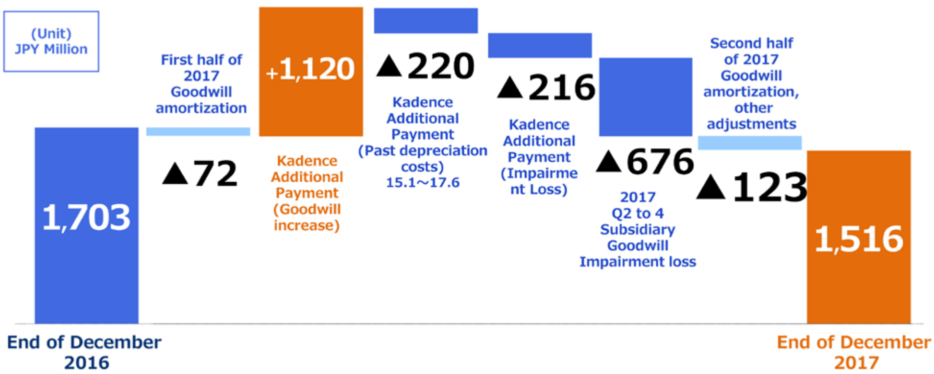
Sharp earnings recovery at Kadence results in additional goodwill amortization and extraordinary losses

2. Explanation of accounting treatment for assessed costs/losses under SG&A expenses and extraordinary losses

The net loss booked is attributable in part to the decline in operating profit, but on top of that there was also a ¥951mn extraordinary loss resulting from a clause in the contract under which Kadence was acquired back in November 2014. When Cross Marketing Group acquired Kadence, it made an initial payment of roughly US$14mn and agreed to make another payment three years later depending on the earnings of Kadence during those three years; this second payment could be anywhere between US$0-15mn. As things turned out, Kadence staged a sharp turnaround after being acquired, booking operating profit of US$5.11mn in its latest fiscal year (FY6/17) versus a modest profit of only US$353,000 in FY6/15. As a result, Cross Marketing Group had to make an additional payment to the seller of US$10mn in August 2017.

In terms of accounting treatment, this additional payment was construed as being made at the time of the original acquisition, thereby increasing the acquisition price and the amount of goodwill that should have been amortized over the three years since the acquisition. The additional goodwill amortization that should have been booked in FY12/15, FY12/16, and through Q2 FY12/17 amounted to a total of ¥220mn, all of which was booked under SG&A expenses in Q2 FY12/17. Along with this, there was also an asset impairment loss of ¥216mn that had to be booked as an extraordinary loss to reflect added goodwill amortization for past years that resulted from the retroactive increase in the acquisition price of Kadence. In addition, the Group recorded impairment losses of ¥676mn due to strictly assessed subsidiaries performances in 3Q FY12/17. The result was large one-time charges in FY12/17, ¥220mn being booked under SG&A expenses and a total of ¥951mn being booked as extraordinary losses.

Changes in acquired goodwill on balance sheet at end of fiscal year



Source: Company's results briefing materials

In this relation, we note that without the additional goodwill amortization booked under SG&A expenses, operating profit would have come in at ¥947mn—a smaller 29.4% YoY decline, though still an indication that FY12/17 was a tough year. The large charges for goodwill amortization and extraordinary losses were no doubt foreseeable to some extent, but as long as they set the stage for real growth in the future it would be fair to say they are one-time expenses.

Kadence-related additional amortization costs and impairment losses also affect the fiscal situation

3. Fiscal situation

As of the end of FY12/17, the Group's consolidated balance sheet showed total assets of ¥9,564mn (-¥369mn YoY). The main factors driving the decline were a ¥114mn decline in cash and deposits (to ¥2,047mn), ¥156mn decline in note and accounts receivable-trade (to ¥3,229mn), and ¥188mn decline in goodwill (to ¥1,516mn). Total liabilities were ¥5,966mn (+¥507mn), reflecting a ¥181mn rise in accounts payable (to ¥1,379mn) and ¥688mn increase in borrowings (to ¥2,833mn). Net assets of ¥3,598mn (-¥875mn) were recorded, with legal retained earnings coming down by ¥835mn.

Simplified balance sheet

(¥mn)

	FY12/16	FY12/17	Change
Current assets	6,557	6,459	-99
Cash and deposits	2,160	2,047	-114
Notes and accounts receivable-trade	3,386	3,229	-156
Non-current assets	3,375	3,105	-270
Property, plant and equipment	457	391	-66
Intangible assets	1,918	1,742	-175
Goodwill	1,703	1,516	-188
Investments and other assets	1,000	972	-28
Total assets	9,932	9,564	-369

	FY12/16	FY12/17	Change
Current liabilities	3,697	3,704	7
Accounts payable-trade	1,198	1,379	181
Short-term loans payable and other short-term borrowings	635	801	166
Non-current liabilities	1,762	2,262	500
Long-term loans payable	1,510	2,032	522
Total liabilities	5,459	5,966	507
Legal retained earnings	3,309	2,484	-825
Shareholders' equity	4,448	3,613	-835
Net assets	4,474	3,598	-875

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

Looking at financial ratios, the impact of the additional goodwill amortization related to Kadence and the asset impairment losses is clearly visible. Profitability indicators like ROA and ROE had both been on the rise since bottoming out in FY12/14, but ROA came down sharply in FY12/17 and ROE went all the way into negative territory. In both cases the main problem was falling profit margins, not a decline in assets turnover or leverage. Financial safety ratios all deteriorated as well, though the Group is still far from being in a dire situation. Accordingly, what management urgently needs to do now is focus on improving profitability. In particular, this means it might be wise for management to slow down and proceed more cautiously on the forward-looking spending and investments that will end up as fixed costs.

Financial indicators

(%, times, ¥mn)

		FY12/13	FY12/14	FY12/15	FY12/16	FY12/17
1-1.	ROA	20.4	8.9	13.8	13.5	7.5
2.	Operating margin	11.5	6.5	8.3	8.4	4.3
3.	Total asset turnover rate	1.8	1.4	1.7	1.6	1.7
2-1.	ROE	19.6	9.6	17.6	20.5	-17.4
2.	Net margin	7.0	3.0	3.8	5.2	-4.2
3.	Total asset turnover rate	1.8	1.4	1.7	1.6	1.7
4.	Leverage	1.6	2.3	2.8	2.4	2.4
3-1.	Net margin	7.0	3.0	3.8	5.2	-4.2
2.	Gross margin	40.2	31.2	42.5	40.9	39.5
3.	SG&A expenses ratio	28.6	31.2	34.2	32.5	35.2
4.	Operating margin	11.5	6.5	8.3	8.4	4.3
5.	Financial income margin	-0.0	-0.1	-0.1	-0.2	-0.2
6.	Pretax margin	11.8	6.2	7.7	8.7	-2.1
7.	Tax rate	39.2	40.0	50.0	41.0	-109.5
4-1.	Gross capital turnover rate	1.77	1.37	1.67	1.60	1.72
2.	Financial asset turnover rate	2.23	2.12	2.57	2.27	2.36
3.	Investment asset turnover rate	100.36	35.09	43.41	45.82	42.06
4.	Equipment asset turnover rate	9.37	4.36	5.33	6.24	7.43
5-1.	Revenue growth	15.6	29.4	82.5	7.5	4.9
2.	Operating profit growth	30.8	-27.5	134.3	8.9	-45.9
3.	Total asset growth	29.9	96.2	26.7	-0.4	-3.7
4.	Shareholders' equity growth	23.8	7.1	40.4	19.8	-18.8
6-1.	Shareholders' equity ratio	61.6	33.6	37.3	44.8	37.8
2.	Quick asset ratio	152.2	73.8	131.5	150.0	142.5
3.	Current ratio	172.4	95.9	157.0	177.4	174.4
4.	Fixed ratio	62.0	140.1	95.5	75.9	85.9
5.	Interest-bearing debt reliance	3.4	33.9	28.5	24.2	29.6
6.	Turnover difference funds	-796	-902	-1,945	-2,188	-1,850
7.	Net working capital	880	1,282	2,250	2,580	2,255
8.	Surplus liquidity	779	1,407	2,384	2,160	2,047
9.	Net cash	645	-1,264	-453	-245	-787
10.	Interest coverage ratio	344.0	77.8	47.0	40.5	21.7

