COMPANY RESEARCH AND ANALYSIS REPORT

Cross Marketing Group Inc.

3675

Tokyo Stock Exchange First Section

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Summary

Management is currently formulating a medium-term management plan that includes measures to address the changes in the environment

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 Company runs a promotion services business to provide marketing support. Despite being a late-comer to the industry when it was founded, the Company 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 Company 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.

As opposed to its competitors, whose functions are relatively separate from one another, the Company'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. In addition to providing proposals, plans and research, the ability of the Company to offer one-stop solutions leveraging the Group's IT solutions capabilities further separates the Company from its peers. The Company is also highly regarded for aspects including its screen design that makes it easier for respondents to answer questions, accurate target selection, and the largest number of registered monitors in Japan. The Company has been growing more than the industry as a whole, boosted by major turning points, including the business and capital alliance with VOYAGE GROUP Inc. (then known as EC Navi) in 2006, and its listing on the Mothers Section of the Tokyo Stock Exchange in 2008. Currently, using the third major turning point of switching to a holding company structure in 2013 as a springboard, the Company is aiming to become the top marketing group in Asia.

For 1H FY12/18, the Company reported revenue of ¥8,608mn (+5.7% year on year (YoY)) and operating profit of ¥459mn (+11.6%). Although the increase in outsourcing costs in the mainstay research business weighed on gross profit, strong performance in the IT solutions business and the absence of the goodwill amortization charges posted in the same period of the previous year resulted in the double-digit increase in operating profit. In addition, both ordinary profit and net profit attributable to owners of parent increased even more than operating profit due to a number of factors, including the contraction in investment losses due to equity method and the absence of the impairment losses that were incurred in the year-earlier period. Operating profit exceeded the initial forecast by ¥30mn. This was attributable to SG&A expenses being kept down by controlling the number of personnel and other expenses, despite the fact that gross profit fell short of expectations due to the increase in outsourcing costs and other factors.

In the domestic research business, there has been as increase in direct sales to major clients and a decline in indirect sales, as the client portfolio appears to have changed. Direct sales often require almost the full lineup of services, from planning and proposals to report generation, and large projects involve researching geographic areas that go beyond the Company's coverage area. Thus, unlike indirect sales, in which the Company can simply provide research data directly or offer the data after processing the data, direct sales have higher outsourcing costs leading to higher cost of sales, as the research is more extensive and a wider range of services are provided. We surmise that operating profit in the research business declined in 1H FY12/18 as a result of the increase in outsourcing costs and higher cost of sales ratio caused by the increase in large global projects.

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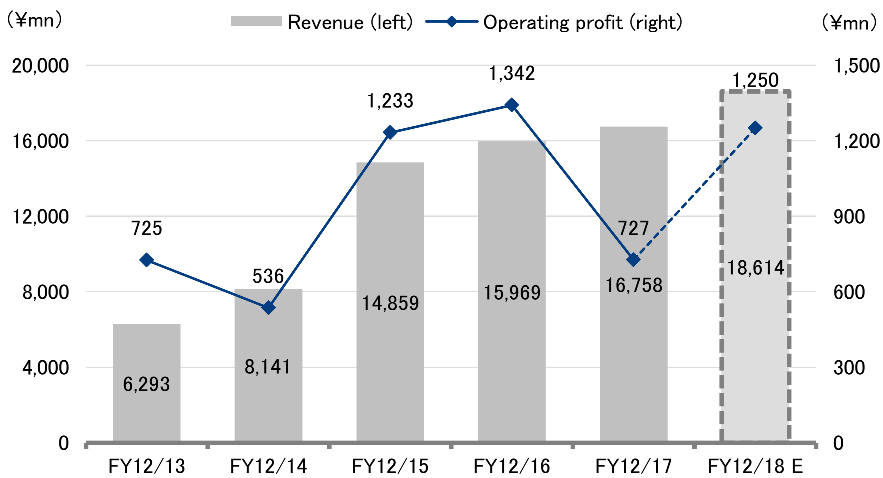
How the Company controls the cost of sales from 2H onward in response to this change in the client portfolio is a key issue, and there are concerns about medium- to long-term impacts depending on the extent of the changes in the client portfolio. Consequently, the Company is carefully examining measures to address this challenge, and has temporarily delayed the release of the medium-term management plan which it had been planning to issue in the summer of 2018. In the near future, we expect management to release a medium-term management plan that includes sound measures to address this issue.

