

Hotto Link Inc.

3680

TSE Mothers

6-Oct.-2020

FISCO Ltd. Analyst

Yuzuru Sato



FISCO Ltd.

<http://www.fisco.co.jp>

■ Index

| | |
|---|-----------|
| ■ Summary | 01 |
| 1. Overview of the FY12/20 1H results | 01 |
| 2. FY12/20 outlook | 01 |
| 3. Future growth strategy | 02 |
| ■ Company profile | 03 |
| 1. Company history | 03 |
| 2. Business description | 04 |
| 3. Hotto Link's strength | 07 |
| ■ Results trends | 08 |
| 1. Overview of the FY12/20 1H results | 08 |
| 2. Trends by business segments | 10 |
| 3. Financial position and financial indicators | 12 |
| ■ Outlook | 13 |
| 1. Outlook for FY12/20 | 13 |
| 2. Growth strategy | 14 |
| 3. SDGs initiatives | 18 |
| ■ Shareholder return policy and business risks | 18 |
| 1. Shareholder return policy | 18 |
| 2. Business risks | 18 |
| ■ Information security measures | 19 |

■ Summary

Possibility of entering a dramatic growth phase led by expansion of the social media advertising market

Hotto Link Inc. <3680> (hereafter, also “the Company”) is an IT company that mainly delivers digital marketing support services that utilize social media data. Its key subsidiaries are U.S.-based Effyis, Inc. which sells data access rights to major social media, and Trend EXPRESS Inc., which is developing services targeting the Chinese market, including Trend PR*1, a Web promotion-support service, and Cross-border EC X (cross)*2, a cross-border EC service to China.

*1 Trend PR is a service intended for companies that are aiming to expand the sales of their own products to Chinese consumers by proposing and implementing optimal promotions based on analysis of word-of-mouth data on SNS. It leverages the strength of being able to use data from a major Chinese SNS provider. Key features are visualization of the effect obtained from marketing costs and realization of high cost efficacy.

*2 Cross-border EC X is the Company’s one-stop service to support customers, from customer acquisition to distribution, through promotions measures that utilize about 450,000 social buyers between Japan and China, the leading stores on the major EC mall Taobao, and the leading KOL.

1. Overview of the FY12/20 1H results

In FY12/20 1H (Jan-Jun 2020), the Company’s consolidated results were ¥1,897mn in net sales (+15.8% YoY) and ¥121mn in operating loss (vs. ¥408mn a year earlier). Despite cancellations and delays of some promotions in Japan and China due to the COVID-19 outbreak, domestic SNS marketing support service rapidly expanded with a 96.7% YoY increase, and net sales reached a new all-time high for 1H. In profits, the Company narrowed losses thanks to benefits from higher sales and success in cost-cutting measures implemented since 2019 (such as business focus and selection and personnel cutbacks).

2. FY12/20 outlook

For the FY12/20 outlook, the Company is currently in the process of carefully assessing the impact of COVID-19 on business and intends to disclose it once reasonable estimates are available. While recovery in promotion deals for inbound demand from China seems unlikely given the current situation, local promotion business in China has started picking up and domestic SNS marketing support service showed signs of recovery from June 2020 onward. Net sales in the FY12/20 2H hence should be stronger than the 1H level. The DaaS business handled by Effyis, meanwhile, is likely to deliver stable growth from the 2H as well with support from an exclusive data partnership concluded in May 2020 with U.S.-based Quora, Inc., which operates one of the world’s largest knowledge-sharing platform Quora and sustained global expansion of social media data demand. FISCO hence expects an ongoing upward trend in sales from 3Q as the overall direction.

Summary

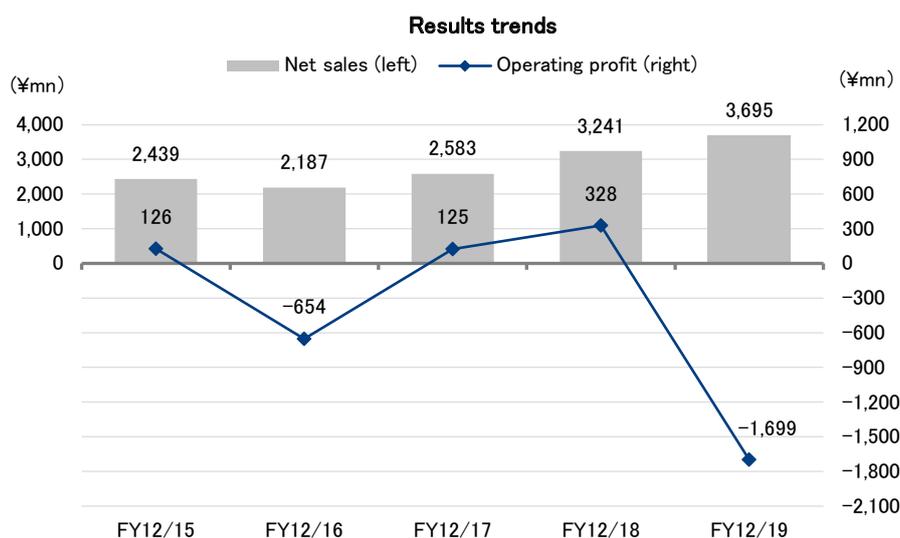
3. Future growth strategy

The Company has outlined a strategy to focus resources on the SNS Marketing Support Business in Japan and marketing support business in the Chinese market handled by Trend EXPRESS that leverage strengths of “big data analysis technology” accumulated since its founding and “global-scale data access rights” related to social media held by Effyis and pursue robust growth. In Japan, social medial advertising is likely to be a growth driver as the online advertising market expands at a double-digit annual rate, and this situation offers an excellent opportunity for the Company to achieve dramatic growth by leveraging strengths in this field. In the Chinese market where Trend EXPRESS operates, word-of-mouth information on social media affects the consumption behavior of individuals more than in Japan. The Company aims to realize strong growth in this business through provision of services with strong cost efficacy using its advantage of full access to data from a major Chinese SNS firm. Effyis aims to acquire further data access rights to major social media and in preparation for a new dark-web data product, it began advance sales and test marketing in 2020. This product addresses needs at government-related entities and companies that handle terrorism countermeasures and other digital risk management. With high added value, it has the potential to make healthy contributions to earnings.

* The “dark web” refers to web sites that cannot be found with Google and other conventional search engines or viewed with Chrome, Firefox, Safari, and other ordinary web browsers. It is often used by criminal organizations.

Key Points

- A key strength is having the organizational structure for collection, analysis, and effective utilization of social media data on a world-leading scale
- Achieved all-time high net sales in FY12/20 1H and narrowed operating losses through implementation of business structural reforms
- