FreeBit Co., Ltd.
3843 TSE Mothers

23-Feb.-16

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Toward a full-fledged growth phase from FY4/17 through the expansion of the main businesses, including Mobile

FreeBit Co., Ltd. <3843> (hereafter, also "the Company"), based on its corporate philosophy of "Being the NET Frontier! (expand the Internet, contribute to society)," leverages its strength of accumulating technological capabilities, of the development of Internet-related core technologies and the management of large-scale systems, to provide a variety of Internet services to corporations and individuals, from infrastructure through to consulting and solutions. In addition to the provision of infrastructure for Internet service providers (ISP), the businesses the Group is involved in include providing support for entering into the mobile business and Internet advertising. Since its IPO in 2007, the Company has been actively acquiring ISP and Internet advertising companies and expanding its business area and scale. At the present time, it has a strategic capital and business alliance with Culture Convenience Club Co., Ltd. (hereafter, "CCC") and is focusing on expanding its Mobile Business.

In the FY4/16 Q2 cumulative consolidated results (May to October 2015) announced on December 11, the Company recorded sales of ¥13,344mn (up 26.8% year-on-year (y-o-y)), operating income of ¥844mn (up 40.9%), and profits attributable to owners of the parent of ¥218mn (down 69.6%), and it maintained double-digit increases in sales and operating income. The main factors behind this were the steady expansions of the Mobile Business and the Ad Technology Business. The reason for the fall in profits was an absence of deferred tax assets, which had been recorded in the same period of the previous fiscal year.

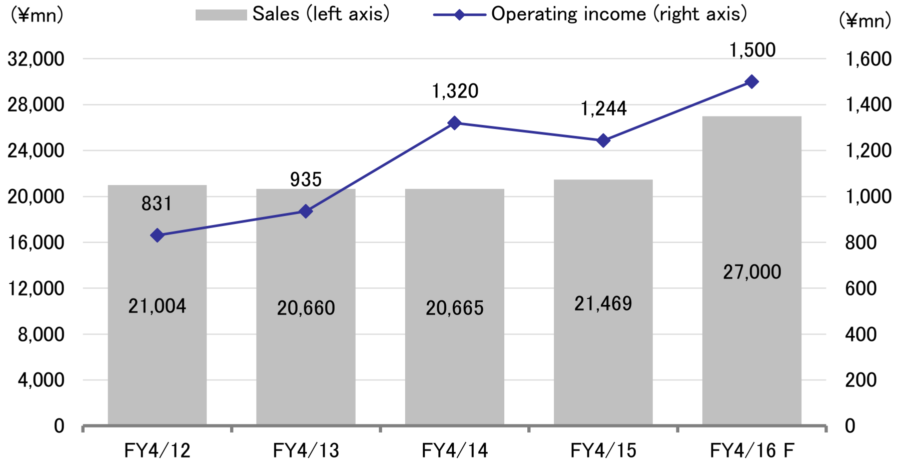
Regarding the FY4/16 forecasts, in its Q2 results the Company can be judged to have made progress basically in line with its targets (the progress rates for the FY4/16 Company forecasts were 49.4% for sales, 56.3% for operating income, and 109.3% for net income) and the initial targets (sales of ¥27,000mn and operating income of ¥1,500mn) have been left unchanged. At FISCO, we view the Company targets as conservative and think it is highly likely that results will exceed them. This is because in addition to the brakes being applied to the decline in sales in the Broadband Business, which has shackled performance in the past, and the strong performance of the Ad Technology Business, we anticipate that the effects from the launch of the LTE compliant new terminal TONE (m15) will spur the expansion of the Mobile Business.

Based on its Medium-Term Management Plan SiLK VISION 2016 (targets: FY4/16 sales of ¥30,000mn and operating income of ¥3,000mn), the Company is developing its business strategy of progressing the vertical integration of the components built up to FY4/13 (multi-layered services), and the horizontal development of the 3 growth (revolution) areas of Mobile Revolution, Life Revolution, and Production Revolution. Although the Company targets in the final fiscal year of the plan are below the Medium-Term Plan targets in terms of profits, as growth trends can be confirmed in the FY4/16 Q2 results for the Mobile Business and Ad Technology Business, which are the main businesses that the Company has been working to expand, we judge that its business is progressing as planned and it is highly likely that the pace of profit growth will accelerate in the future.

Check Point

- Changed the business segments from FY4/16 with the objective of clarifying trends in its main businesses
- Achieved double-digit increases in sales and income in FY4/16 Q2 results, and its main businesses, the Mobile Business and Ad Technology Business, are expanding
- Future sales of the LTE compliant new terminal TONE (m15) launched in November 2015

Results trend



Company Profile and History

Infrastructure provider based on the Internet, expanding its business through active M&As

Based on its corporate philosophy of “Being the NET Frontier! (expand the Internet, contribute to society)” and its mission of “Creating New Products from Zero,” the Company leverages its strength of accumulating technological capabilities, of the development of Internet-related core technologies and the management of large-scale systems, to provide a variety of Internet-related services to corporations and individuals. These proprietary network services that combine cutting-edge technologies, including patented technologies, and marketing that anticipates market needs, enable it to provide solutions that create new value based on the keywords of “Monozukuri (craftsmanship) in the IT age.”

The predecessor of the Company, FreeBit.com Co., Ltd., was founded in May 2000 (name changed to FreeBit Co., Ltd. in December 2002) by Atsuki Ishida, Chairman of the Board & Founder, who was involved in the founding of DREAM TRAIN Internet INC. (hereafter, “DTI”), which is a subsidiary of Mitsubishi Electric Information Network Corporation, and by Nobuaki Tanaka, President, Member of the Board. Based on its proprietary technology it independently developed, it deployed Internet business support operations for companies managing ISP and its sales grew. It listed on the Tokyo Stock Exchange (TSE) Mothers Market in March 2007.

After it listed, the Company developed its strategy based on its Medium-Term Management Plan. At the same time as expanding its business area and scale through actively conducting M&As, it implemented business-structure reforms targeting selection and concentration, which brings it up to the present day. This stage, from its foundation up to the present day, can be divided according to the three Medium-Term Management Plans, of SiLK*[1] VISION 2010, SiLK VISION 2012 & 2012 ver.2*[2], and SiLK VISION 2016.

*1 Rather than developing the Web like a cobweb as it had been developed in the US, the Company aims to create SiLK as a “smooth and soft Internet,” with the word SiLK expressing the Japanese style Internet service.

*2 As SiLK VISION 2010 progressed better than anticipated and the targets were expected to be achieved one year ahead of schedule, the Company formulated SiLK VISION 2012 (FY4/10 to FY4/12) and announced it in April 2009. Subsequently, taking into account the effects of the execution of M&As and other factors, in August 2010 it announced SiLK VISION 2012 ver.2 (FY4/10 to FY4/13) that extended the plan’s period by one year.

* MVNO is the abbreviation of Mobile Virtual Network Operator. It is a virtual mobile communications business and involves conducting an independent communication business by borrowing the lines from communication businesses with a wireless communication infrastructure, such as NTT DOCOMO, INC. <9437>, KDDI Corporation<9433>, and the SoftBank Group Corp. <9984>.

1) SiLK VISION 2010 (FY4/08 to FY4/10)

The Company developed a hybrid strategy based on the Medium-Term Management Plan SiLK VISION 2010 it announced in June 2007 (aiming to acquire ISPs, integrate them with DTI, and increase user numbers. At the same time, aiming to differentiate itself by providing proprietary services utilizing its own technologies). After DTI was consolidated in August of the same year, in March 2009 Media Exchange Co., Ltd. (name changed to FreeBit Cloud Co., Ltd. in September 2010. Merged with DTI in February 2014) and its subsidiary GIGAPRIZE Co., Ltd. <3830> were consolidated. In this way, the Company has been conducting M&As and integrating ISP operators.

2) SiLK VISION 2012 & 2012 ver.2 (FY4/10 to FY4/13)

For the period from 2010 onwards, formulation of the following Medium-Term Management Plan SiLK VISION 2012 that centered on the Smart Infra strategy was announced in April 2010. Under this strategy, the Company aimed to utilize its proprietary technologies, such as network virtualization and transitioning to IPv6, to convert the global Internet infrastructure to “Smart Infra: a light and smart infrastructure.” Based on this strategy, from August 2010 it made consolidated subsidiaries of the Internet advertising agency Full Speed Inc.<2159>, FORiT Inc. that operates an affiliate advertising business and provides its proprietary program Affiliate B, and BEKKOAME INTERNET INC. that operates an IT platform business. Aiming to make its services multi-layered, at the same time as entering into the Cloud business, MVNO*, and Ad Technology Business, the Company has been conducting structural reforms and technological integration in the companies it has acquired, and it has become a corporate group possessing a complete set of components relating to Internet services.

3) SiLK VISION 2016 (FY4/14 to FY4/16)

The Company is developing its strategy of aiming to expand its main business areas based on its Medium-Term Management Plan SiLK VISION 2016 announced in March 2013 (the vertical integration of the components built up to FY4/13 (multi-layered services), and the horizontal development of the 3 revolution areas of Mobile Revolution, Life Revolution, and Production Revolution).

In the Mobile Business, FreeBit Mobile Inc. was established in January 2015 to operate an MVNO business. In February of the same year in this business, the Company formed a strategic alliance with CCC, and then in March changed the corporate name of FreeBit Mobile to Tone mobile inc., and it became the Company’s equity method affiliate (the Company’s capital contribution ratio is 49%). On the other hand in the Ad Technology Business, in October of the same year, Full Speed took over the ad network business for smartphones of Liveaid Inc., and in addition, collaborated with IREP Co., Ltd. <2132>, which is the largest SEM management company in the industry, and founded the joint venture company THINKS Co., Ltd. (the Full Speed capital contribution ratio is 49%).

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History of FreeBit

	Event
May 2000	Founded as FreeBit.com Co., Ltd. in Shibuya Ward, Tokyo, to provide Internet business support
June 2000	Started providing services to ISP (communication operators)
December 2002	Changed its corporate name from FreeBit.com Co., Ltd., to FreeBit Co., Ltd.
December 2003	Launched the FreeBit OfficeOne IP Business Phone, an IPv6 compliant IP telephone service for corporations
May 2004	Announced and launched the OverLay Internet technology Emotion Link
May 2006	Launched the VPN service MyVPN for multi-sites and multi-stores
March 2007	FreeBit Co., Ltd. was listed on the TSE Mothers market
August 2007	Made a consolidated subsidiary of DREAM TRAIN Internet INC., that operates an ISP business for individuals
April 2008	Officially launched operations of Karatsu SiLK Hotlines as a call center business
March 2009	Made a consolidated subsidiary of Media Exchange Co., Ltd. (currently merged into DREAM TRAIN Internet INC.) At the same time, made a consolidated subsidiary of Media Exchange's subsidiary GIGAPRIZE Co., Ltd., which operates a condominiums ISP business
March 2010	Launched the virtual data center service (IaaS) FreeBit CloudVDC (formerly: MeX VDC ENTERPRISE-FARM)
August 2010	Made consolidated subsidiaries of the Internet advertising agency Full Speed Inc., FORiT Inc. that operates an a affiliate advertising business and provides its proprietary program Affiliate B, and BEKKOAME INTERNET INC. that operates an IT platform business
November 2010	GIGAPRIZE Co., Ltd. launched the service RentAgent for people renting an apartment
December 2012	Full Speed Inc. launched the advertising management integration program AdMatrix series
July 2013	FreeBit Co., Ltd. launched the MVNE service FreeBit MVNO Pack (formerly: YourNet MVNO Pack) for MVNO through an L2 connection with NTT DOCOMO, INC.
November 2013	With the aim of improving efficiency, incorporated the SiLK Hotlines call center business within FreeBit Co., Ltd. and founded Freebit Smart Works Inc.
October 2014	With the aim of improving efficiency in its Internet connection-related business, transferred GIGAPRIZE Co., Ltd. to be a direct subsidiary of FreeBit Co., Ltd.
January 2015	Founded FreeBit Mobile, Inc. to operate an MNVO business
February 2015	FreeBit Co., Ltd. implemented a strategic alliance with the Culture Convenience Club Group
March 2015	Changed the corporate name of FreeBit Mobile, Inc. to Tone mobile inc. In conjunction with the implementation of a third-party allocation of shares to Culture Convenience Club Co., Ltd, Tone mobile inc. became an equity method affiliate of FreeBit Co., Ltd.
April 2015	Founded freebit investment inc. with the objective of conducting investments for business expansion
October 2015	Full Speed Inc. takes over the ad network (AID) business for smartphones of Liveaid Inc.
November 2015	Full Speed Inc. collaborates with IREP Co., Ltd., the largest SEM management company in the industry, to found the joint venture company THINKS Co., Ltd.

Source: Prepared by FISCO with reference to the Company's securities reports, homepage, etc.