Key Points

- Major player in the research industry aiming to be top marketing group in Asia
- Achieved top and bottom line growth in 1H FY12/18 despite an increase in outsourcing costs
- Currently formulating a medium-term management plan that includes measures to address changes in the environment

Results trends



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

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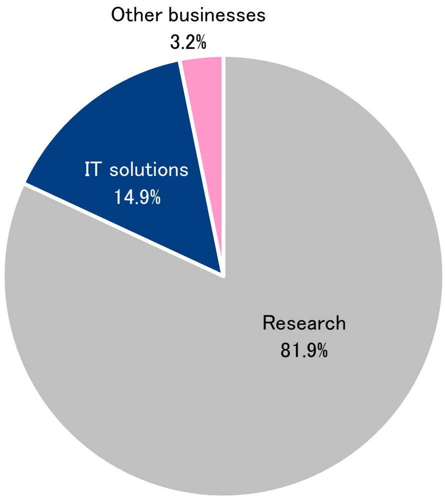
Company profile

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

1. Business overview

The Company 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 solutions 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 Company has greatly expanded its business interests from online survey-based marketing research to marketing solutions. The Company 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 1H FY12/18, the Company had a total of more than 20 offices in 11 countries as well as 32 subsidiaries and 3 affiliated companies.

REVENUE BREAKDOWN BY SEGMENT (1H FY12/18)



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

Growth to become one of the leading companies in the domestic research sector

2. History

The Company 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, the operator of ad platform and point media businesses). In March 2007, it entered into capital 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 TSE 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 Company is accelerating M&A and new business and overseas initiatives. Despite having been a late starter, the Company is now counted among the research industry's leading companies in Japan.

Steadily growing marketing research industry in Japan

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).

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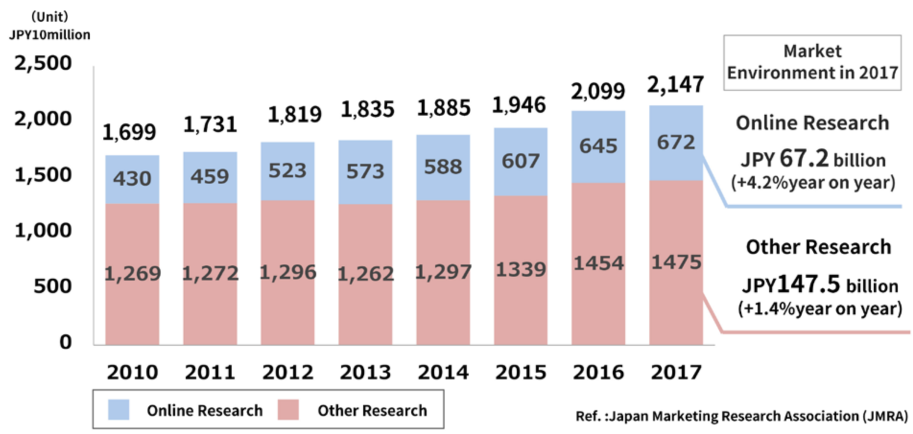
Domestic marketing research market



Source: The Company's results briefing materials

High quality and number of registered monitors supporting the mainstay online research business

4. Research business

(1) Research business

Marketing research usually 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 Company's mainstay online research service consists of the following detailed flow for the full lineup of services. 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., which notifies registered monitors and recruits questionnaire respondents from the 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.

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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 Company's marketing research business. In terms of quantity, at 1.74mn people, the Company has a very large number of active registered monitors. These registered monitors are recruited from the members-only websites run by VOYAGE GROUP, Credit Saison Co., Ltd. <8253>, and others, and managed by Research Panel. 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 Company 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 2.46mn active monitors. This means the Company could potentially make use of a total of 4.20mn 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 online research's early years has almost entirely disappeared now thanks to cumulative efforts with these measures and there has been sufficient securing of quality.