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

Expecting sharp turnaround in FY12/18 and moving the net loss well into the black

4. FY12/18 outlook

For FY12/18, the Group is forecasting revenue of ¥18,614mn (+11.1% YoY), operating profit of ¥1,250mn (+72.1%), ordinary profit of ¥1,172mn (+95.6%), and net profit attributable to owners of parent of ¥600mn (versus a loss of ¥703mn for the previous year). The bullish outlook is based in large part on expectations of a strong recovery in sales and earnings in the domestic research business. In some respects the forecast seems a bit conservative but, after failing to meet its forecast last year, it is likely that management wanted to make an extremely realistic forecast for this year.

Forecasts for FY12/18

	FY12/17 (¥mn)	Ratio to revenue (%)	FY12/18 (¥mn)	Ratio to revenue (%)	Change (%)
Revenue	16,758	100.0	18,614	100.0	11.1
Gross profit	6,623	39.5	-	-	-
SG&A expenses	5,896	35.2	-	-	-
Operating profit	727	4.3	1,250	6.7	72.1
Ordinary profit	597	3.6	1,172	6.3	95.6
Net profit (loss) attributable to owners of parent	-703	-4.2	600	3.2	Move back into the black

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

Segment forecasts for FY12/18

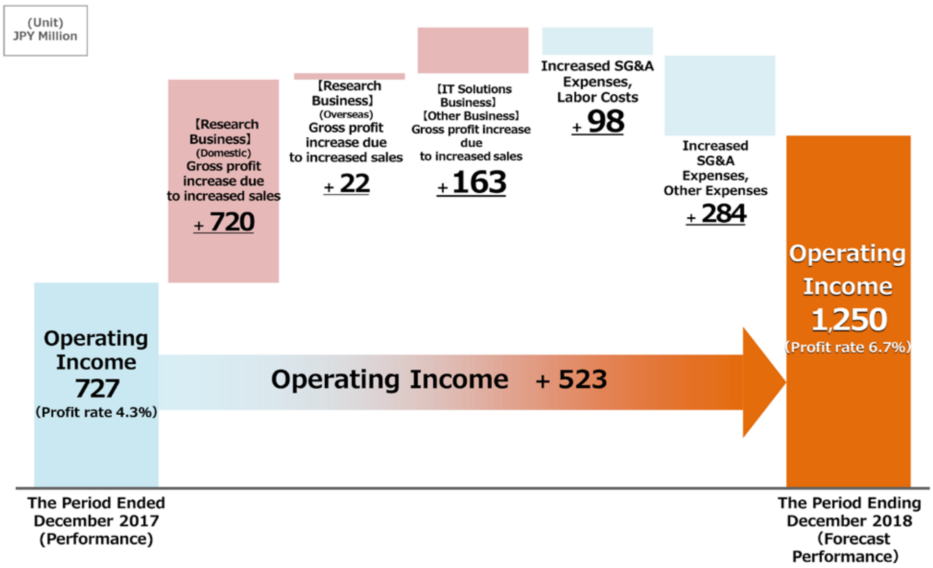
	FY12/17 (¥mn)	Ratio to revenue (%)	FY12/18 (¥mn)	Ratio to revenue (%)	Change (%)
Research	14,058	83.9	15,211	81.7	8.2
Domestic research	9,075	54.2	10,213	54.9	12.5
Overseas research	4,983	29.7	4,998	26.9	0.3
IT solutions	2,147	12.8	2,652	14.2	23.5
Other businesses	553	3.3	750	4.0	35.6

Source: Prepared by FISCO from Company materials

In the domestic research business, management is looking for sales to grow at a double-digit pace and top the ¥10.0bn mark as it slows down on new hiring while stepping up efforts on the sales front after getting new employees up to speed and increasing productivity. Along with the increase in productivity, profitability is also expected to improve. In the overseas research business, a lull in M&A activity and the completion of its basic infrastructure will give management time to stabilize operations and set the stage for growth by making needed personnel changes and consolidating the growing number of overseas subsidiaries. With no large special orders on the horizon, this means sales in the overseas research business are expected to be basically flat, though higher earnings can still be expected in the absence of the extra goodwill amortization charges that weighed down earnings last year. In the IT solutions business, the outlook for continued strong growth in demand for system and software development and steady growth in outsourcing bodes well for strong growth in sales and earnings in the year ahead. In other businesses, sales growth will continue thanks to strong demand for ad promotion services, but contributions to profits will be small as additional investments in human resources are expected to limit gains at the bottom line.

In short, the forecast for FY12/18 sees earnings basically getting back to where they were before last year as the extra goodwill amortization charges (for past years) that were incurred last year drop out and earnings generated by the top-line gains at the domestic research and IT solutions businesses more than cover increases in personnel and other SG&A expenses. Regarding net profit, earnings are expected to stage a sharp turnaround and finish well in the black as they benefit further from the dropout of the large extraordinary losses booked in FY12/17.

Breakdown of factors expected to contribute to changes in operating profit in FY12/18



Source: Company's results briefing materials

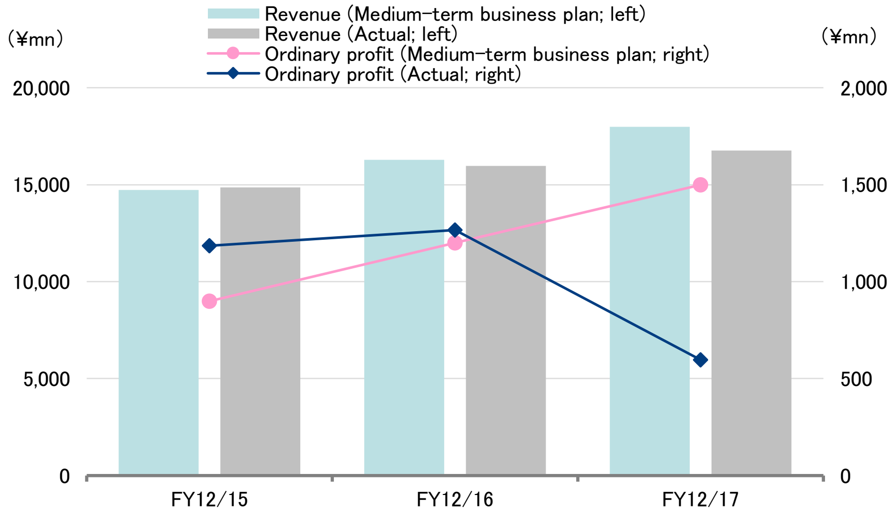
Medium-term management plan

Challenges encountered while executing previous medium-term business plan

● Review of the 2015-2017 medium-term business plan

Since its founding, the Group has worked to develop a variety of marketing research services; along the way, it has also moved into related mobile and smartphone services and promotions and extended its geographic footprint overseas. The Group's medium-term business plan lays out the initiatives that are aimed at further expanding the scope of its business. In the 2015-2017 medium-term business plan, the main focus was on geographic expansion and expansion into new business areas. The plan targeted final-year revenue of ¥17,985mn and ordinary profit of ¥1,500mn in FY12/17, but the Group finished well short of those targets with revenue of ¥16,758mn and ordinary profit of only ¥597mn. On top of that, the Group recorded net loss attributable to owners of parent of ¥703mn as earnings were further battered by special goodwill amortization charges related to its past acquisition of Kadence and asset impairment losses.

2015–2017 medium-term business plan results versus plan



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

While failing to meet the performance targets for sales and earnings set under the medium-term business plan, the Group was able to take advantage of solid demand in the marketing-related markets both at home and abroad, expanding into new business areas as targeted in the plan, and entering the final phase of its planned expansion in Asia with the acquisition of a company in Thailand and preparations for the establishment of a new company in the Philippines. The Group also started working to develop business on the West Coast of the United States, while there is some overlap in sales territories plans to start consolidating in Japan As for expansion into new business areas, the Group moved into medical-related and blind (or anonymous) surveys during this timeframe and built up businesses in peripheral areas, including a promotion services business (D&M) and an engineer dispatch service. All things considered, we believe it is fair to say that over the three-year period covered by the previous medium-term business plan the Group did indeed meet its objective of expanding both geographically and into new business areas, and is well on its way to becoming the top marketing company in Asia.