● Shareholder situation

Looking at the situation in terms of the 10 largest shareholders, in addition Atsuki Ishida, Chairman of the Board & Founder (holding ratio, 14.95%) and Nobuaki Tanaka, President and Member of the Board (11.11%), the main shareholders are CCC, with which it has a strategic capital and business alliance in the Mobile Business, and its subsidiary CCC Mobile Co., Ltd; its business partner OBIC Business Consultants Co., Ltd. <4733>; Keio University professor Jun Murai, who taught Chairman Ishida at university; and freelance journalist Taro Kimura. Combining their shareholdings, the stable shareholder ratio is 42.89%, and when the holdings of other executives and the Employee Stock Ownership Association are added to this, the stable shareholder ratio becomes slightly less than 50%.

Business overview

Provides a wide range of Internet-related services, from infrastructure to consulting and solutions

In addition to the Company, the Group is comprised of 11 consolidated subsidiaries, such as DTI, GIGAPRIZE and Full Speed, and 2 equity method affiliates, including Tone mobile.

In terms of its businesses, it previously disclosed information on 6 business segments based on the Smart Infra strategy described in SiLK VISION 2012 (Broadband Infrastructure Business (FY4/15 sales ratio, 32.2%), Cloud Computing Infrastructure Business (8.5%), Ad Technology Infrastructure Business (37.4%), Next Generation Internet Ubiquitous Infrastructure Business (0.1%), B2C Business (21.1%) and Other businesses, 0.7%)). However, since FY4/16, with the objective of clarifying the future trends in its main businesses, it changed its business segments to the Broadband Business (2016 Q2 sales ratio, 35.9%), the Mobile Business (14.0%), the Ad Technology Business (43.0%), the Cloud Business (6.7%), and Other businesses (0.4%).

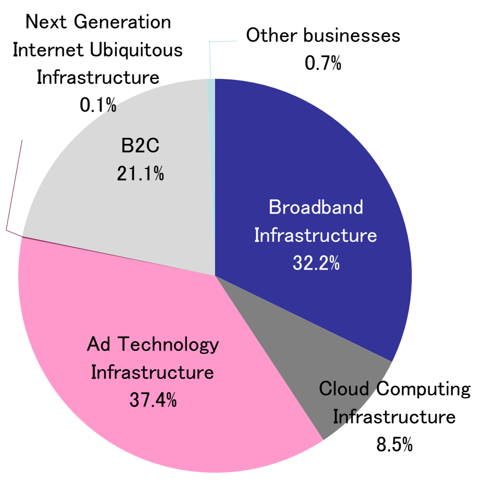
Overview of the changes to the segments

Former segments	Business descriptions
Broadband Infrastructure	The provision of a one-stop service to meet the needs of ISP operators for network lines, mobile connection lines, applications, billing operations, and call support operations.
Cloud Computing Infrastructure	The provision of services for corporations centered on VDC through virtual technology and management expertise. Also, the provision of infrastructure for corporations conducting iDC.
Ad Technology Infrastructure	The provision of services centered on listing advertising, SEM high-speed solutions, and affiliate Web marketing services.
Next Generation Internet Ubiquitous Infrastructure	The provision of ubiquitous-related products characterized by virtualization and IPv6 technology. Provides products in a variety of fields, including Plug in Cloud architecture that makes network compliant devices that are not compliant with the network and realizes the shift to Cloud and M2M cooperation.
B2C	The provision of Internet-related services for individuals, including Internet connection services and Cloud services.
Other businesses	Businesses not categorized into the above-described segments.

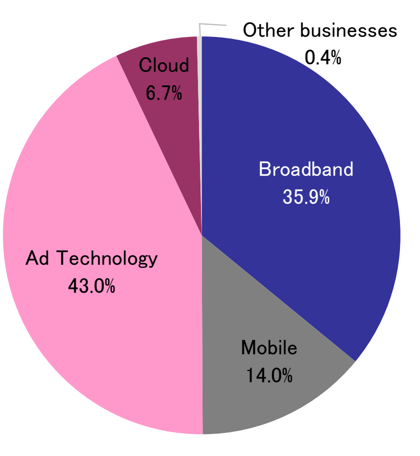
New segments	Main services
Broadband Business	Business support services for ISP, and Internet connection services through fixed lines for customers including general corporations, collective housing, and individuals.
Mobile Business	Business support services for MVNO (mobile virtual network operators) and mobile communication services for individuals
Ad Technology Business	Internet marketing-related services for corporations
Cloud Business	Virtual data center (VDC) services for corporations Cloud services for corporations/individuals
Other businesses	SI and other services not included in the above-described services

Source: Prepared by FISCO based on the Company's financial results summary, securities reports, and financial results briefing materials

Sales ratios by former segments (FY4/15)



New segments sales ratio (FY4/16 Q2)



● **Broadband Business**

The Company, GIGAPRIZE, and DTI conducts this business. Targeting the approximately 300 ISP nationwide in Japan and collective housing (condominiums), it provides a high-speed Internet backbone over fixed and mobile lines, and provides ISP services to support ISP's shift to broadband.

In addition, DTI provides Internet connection services for individuals. Currently, GIGAPRIZE is focusing on expanding ISP services for condominiums through an unified service, from technological surveys and specification design through to maintenance. In addition, it is aiming to strengthen its provision of total IT solutions for the real estate industry and in October 2015, it formed a capital and business alliance with For Members Co., Ltd. which is a developing a franchise of AEON Housing, the real estate intermediary business of AEON MALL Co., Ltd. <8905>, and For Members was made an equity method affiliate (capital contribution ratio of 19.98%).

In terms of the main users, in addition to the Company's subsidiaries DTI and GIGAPRIZE, it holds the largest share of the domestic market based on the number of client companies, with over 300 such companies in the ISP business, including Hi-Bit Inc. Its performance for introducing ISP into collective housing, its focusing area, was 100,829 homes at the end of April 2015 and 122,009 homes at the end of October 2015. Its competitors include Internet Initiative Japan Inc. <3774> (hereafter, IIJ) for corporations and Asahi Net, Inc. <3834> for individuals

● **Mobile Business**

The Company, DTI, and its equity method affiliate Tone mobile conduct this business. As an MVNE (mobile virtual network enabler)*1, the Company provides its support package FreeBit MVNO Pac*2 for MVNO-entrant businesses. It also provides pre-paid SIM sales / rental routers for foreign tourists visiting Japan, and additionally conducts a smart device business that provides smartphones to Tone mobile. Other than these services, DTI provides the mobile high-speed data communication service DTI SIM, which realizes the most inexpensive plan in the industry.

The main users of FreeBit MVNO Pack are U-NEXT Co. Ltd. <9418> (mobile data communication service U-mobile*d), TOSHIBA CORPORATION <6502> (M2M services), BENEFIT JAPAN CO., LTD, Yamada Denki Co., Ltd. <9831> (YAMADA SIM), and also includes group companies Tone mobile and DTI (inexpensive SIM service). The FreeBit MVNO Pack bandwidth at the end of 2015 had expanded at a pace of 4.6 times compared to the end of 2014 due to the growth in the number of users, in conjunction with the increase in the number of companies introducing it. Competitors include Japan Communications Inc. <9424> and IJJ.

Conversely, Tone mobile*3, which is the joint venture company of the Group and CCC, mainly provides smartphones to individuals as an MNVO. In November, the Company launched sales of the LTE compliant new terminal TONE (m15) that it developed with the concept of "Quality to provide peace of mind to everyone" (terminal price, ¥29,800; monthly usage fee, ¥1,000) at Tsutaya Electrics Futakotamagawa and Daikanyama Tsutaya Books. Going forward, the plan is to expand sales to TSUTAYA directly-managed stores and franchise stores.*4

● **Ad Technology Business**

This business is conducted by consolidated subsidiary Full Speed and FORiT, the subsidiary of Full Speed. They utilizes the marketing platform AdMatrix*5 series developed in-house by Full Speed and Affiliate B, a program developed by FORiT to provide highly original Internet advertising solutions services, including for SEO, listing advertising, social media marketing, display advertising, and affiliate advertising.

In October, Full Speed formed a strategic business alliance with IREP with the objectives of improving the expertise of managed advertising and strengthening the structure for providing services at the highest level in the industry, and they founded the joint venture company THINKS. Additionally, it is bolstering the Ad Technology Business, including by taking over businesses, such as the ad network business for smartphones of Liveaid.

The main users are around 1,500 companies with no bias toward any particular industry. There are many competitors, including MicroAd, Inc. under CyberAgent, Inc. <4751> Group, the VOYAGE GROUP Inc.<3688>, FreakOut Inc. <6094>, and UNITED, Inc. <2497>.

*1 MVNE are operators that provide support to companies entering the MVNO business. Positioned between communication businesses and MVNO, they provide a variety of services, from billing controls, user support, application platforms, provision of contents, systems management, and customer care, through to negotiating with mobile communication businesses.

*2 The package service that the Company provides by which all businesses can realize an MVNO business at low cost and low risk in a short span of time.

*3 It was founded in February 2015 through a capital and business alliance with CCC in order to strengthen its planning and sales force toward the goal of capturing one million users in the mobile area. Its predecessor was FreeBit Mobile (founded January 2015), which was based on the Group's smartphone carrier business that it entered-into in November 2013. Its corporate name was changed in March 2015, and following a third-party allocation of shares to CCC, it became the Company's equity method affiliate (the Company's capital contribution ratio is 49%).

*4 As of December 18, it is for sale at one store in Hokkaido, one store in Tohoku, eight stores in Kanto (of which, seven are in Tokyo), two stores in Chubu, two stores in Kansai, one store in Chugoku/Shikoku, and three stores in Kyushu.

*5 The advertising management integration platform provided by Full Speed. It maximizes advertising through the integrated management of all marketing phases, from awareness of the advertising among site users through to applications and purchases.

● **Cloud Business**

This business is conducted by the Company, BEKKOAME INTERNET, and DTI. They utilize the data center management expertise cultivated in broadband infrastructure management to provide a wide range of Cloud services, including IaaS*1, SaaS*2, and VPN, and also to provide virtual cyber services and large-scale email systems that utilize the Cloud to the greatest possible extent.

The main users of the virtual data center (VDC)*3 service are corporations, including game companies and TV stations. Conversely, the main users of the Cloud services are both corporations and individuals. In addition to IIJ, competitors include SAKURA Internet Inc. <3778> and Bit-isle Equinix Inc.

● **Other businesses**

Corresponds to SI businesses providing services not described above

*1 Infrastructure that enables services to be used remotely over the Internet, such as the equipment and lines needed to operate the information system.

*2 A mechanism that enables the user to call for and use the software when they need it, such as over the Internet.

*3 A mechanism or service for virtually building the functions of a data center so they can be used over the Internet

The Company's characteristics, strengths and business risks

One of only a few companies that possess the high-level technological development capabilities and application capabilities to provide a one-stop Internet service

The Company's strength is that it is one of only a few companies that can provide a one-stop service by offering a variety of multi-layered Internet-related services based on its proprietary technologies. This strength is built on three points: 1) the Company possesses many proprietary technologies that it developed independently*4, 2) it has the application technological capabilities that enable it to turn these technologies into core component API*5, and 3) it has a business model in which 90% of earnings are from continuous billing.

Recently, the Company has focused on expanding its Mobile Business and Ad Technology Business. Therefore, we think that the risks in these businesses could constitute the greatest risk factors.

First, with regards to the Mobile Business, the risks that can be cited are the reduction in mobile phone charges and the launch of Tone mobile. With regards to the reduction in mobile phone charges, when a price reduction by a major communicator operator, such as NTT DOCOMO, is considerable, it has a negative impact, as the MVNO share of the Company's users declines, causing its results to worsen. But the current situation, that sales in which the terminal is free will not be possible, is expected to remain, so it is difficult to imagine that a full-fledged price war will develop. So for MVNO, it is highly likely that this will instead have a positive effect, which is why we think it will not be a risk.

With regards to the launch of Tone mobile, its results may fluctuate depending on the progress made in store development and the scale of the investment in advertising expenses. Specifically, while advertising will be conducted in conjunction with the period for store expansion (from February), if the progress made by CCC in its store development is slower than anticipated, the acquisition of users will fall below the target, which will have an adverse effect on sales of terminals and communication services.

On the other hand, the risks for the Ad Technology Business can be considered to be the acquisition of clients for the main products, such as AdMatrix, falling below the target.

*4 It has already acquired patents for 37 technologies (of which, 26 are overseas) and is currently applying for patents for 25 technologies (of which, 23 are overseas).

*5 A key component. The Company focuses on the development of core components that will become the foundation of its services. It is able to provide a variety of services through combining these component API.

Results trends

Results to shift to a full-fledged growth phase on the completion of the business restructuring

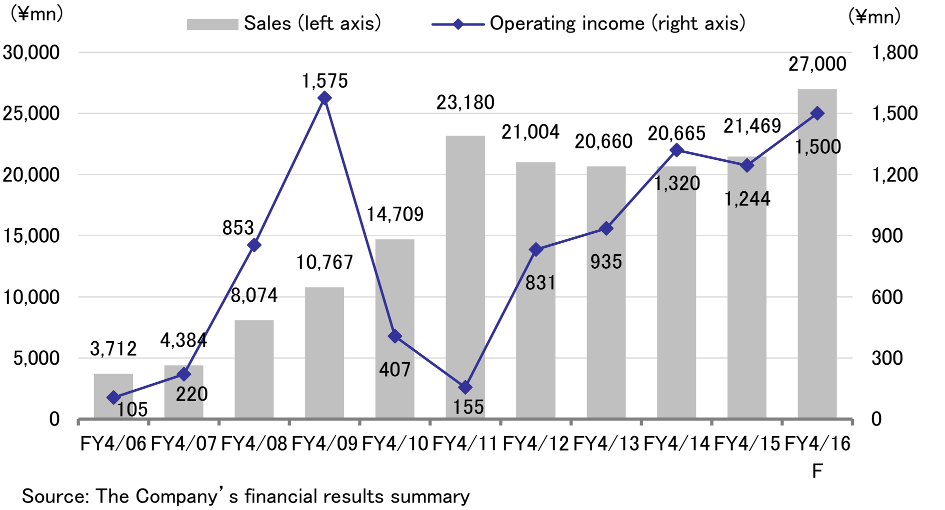
● **Past results trend**

1) FY4/06 to FY4/14

Looking at the results trends from FY4/06, due to the acquisitions of DTI and Full Speed, sales steadily expanded from FY4/11. In contrast, operating income peaked in FY4/09 and then deteriorated up to FY4/11. The factor behind this was a reaction from the FY4/09 profit level, which was an expansion to a level above the Company's actual strength due to the effects of keeping down costs, particularly advertising costs, immediately after DTI was made into a subsidiary. In addition, in FY4/11 profits were negatively affected by the liquidation of the low-profitability, non-core businesses of the acquired companies (apparel, consumer electronics, and outbound telemarketing).

In May 2010, the Company categorized its expanding businesses into core and non-core businesses and announced the SiLK Renaissance restructuring to establish a system to concentrate the investment of resources into core businesses that were unique and competitive. During FY4/11, it implemented business structural reforms to separate the non-core businesses. From actualizing the results of this, profits changed to an improvement trend from FY4/12.

Past results trends



Source: The Company's financial results summary

2) FY4/15 consolidated results overview

In the FY4/15 consolidated results, sales increased 3.9% y-o-y to ¥21,469mn, operating income declined 5.8% to ¥1,244mn, and net income rose 335.1% to ¥1,025mn. The reasons for the significant rise in net income included the recording of deferred tax assets following the merger of the subsidiaries DTI and FreeBit Cloud, the recording of gains on the sale of investment securities by Full Speed, and the recording of gains from a business transfer following the transfer to CCC of the freebit mobile business Franchise Program Master License.

FY4/15 consolidated results overview

(unit: ¥mn)

	FY4/14		FY4/15		
	Result	vs sales	Result	vs sales	y-o-y
Sales	20,665	-	21,469	-	3.8%
Cost of sales	12,667	61.2%	13,909	64.7%	9.8%
Gross profit	7,998	38.7%	7,560	35.2%	-5.4%
SG&A expenses	6,677	32.3%	6,315	29.4%	-5.4%
Operating income	1,320	6.3%	1,244	5.7%	-5.8%
Ordinary income	1,219	5.9%	982	4.5%	-19.4%
Income before income taxes	909	4.4%	1,518	7.0%	66.8%
Net income	235	1.1%	1,025	4.7%	335.0%

Source: Prepared by FISCO based on the Company's financial results summary and briefing materials

The main factors behind the Company securing an increase in sales were the continued growth of the Mobile Business and Full Speed's Ad Technology Business. In contrast, the main reasons for the decline in operating income were the decline in income from the fall in sales from the fixed network of the Company and DTI, and the costs incurred from the strategic investment in accordance with the Medium-Term Management Plan, including the costs for freebit mobile. Operating income declined due to the above reasons despite the positive factors, including the higher income from the increase in sales from the Mobile Business and the expansion of condominium Internet services, and also the improvement in earnings following the withdrawal from the EC business in BEKKOAME INTERNET.

Conversely, compared to the Company targets (sales of ¥27,000mn, operating income of ¥1,500mn, and net income of ¥200mn), sales and operating income were both below target, but net income was above it. The main reasons why sales and operating income fell below the targets were 1) in preparation for business development following the alliance with CCC, the activity plan was postponed, and as a result, freebit mobile sales were down ¥1,248mn (the impact on operating income was ¥160mn), and 2) the recording of \400mn in proceeds on the transfer to CCC of the Franchise Master Program, a freebit mobile business, as an extraordinary gain that had been scheduled to be recorded in sales (impact on operating income, ¥400mn).

●Overview of the FY4/16 Company targets and the FY4/16 Q2 cumulative consolidated results

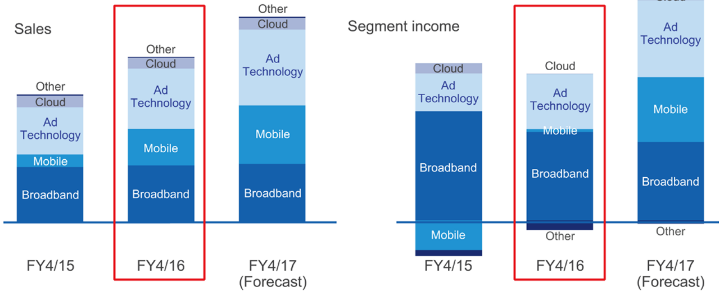
1) Overview of the FY4/16 Company targets

The Company targets in FY4/16 are sales of ¥27,000mn (up 25.8% y-o-y), operating income of ¥1,500mn (up 20.5%), and profits attributable to owners of the parent of ¥200mn (down 80.5%). The increase in income is mainly from the forecast expansion of the Ad Technology Business and the Mobile Business.

FY4/16 sales by segment, income targets, and yearly trends

Segment	FY4/16 (¥mn)	
	Sales	Segment income
Broadband Business	9,675	1,367
Mobile Business	5,273	44
Ad Technology Business	10,305	850
Cloud Business	1,891	6
Other businesses	102	−149

Yearly trends by segment



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The Group's basic policy is to aim to expand its market share through cultivating its three main areas of Mobile, Ad Technology, and Life (the IoT (Internet of Things)* for households, mainly for condominium Internet services).

Even though the plan is to implement strategic investment of ¥655mn in the main businesses of the Mobile Business and Ad Technology Business, the target is for this amount to be absorbed by the growth in income in both businesses and for them to secure double-digit increases in operating income.

* Performs automatic recognition, automatic controls, remote measurements, etc., through connections to the Internet and mutual communication not only for information communication devices, such as computers, but also for various other items that do not have a communication function.

Details of the strategic investment

(unit: ¥mn)

Investment field		Item	Plan
NW-related	Mobile	Capital investment with an eye to business growth, acquiring various types of licensing, and building systems	370
	Fixed network	Strengthening the network toward improving quality in response to the increase in traffic	210
Ad technology-related		The continual development of ad technology-related merchandise, including DSP	75

Source: The Company's results briefing materials

2) FY4/16 Q2 cumulative (April to October 2015) consolidated results

In the FY4/16 Q2 cumulative consolidated results, sales were ¥13,344mn (up 26.8% y-o-y), operating income was ¥844mn (up 40.9%), and profits attributable to owners of the parent were ¥218mn (down 69.6%). The progress rates compared to the FY4/16 Company forecasts were 49.4% for sales, 56.3% for operating income, and 109.3% for net income.

Overview of the FY4/16 Q2 results

(unit: ¥mn)

	FY4/15 Q2		FY4/16 Q2		
	Result	Relative to sales	Result	Relative to sales	y-o-y
Sales	10,521	–	13,344	–	26.8%
Cost of sales	6,659	63.2%	9,421	70.6%	41.5%
Gross profit	3,862	36.7%	3,922	29.3%	1.6%
SG&A expenses	3,262	31.0%	3,077	23.0%	-5.7%
Operating income	599	5.7%	844	6.3%	40.9%
Ordinary income	511	4.8%	591	4.4%	15.7%
Comprehensive profit attributable to owners of the parent	718	6.4%	218	4.8%	-69.6%

Source: Prepared by FISCO based on the Company's financial results summary and briefing materials

The main factors behind the double-digit increase in sales were the strong performances of the Mobile Business and Full Speed's Ad Technology Business. Cost of sales increased 41.5% y-o-y to ¥9,421mn, due to the rise in costs to purchase bandwidth in conjunction with the expansion of the Mobile Business, while the cost of sales rate rose from 63.3% in the same period in the previous fiscal year to 70.6%. Conversely, SG&A expenses fell 5.7% to ¥3,077mn, due to the declines in advertising expenses and sales promotions expenses following the FreeBit Mobile company split and the decrease in customer-acquisition incentives in the fixed network. As a result, operating income increased greatly, by 40.9% y-o-y, and the operating margin rose from 5.7% in the same period in the previous fiscal year to 6.3%.

The recording of a major increase in operating income was because the negative effects of a decline in income (¥183mn) due to the fall in sales from the Company's and DTI's fixed networks and also the decline in income (¥174mn) due to incurring costs to strengthen the fixed network, were exceeded by the positive effects of increases in income from the growth in sales in the Ad Technology Business (¥343mn) and in condominiums Internet (¥112mn), and also from higher sales of the MVNO Pack (¥41mn).

The main negative factors behind the decline in profits attributable to owners of the parent included 1) the difference in corporation tax and the corporation tax adjustment amount (¥388mn), 2) a reduction in gains on the sale of investment securities (¥103mn), 3) a change in gains from equity following the Full Speed capital increase in the previous fiscal year (¥79mn), and 4) an increase in profits attributable to non-controlling interests (¥75mn).

FISCO

FreeBit Co., Ltd.
3843 TSE Mothers

23-Feb.-16

* DTI Hikari user numbers increased by around 8 times in approximately 6 months, while DTI with DoCoMo Hikari user numbers also increased by more than 4 times in 5 months.

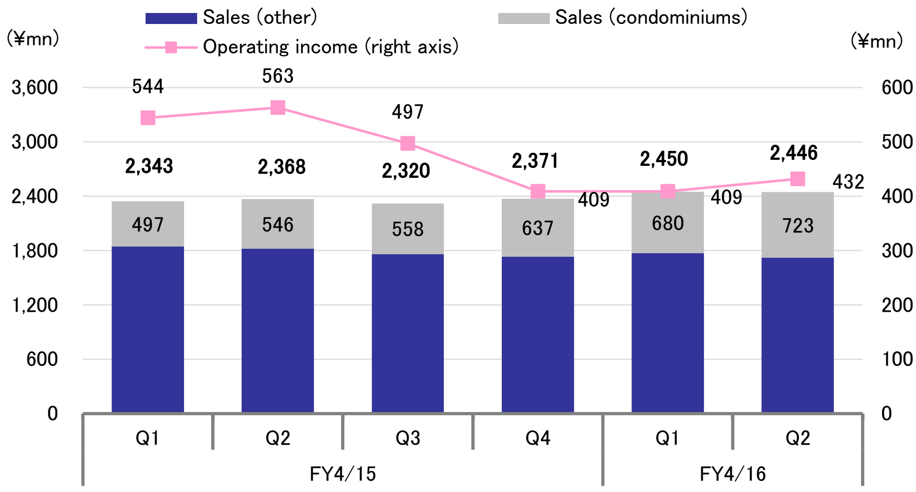
The conditions according to segment are as follows.

1) Broadband Business

Due to factors including GIGAPRIZE's Internet services for collective housing trending strongly (an increase of 21,180 homes compared to end of April 2015) and the increase in user numbers* following the start of the DTI's provision of ISP collaborative products for individuals, of DTI Hikari and DTI with DoCoMo Hikari, sales increased to ¥4,897mn (up 3.9%). However, due to the negative factors, of the decline in sales from existing fixed lines and higher cost from the growth in communication traffic in conjunction with greater viewing of videos, segment income fell ¥841mn (down 24.1%).

But looking at the trends on a quarterly basis, with the expansion in the condominium ISP business as the growth engine, both sales and segment income appear to have bottomed out and to be rebounding, while the decline from existing fixed lines also looks to have been halted.

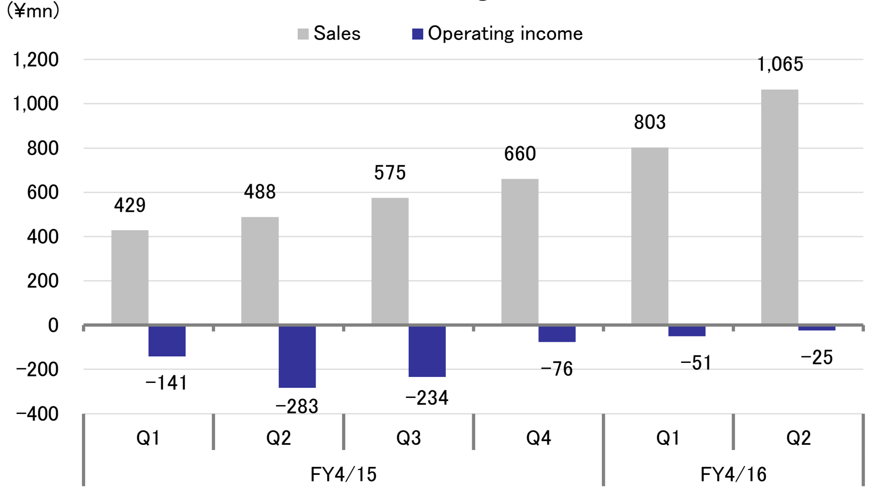
Broadband sales / segment income trends



2) Mobile business

In addition to the increase in the acquisition of users from businesses providing the MVNO support package FreeBit MVNO Pack, MVNO services for inbound also trended strongly. As a result of these and other factors, sales grew significantly to ¥1,868mn (up 103.6% y-o-y). In addition to the increase in income from the higher sales, the income-improvement effects from the FreeBit Mobile company split also contributed, resulting in the segment loss being reduced by ¥76mn compared to the same period in the previous fiscal year, from ¥425mn to ¥348mn.

Mobile business sales / segment income trends

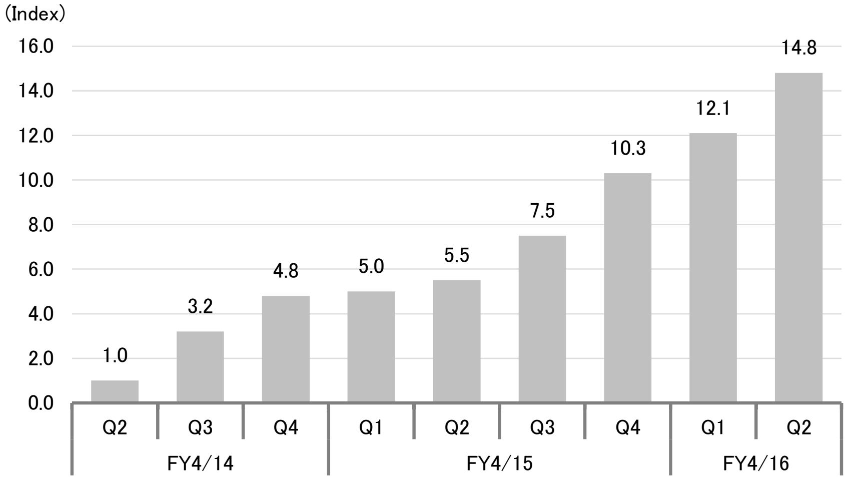


Source: Prepared by FISCO based on the Company's results briefing materials

3) Ad Technology Business

Significant increases in both sales and income were recorded, with sales rising 44.4% to ¥5,751mn and segment income by 81.3% to ¥426mn. In addition to the contribution from the increase in sales from the growth in sales of the AdMatrix series, which is an advertising management comprehensive platform independently developed by Full Speed, sales of affiliate advertising and social media marketing services also rose. Moreover, sales of Affiliate B, the affiliate program of FORiT, trended strongly.

Admatrix DSP services quarterly sales trend



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

4) Cloud Business

Both sales and income declined, with sales falling 3.3% to ¥970mn and segment income down 33.5% to ¥28mn. Despite the increase in sales from the sales growth of Cloud services and network security services, centered on FreeBit Cloud VDC, which boasts strong security and high reliability, these declines were due to negative factors including the fall in sales of housing-hosting services by BEKKOAME INTERNET, and the costs associated with the development of highly differentiated products and the cost structural reforms.

The FY4/16 outlook

The full-year outlook is for the initial forecasts to be left unchanged, although it is highly likely that results will exceed them

The Q2 results were basically in line with the FY4/16 Company forecasts, so the initial forecasts have been left unchanged (sales of ¥27,000mn and operating income of ¥1,500mn).

Progress rate by segment in FY4/16 1H and the forecast for 2H

(¥mn)

	FY4/15		FY4/16						
	1H result	Ratio	1H result	Ratio	y-o-y	Progress rate	2H Company forecasts	Ratio	Targets
Sales total (before elimination of internal transactions)	10,521	-	13,344	-	26.8%	49.4%	13,655	-	27,000
Broadband	4,712	44.8%	4,897	36.7%	3.9%	50.6%	4,777	35.0%	9,675
Mobile	917	8.7%	1,868	14.0%	103.6%	35.4%	3,404	24.9%	5,273
Ad Technology	3,982	37.9%	5,751	43.1%	44.4%	55.8%	4,553	33.3%	10,305
Cloud	1,004	9.5%	970	7.3%	-3.3%	51.3%	920	6.7%	1,891
Other businesses	102	1.0%	51	0.4%	-49.3%	50.8%	50	0.4%	102
Adjusted amount	-198	-1.9%	-196	-1.5%	-1.0%	-	-49	-0.4%	-246
Operating income	599	-	844	-	40.9%	56.3%	655	-	1,500
Broadband	1,108	184.7%	841	99.6%	-24.1%	61.6%	525	80.2%	1,367
Mobile	-425	-70.9%	-76	-9.1%	-81.9%	-	120	18.4%	44
Ad Technology	235	39.2%	426	50.4%	81.3%	50.1%	423	64.7%	850
Cloud	42	7.1%	28	3.4%	-33.5%	472.5%	-22	-3.4%	6
Other businesses	-35	-5.9%	-72	-8.6%	102.5%	-	-76	-11.7%	-149
Adjusted amount	-325	-54.2%	-302	-35.7%	-7.1%	-	-315	-48.2%	-618

Source: Prepared by FISCO based on the Company's financial results summary and briefing materials

At FISCO, we think the fact the Company targets have been left unchanged is conservative and that it is highly likely that results will exceed them. First, looking at sales by segment, except for the Mobile Business, the Q2 progress rates exceed 50% of the full-year targets, so it can be considered highly likely that the results will exceed the targets in each of the segments. With regards to income also, except for the Mobile Business, the progress rates are again above 50% and the same as for sales, we think it is very likely that results will exceed the targets.

The Broadband Business progress rates are 50.6% of the sales target and 61.6% of the income target. A stumbling block in this business has been the decline in sales from existing fixed lines and the resulting decline in income. However, in addition to the strong performance of the condominiums ISP business and the growth in user numbers from the launch DTI's collaborative ISP products for individuals, of DTI Hikari and DTI with DoCoMo Hikari, the effects of GIGAPRIZE's capital and business alliance with For Members are expected to be actualized and the forecast is for the strong performance to continue in 2H.

The progress rates in Full Speed's Ad Technology Business are 55.8% of the sales target and 50.1% of the income target. Following the completion of the first phase of the systems development, sales of the AdMatrix DSP service, which started full-fledged operations in FY4/16, have been solid. In addition, it is considered highly possible that the effects of the ad network business for smartphones, which was a business transferred in October, and of the business alliance with IREP, will push-up the results. So it is thought highly likely that 2H results will exceed the targets.

With regards to the Mobile Business, whose sales were greatly below the target, we do not think it is necessary to be pessimistic upon considering the following factors:1) the effects of the launch of the new terminal TONE (m15) in November are expected to be actualized and the March and April demand period from people starting school and work is approaching and 2) increases in sales from SIM and DTI SIM are forecast. With regards to profits also, if it becomes apparent that the improvement trend is continuing and sales are growing from the effects of the launch of TONE (m15) and other factors, then we think it is very possible that sooner or later this business will return to profitability.

Financial position

Major improvement in the financial position from the FY4/15 capital increase

At the end of FY10/15, total assets had increased ¥978mn from the end of the previous fiscal year to ¥20,301mn. Breaking this down, current assets rose ¥1,384mn due to increases in cash and deposits (¥258mn), notes and accounts receivable-trade (¥368mn), and merchandise and finished goods (¥248mn). Conversely, non-current assets fell ¥406mn, as although software increased (¥163mn), this was exceeded by declines in goodwill (¥212mn) and investment securities (¥215mn).

Liabilities increased ¥1,019mn compared to the end of the previous fiscal year to ¥9,688mn. This was because although long-term loans payable (including the current portion of long-term loans payable) fell ¥607mn, short-term loans payable (¥1,051mn) and accounts payable (¥817mn) increased. Also, net assets fell ¥41mn to ¥10,613mn mainly due to the acquisition of treasury shares (¥263mn), despite increases in retained earnings (¥60mn) and non-controlling interests (¥179mn).

The balance sheet and management indicators

(¥mn)

	FY4/13	FY4/14	FY4/15	FY4/16 Q2	Change	Breakdown
Current assets	10,536	10,030	12,596	13,981	1,384	Cash and deposits +258, Notes and accounts receivable-trade +368, Merchandise and finished goods +248
Non-current assets	4,076	6,701	6,726	6,320	-406	Software +163, Goodwill -212, Investment securities -215
Total assets	17,869	16,732	19,323	20,301	978	
Current liabilities	7,744	7,915	6,983	8,277	1,293	Short-term loans payable +1051, Accounts payable-other +817, Current portion of long-term loans payable -305
Non-current liabilities	3,883	2,330	1,686	1,411	-274	Long-term loans payable -301
Total liabilities	11,627	10,245	8,669	9,688	1,019	
Net assets	6,242	6,486	10,654	10,613	-41	Retained earnings +60, Treasury shares -263
Total liabilities and net assets	17,869	16,732	19,323	20,301	978	Non-controlling interests +179
Operating cash flow	1,688	1,689	2,207	652		
Investing cash flow	-831	-234	-524	-120		
Financing cash flow	-986	-1,492	585	-166		
Cash and cash equivalents	4,708	4,706	6,983	7,341		
Interest-bearing debt	6,219	5,071	3,197	3,641		
Net cash	-1,534	-309	3,786	3,700		
Indicators of financial strength						
Current ratio	136.0%	126.7%	180.3%	168.9%		
Equity ratio	33.2%	36.1%	50.9%	47.5%		
D/E ratio	105.0%	84.3%	32.4%	37.7%		
Indicators of profitability						
ROE	-3.0%	3.9%	12.9%	–		
ROA	2.6%	7.1%	5.4%	–		
Operating margin	4.5%	6.3%	5.7%	6.3%		

Source: Prepared by FISCO based on the Company's securities reports and financial results briefing

Due to the increase in short-term loans payable, the current ratio and the equity ratio, which are indicators of financial strength, slightly worsened compared to the previous fiscal year, in which the financial condition significantly improved due to the third-party allocation of shares to CCC. But despite this, there has been no change to the medium-term improvement trend.

Medium-term growth strategy

Business development is moving in the direction described in the Medium-Term Management Plan and the pace of growth may accelerate

Based on the SiLK VISION 2016 announced in March 2013 (FY4/16 targets: sales of ¥30,000mn and operating income of ¥3,000mn), the Company is developing its business strategy of progressing the vertical integration of the components built up to FY4/13 (multi-layered services), and the horizontal development of the 3 growth (revolution) areas of Mobile Revolution, Life Revolution, and Production Revolution.

The Company targets for FY4/16, which is the final fiscal year for the plan, are sales of ¥27,000mn and operating income of ¥1,500mn. While sales are expected to exceed this target, operating income is set to fall below it. We judge that its businesses are progressing as the Company expected because the 1) downward deviation of operating income is to a large extent due to the effects of the transfer of the freebit mobile business to Tone mobile and 2) from its FY4/16 Q2 results, it can be confirmed that the growth trends in the Mobile Business and Ad Technology Business, which are the businesses the Company has been working to expand based on SiLK VISION 2016, have solidified. It is highly likely that the pace of income growth will accelerate from FY4/17 onwards.

Returning Profits to Shareholders

Basic policy is to continuously return profits to shareholder from a medium- to long-term perspective

While the Company is developing and expanding its business for the future by retaining the internal reserves necessary to strengthen its management foundations and financial position, its basic policy is to prioritize continuous returns of profits to shareholders at the same time as obtaining their understanding on its policy for business expansion that it is aiming for from a medium- to long-term perspective.

With regards to the payment of dividends from retained earnings, the Company appropriately returns profits to shareholders in consideration of the progress made in its Medium-Term Management Plan and business performance in each respective consolidated fiscal year. In FY4/15 it paid a dividend of ¥7 (a dividend payout ratio of 13.6%), and while the dividend for April 2016 is still unknown, it is expected to be around the same level as the previous fiscal year.

In addition, the Company conducted a share buyback with the objective of raising value per share and also to implement a flexible capital policy in response to changes in its management environment (acquisition period, September 14 to December 31, 2015: number of shares to be acquired (upper limit), 350,000 shares; total cost of acquisition (upper limit) ¥300mn). As a result of this buyback, it acquired 350,000 shares (acquisition period, September 14 to October 1) at a total cost of ¥263.9mn.

Other than this share buyback, the Company has acquired its own shares on two other occasions in the past. The same as the current buyback, the objectives were to raise value per share and to implement a flexible capital policy in response to changes in its management environment. But it is considered that the share price was judged to have remained undervalued due to the slump in results. At FISCO, when considering that presently the results have clearly changed direction toward a full-fledged growth trend, going forward we consider that the Company will continue with its policy of returning profits to shareholders through stably paying dividends and conducting share buybacks.

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