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

The Company 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 Company supplies various research services that combine IT 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 Company 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 Company has accelerated its Asian expansion with overseas sales already accounting for 30% of total revenue 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

Integrated service through marketing solutions

5. IT solutions business and other businesses

The IT solutions business offers a 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 servers, online promotions, and security measures. The Company has experience in building and operating systems for financial institution apps and settlement and point management that require robust performance, large-scale systems with millions of members, along with other systems. The Company also engages in development supporting the latest features for rapidly advancing mobile equipment. Furthermore, the Company is capable of linking a smooth PDCA cycle to client companies' marketing strategies by leveraging the strength of having a marketing research company in the Group, leading to even greater outcomes.

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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 Company operates promotion and other support services for marketing. The main business here is D&M, Inc., which operates a promotion services business. Revenue in this area has 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 directors fall under cost of sales while selling and overhead costs (the functions used in common with the headquarters) are booked under SG&A expenses. With regard to the flow of business and the functions, after the sales team brings in a project, researchers 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, and the researchers create a research report. Simplifying the contributions to earnings, one might say that the Company should be able to increase both sales and gross profit by increasing productivity through a proper balancing of the skills of the directors, and by building up the expertise and size of the research department. 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.

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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 19.0%, INTAGE 8.0%, 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 Company should be able to generate roughly the same operating margin as Macromill. It is not even close, however, because the proportion of revenues coming from highly profitable online research have gotten smaller and smaller over the years as the Company 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 Company 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 latter, we agree with management that now is probably a good time to stop to assess operations, pursue synergies, and focus on profits. In fact, the Company is apparently consolidating a number of subsidiaries. On an additional note, it should be remembered that the Company's operating profit margin in FY12/17 was lower than it normally is owing to one-time charges. It was 8.4% in FY12/16, which was at the same level with INTAGE.

Strength lies in the support structure that brings together sales and research staff

2. Strengths and weaknesses

As opposed to its competitors, whose functions are relatively separate from one another, the most distinguishing feature of the Company'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; distribution settings 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 these services might not vary much from competitors, the Company'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 Company 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 longtime TSE Mothers listing, and low overseas recognition. However, with the listing on TSE's First Section in 2018, efforts to improve efficiency through the consolidation of domestic subsidiaries, and overseas brand integration to Kadence, which the Company acquired in 2014, it is making progress both in terms of improving profitability and increasing recognition.

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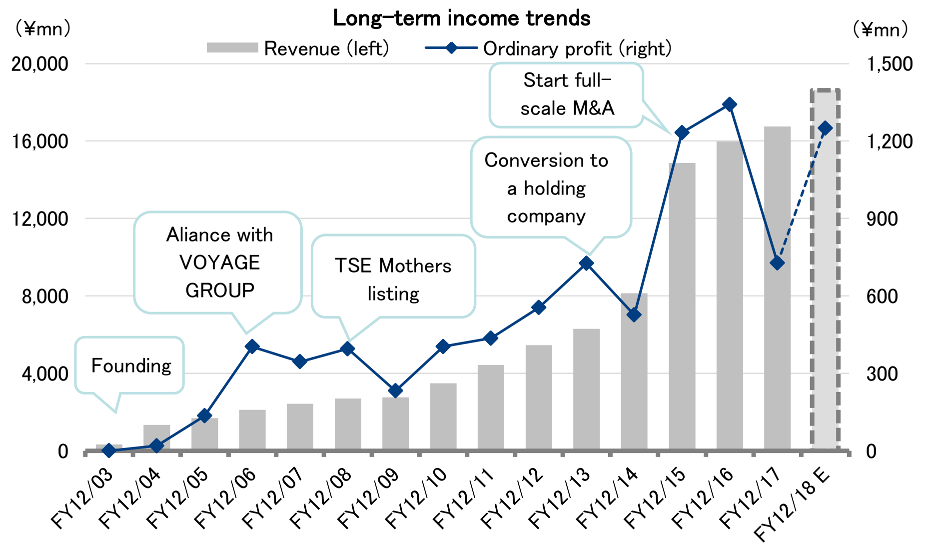
Turning points - Alliance with VOYAGE GROUP, TSE Mothers listing, and conversion to a holding company

3. Turning points

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 Company's growth story as being marked by three major turning points thus far.



Source: Prepared by FISCO from Company materials

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 capital 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 Company's services in a complementary manner. This relationship brought "indirect sales." The Company 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.

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The Company 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 Company'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 Company must navigate is not just increasing the number of its subsidiaries: it is also 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

In 1H FY12/18, profits exceeded forecasts despite revenue falling short

1. 1H FY12/18 results

For 1H FY12/18, the Company reported revenue of ¥8,608mn (+5.7% YoY), operating profit of ¥459mn (+11.6%), ordinary profit of ¥409mn (+20.3%), and net profit attributable to owners of parent of ¥187mn (increase of ¥371mn). Although the increase in outsourcing costs in the mainstay research business weighed on gross profit, strong revenue in the IT solutions business and the absence of the goodwill amortization charges posted in the same period of the previous year resulted in the double-digit increase in operating profit. In addition, ordinary profit increased even more than operating profit due to a number of factors, including the contraction in investment loss due to equity method and the absence of the impairment losses that were incurred in the year-earlier period, while net profit attributable to owners of parent jumped well into positive territory. Although revenue fell ¥89mn short of the forecast at the start of the fiscal year, the strong performance by the IT solutions business and other factors allowed operating profit to exceed the initial forecast by ¥30mn, while ordinary profit and net profit attributable to owners of parent surpassed the initial forecasts by ¥26mn and ¥15mn, respectively. All in all, the Company's operating performance was quite solid.

1H FY12/18 results

(¥mn)

	1H FY12/17	Ratio (%)	1H FY12/18	Ratio (%)	Change (%)
Revenue	8,141	100.0%	8,608	100.0%	5.7%
Gross profit	3,394	41.7%	3,178	36.9%	-6.3%
SG&A expenses	2,982	36.6%	2,719	31.6%	-8.8%
Operating profit	411	5.0%	459	5.3%	11.6%
Ordinary profit	340	4.2%	409	4.7%	20.3%
Net Profit Attributable to Owners of Parent	-184	-2.3%	187	2.2%	-

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

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Breaking down results by segment, the research business posted revenue of ¥7,260mn (+3.2% YoY) and operating profit was ¥1,023mn (-1.7%). In Japan, centered on core operating company Cross Marketing Inc., there was an increase in orders received for large projects which are direct sales, due to the enhanced ability to work on overseas research leveraging Group coordination and the development and provision of new services. Overseas sales also increased, as Kadence Group continued to receive orders for large projects. Meanwhile, operating profit was lower than in the same period of the previous fiscal year, owing to the increase in outsourcing costs to handle the large projects for which orders were received both in Japan and overseas.

The IT solutions business reported revenue of ¥1,321mn (+30.6% YoY) and operating profit of ¥110mn (+67.8%). The Company maintained good relationships with existing clients centered on the financial services industry, which resulted in the Company continuing to receive orders for development projects. Earnings were driven by both Cross Communication Inc., which develops systems, and Cross J Tech Inc., which dispatches engineers. Other businesses reported revenue of ¥284mn (-12.8% YoY) and operating profit of ¥1mn (-95.7%). D&M, which engages in the promotion services business, is currently pushing through with business alliances and other activities to expand the scope of its services as well as cultivating clients, but factors including the change in the sales mix and up-front hiring of personnel with the aim of expanding its business led to a YoY decline in both revenue and operating profit.

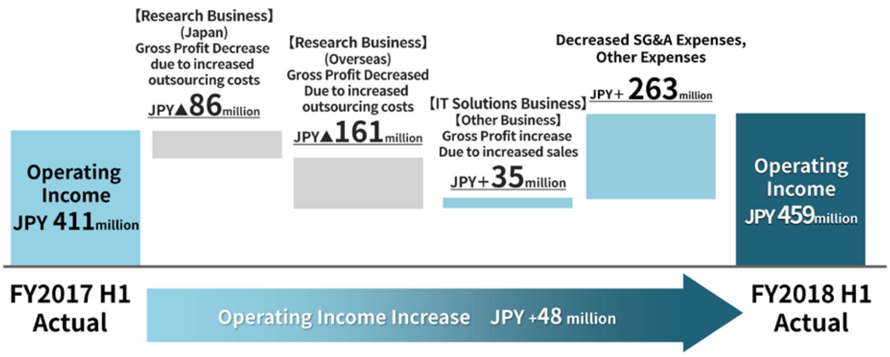
1H FY12/18 results by business segment

(¥mn)