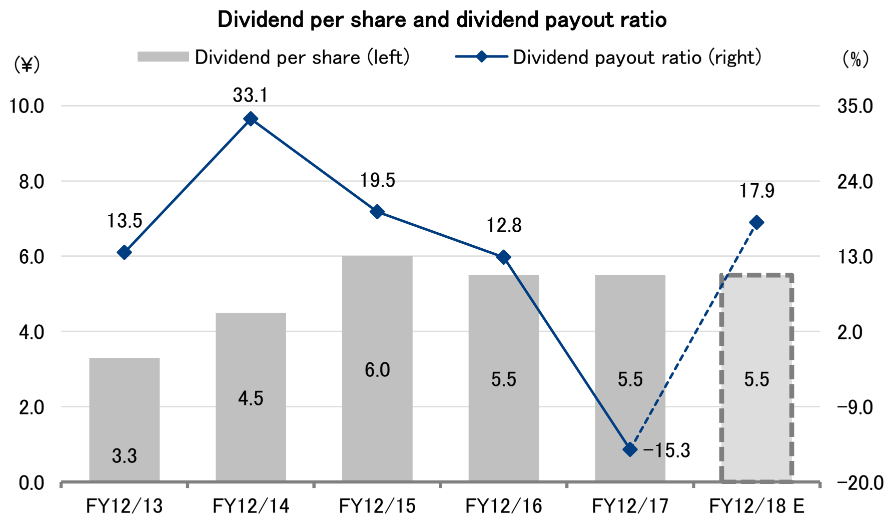
This is not to say challenges were not encountered. At existing businesses, management worked to establish a solid earnings structure and foster steady growth; growth was achieved in some areas, but it became evident that earnings needed to be turned around in the mainstay domestic research business if the Group as a whole was to grow. On the personnel front, efforts were made to raise the proficiency level of existing employees with the help of additional training and good progress was made at the organizational level, but the education and training of new employees remains problematic. With respect to new businesses, good progress was made fostering new businesses and in terms of geographic expansion, but still more needs to be done to establish profitable and growing businesses. With respect to overseas expansion, the Group is on the brink of the final phase of its geographic expansion plans that call for establishing a network that will cover all of Asia, but is still facing challenges when it comes to governance of those overseas subsidiaries and expanding into those parts of Asia where it has no presence.

Of the current challenges faced by management, we think it fair to say the most urgent is restoring growth at existing businesses. In addition to initiatives aimed at reviving earnings at existing businesses, we believe it is also important that management carefully ascertain the growth and profit potential of all of the Group's businesses. For this reason, we do not expect to see the next medium-term business plan released until sometime this summer, after management has had sufficient time to ascertain whether the earnings recovery is on track.

Shareholder return policy

Annual dividend maintained despite losses in FY12/17

With regard to dividends, the Group maintains a policy of providing stable returns to shareholders in the form of dividends. However, in view of the great demands on capital at this time and business investment plans for the future, management has decided to pay an annual dividend based on a dividend payout ratio of roughly 15% of consolidated earnings. Reflecting the policy of providing stable returns to shareholders, a dividend of ¥5.5 per share was paid in FY12/17, the same as in FY12/16, despite recording a net loss as a result of additional payment made for Kadence and other extraordinary charges. The forecast calls for a dividend payment of ¥5.5 per share again in FY12/18, even though this will mean the dividend payout ratio will be higher than the payout ratio targeted by management.



* 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

Information security

The research business operated by Cross Marketing collects personal information from those surveyed. Group companies that may come into possession of personal information—including the parent company, UTIL, Inc., Research and Development, Inc., and Research Panel, Inc.—have all been certified as meeting the data privacy standards set forth by JIPDEC (Japan Information Processing and Development Center) for the proper collection, management, and handling of personal information.

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