Revenue (before adjustments)	1H FY12/17	Ratio (%)	1H FY12/18	Ratio (%)	Change (%)
Research	7,033	81.9%	7,260	81.9%	3.2%
Domestic research	4,448	53.1%	4,472	50.5%	0.5%
Overseas research	2,468	29.5%	2,644	29.8%	7.2%
IT solutions	1,011	12.1%	1,321	14.9%	30.6%
Other businesses	325	3.9%	284	3.2%	-12.8%
Profit (before adjustments)	**1H FY12/17**	**Profit margin (%)**	**1H FY12/18**	**Profit margin (%)**	**Change (%)**
Research	1,041	14.8%	1,023	14.1%	-1.7%
IT solutions	65	6.5%	110	8.3%	67.8%
Other businesses	32	9.9%	1	0.5%	-95.7%

Note: Domestic research and overseas research revenue represent values after adjustments.
Source: Prepared by FISCO from the Company's financial results and other materials

Breakdown of factors that contributed to changes in operating profit in 1H FY12/18



Source: The Company's results briefing materials

In comparison with initial earnings forecasts, the curbing of SG&A expenses offset the uphill battle in research

2. Differences from forecasts in each business and challenges

For 1H FY12/18, overall operating performance was solid vis-à-vis forecasts, but there were significant flows back and forth between the segments and between earnings and costs. On an overall consolidated basis, gross profit fell short of expectations due to the increase in outsourcing costs and other factors, but the Company was able to reach its operating profit expectations by curbing the planned up-front hiring of personnel as well as by reducing various expenses which had been estimated slightly conservatively.

The Company had projected a significant increase in full fiscal year revenue in the domestic research business, but revenue in 1H FY12/18 were mostly flat. This was caused by the decline in indirect sales due to certain existing clients going under the corporate umbrella of the Company's competitors, bringing about a change in the client portfolio, despite enhanced sales efforts yielding an increase in direct sales to major clients. Direct sales often require almost the full lineup of services, from planning and proposals to report generation, and large projects involve researching geographic areas that go beyond the Company's coverage area. Thus, unlike indirect sales, in which the Company can simply provide research data directly or offer the data after processing it, direct sales have higher outsourcing costs leading to higher cost of sales, as the research is more extensive and a wider range of services are provided.

We surmise that operating profit in the domestic research business fell short of the forecast in 1H FY12/18 as a result of the increase in outsourcing costs and higher cost of sales ratio caused by the increase in large global projects. The reason for increase in the cost of sales ratio in the overseas research business was similar. Although marketing measures resulted in high single-digit growth in revenue, the number of large projects increased, leading to higher outsourcing costs and a decline in the gross profit margin, just as the Company was restructuring the organization, including the consolidation of offices. The Company's ability to control the cost of sales in both domestic and overseas research from 2H onward to address this change in the client portfolio is now a key issue.

In the IT solutions business, the Company maintained good relationships with existing clients, which resulted in the Company receiving solid orders for development projects and dispatch of engineers, allowing profits to increase significantly. However, securing engineers in order to staff large projects has become a challenge. In other businesses, the Company has dealt with the impacts from changes to Google's and Yahoo's search algorithms, and currently the reinforcement of the sales organization has been helping to engineer an improvement in earnings, but increasing data coordination and tie-ups have become matters that need to be addressed before entering the growth trend from 2H onward. Total revenue from the IT solutions business and other businesses fell slightly short of the Company's forecast, leading to a shortfall in gross profit.

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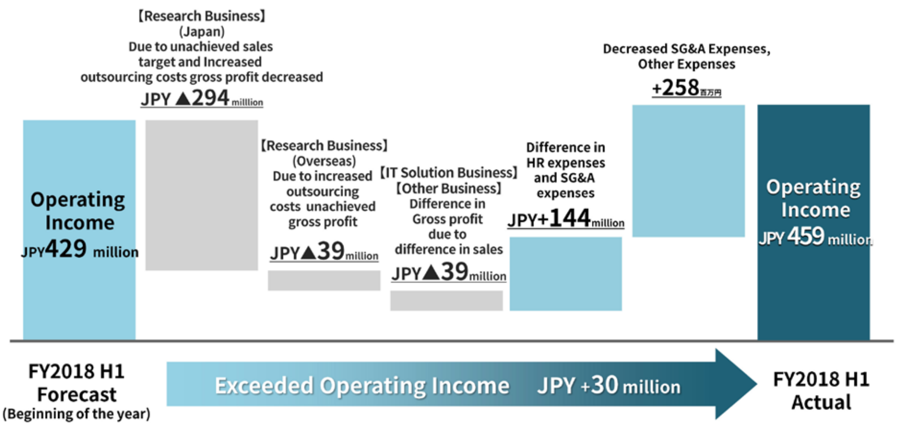
Analysis of 1H FY12/18 operating profit discrepancy with forecast



Source: The Company's results briefing materials

Investments and repayments progress as planned, resulting in improved fiscal soundness

3. Fiscal situation

As of the end of 1H FY12/18, the Company's consolidated balance sheet showed total assets of ¥9,024mn (-¥540mn versus the end of FY12/17). The main factors were a ¥351mn increase in cash and deposits, a ¥691mn decline in notes and accounts receivable-trade, and a ¥145mn decline in goodwill. Total liabilities were ¥5,354mn (-¥611mn), with the main factors being a ¥261mn decline in short- and long-term borrowings and a ¥210mn decline in accounts payable-trade. Net assets of ¥3,669mn (+¥71mn) were recorded, and the shareholders' equity ratio improved 3.0 percentage points versus the end of FY12/17 to 39.3%. Meanwhile, cash and equivalents totaled ¥2,397mn, a decline of ¥316mn compared to the year-earlier period. Net cash provided by operating activities was ¥798mn (¥334 less than the same period of the previous fiscal year), due to factors including the increase in pre-tax profit and a decline in receivables. Net cash used in investment activities was ¥128mn (down ¥30mn YoY) due to the increase in capital investment and other factors. Cash flow from financing activities was outflow of ¥295mn (increase of ¥182mn YoY) due to the repayment of borrowings and other factors.

Simplified balance sheet

(¥mn)

	FY12/17	1H FY12/18	Change
Current assets	6,459	6,081	-377
Cash and deposits	2,047	2,398	351
Notes and accounts receivable-trade	3,229	2,539	-691
Non-current assets	3,105	2,942	-163
Property, plant and equipment	391	387	-4
Intangible assets	1,742	1,594	-148
Goodwill	1,516	1,370	-145
Investments and other assets	972	962	-10
Total assets	9,564	9,024	-540

	FY12/17	1H FY12/18	Change
Current liabilities	3,704	3,350	-354
Accounts payable-trade	1,379	1,169	-210
Short-term loans payable and other short-term borrowings	801	798	-4
Non-current liabilities	2,262	2,004	-257
Long-term loans payable	2,032	1,765	-268
Total liabilities	5,966	5,354	-611
Legal retained earnings	3,613	3,770	157
Shareholders' equity	2,484	2,627	143
Net assets	3,598	3,669	71

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

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Expecting initial FY12/18 forecasts to be achieved

4. FY12/18 outlook

For FY12/18, the Company 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). This outlook is based on expectations for a recovery in sales and earnings, especially in the mainstay domestic research business, driven by the establishment of a robust earnings base and the expansion of the Group's overall scope of business. The absence of the extra goodwill amortization charges from previous years and extraordinary losses that were incurred in FY12/17 are also expected to contribute to the recovery in earnings. The changes in the client portfolio that have taken place during FY12/18 have resulted in large flows back and forth between segments and between revenues and costs, but based on the fact that 1H results ultimately ended up close to forecasts, the Company decided to leave its full-year forecasts unchanged. Still, the Company's results were aided by the curbing of conservatively estimated SG&A expenses, so efforts to resolve issues will be the key to achieving forecasts for the full fiscal year.

Forecasts for FY12/18

(¥mn)

	FY12/17	Ratio to revenue (%)	FY12/18 forecast	Ratio to revenue (%)	Change (%)
Revenue	16,758	100.0%	18,614	100.0%	11.1%
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%	-

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

Based on the forecasts by segment made at the beginning of the fiscal year, in the domestic research business, management is looking for revenue 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 revenue in the overseas research business are expected to be basically flat. In the IT solutions business, the outlook for continued strong growth in demand for system and software development and steady expansion in the engineer dispatch business bodes well for strong growth. In other businesses, revenue growth will continue thanks to strong demand for ad promotion services, but contributions to profits will be small due to upfront investment in personnel. All in all, the increase in revenue in the domestic research business and the IT solutions business was expected to more than cover the increase in personnel and other SG&A expenses.

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Still, while 1H results on the whole were in line with forecasts, revenue was weak in the domestic research business and strong in the overseas research business, while in terms of profits, the Company is covering the increase in outsourcing costs by controlling the number of personnel. As discussed above, a number of issues need to be addressed in order for the Company to achieve its forecasts, with the change in the client portfolio in the domestic research business being a particular concern. This change is the content gap between the sales mix and the cost of sales, and it has the potential to have a significant impact on the business structure over the medium to long term. Although efforts to bolster global business and the development of new services have been successful, and large projects received by the Company's major operating companies contributed to the increase in revenue, large global projects in particular involve research that is wider in scope and area, leading to an increase in outsourcing costs and thus higher cost of sales. Meanwhile, in indirect sales, changes in clients' activities have caused a decline in high gross margin indirect sales, consequently leading to a drop in the overall gross margin. This can be seen as a transition period, but if the Company does not make adjustments to the sales mix and costs of sales quickly enough, the impact that the increase in outsourcing costs has on the consolidated business could become even larger. We believe that the key to addressing this issue is aggressively controlling the cost of sales.

Segment forecasts for FY12/18

(¥mn)

	FY12/17	Ratio to revenue (%)	Progress	FY12/18 forecast	Ratio to revenue (%)	Change (%)	Progress
Research	14,058	83.9%	50.0%	15,211	81.7%	8.2%	47.7%
Domestic research	9,075	54.2%	49.0%	10,213	54.9%	12.5%	43.8%
Overseas research	4,983	29.7%	49.5%	4,998	26.9%	0.3%	52.9%
IT solutions	2,147	12.8%	47.1%	2,652	14.2%	23.5%	49.8%
Other businesses	553	3.3%	58.8%	750	4.0%	35.6%	37.8%

Note: Progress is the achievement percentage through 1H compared to the full year results/forecast.
Source: Prepared by FISCO from Company materials

Medium-term management plan

The previous medium-term management plan which was the infrastructure to become the top marketing company in Asia

1. Review of the previous medium-term management plan

The Company formulated a medium-term management plan in 2014, positioning 2015-2017 as a period for geographic expansion as well as for entering into new business domains. The plan targeted final-year revenue of ¥17,985mn and ordinary profit of ¥1,500mn in FY12/17, but the Company finished short of those targets with revenue of ¥16,758mn and ordinary profit of ¥597mn. On top of that, the Company recorded net loss attributable to owners of parent of ¥703mn, as earnings were further impacted by special goodwill amortization charges related to its past acquisition of Kadence and impairment losses. While failing to meet its numerical targets, the Company was able to take advantage of solid demand in the marketing-related markets both at home and abroad, expanding into new areas as targeted in the plan, and entering into 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 Company also started working to develop business on the West Coast of the United States, and is currently starting to consolidate subsidiaries, including in areas where there is some overlap. As for expansion into new business areas, the Company moved into medical-related and blind (or anonymous) surveys during this timeframe and built up peripheral businesses, including a promotion services business (D&M) and an engineer dispatch service. We believe it is fair to say that over the three-year period covered by the previous plan the Company did expand both geographically and into new business areas, and is well on its way to building the infrastructure to become the top marketing company in Asia. This three-year period provided momentum ahead of the next medium-term management plan.

Currently formulating a medium-term management plan that includes measures to address the change in the client portfolio

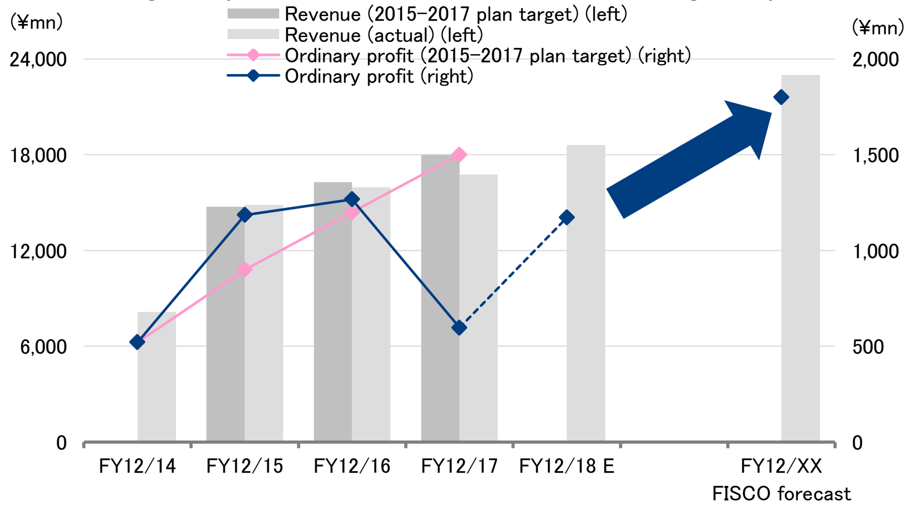
2. Challenges heading into the next medium-term management plan

There have been some issues that became visible as a result of the completion of the previous medium-term management plan. In 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 Company 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 Company 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.

Initially, management was planning to release the next medium-term management plan in the summer of 2018 after resolving these issues and confirming that the earnings recovery is on track, as well as working out a new growth strategy. However, with various issues existing in each business area, it now appears that it will take some time for management to formulate a new growth strategy, which includes verifying the current foundation for growth. In addition, the IT solutions business continues to receive orders for large projects, so securing sufficient engineers is a challenge, while in other businesses the challenge will be to expand highly profitable data coordination and cooperation in advance of entering the 2H growth trend. Among these challenges, dealing with the change in the client portfolio is one that will have a large impact on not only short-term results but also on the Company's business structure itself, so measures must be carefully considered based on a medium- to long-term perspective, and we believe that it will take some time to hammer out measures to resolve this issue. Consequently, we expect a sound medium-term management plan to be formulated in the near future.

If the situation remains the same as in 1H, the Company will have difficulty achieving its full-year forecasts for the full FY12/18, as the cost of sales ratio continues to increase while it will be tougher to find ways to reduce SG&A expenses. However, management is currently working on measures targeting the challenges facing it, especially with respect to controlling the cost of sales, and right now the full-year forecasts are still viewed as achievable. We also expect these measures to become the foundation that will support the medium-term re-growth of the research business. Furthermore, we think that double-digit growth over the medium to long term is possible if the Company is able to bolster direct sales, which can generate large profits, as well as businesses peripheral to research.

Differences in forecasts and actual results for 2015–2017 medium-term management plan and direction of next medium-term management plan



Source: Prepared by FISCO from Company materials

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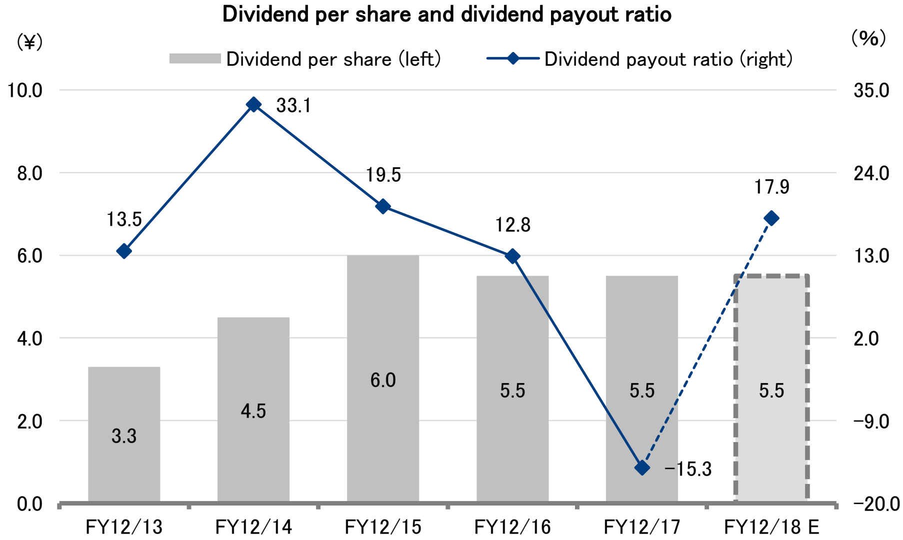
Shareholder return policy

Annual dividend to be maintained in FY12/18

With regard to dividends, the Company maintains a policy of providing stable returns to shareholders in the form of dividends. However, in view of the great demands on capital at the present 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 attributable to owners of parent 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. For FY12/18 interim dividend, the Company maintains the plan of ¥2.5 per share.

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

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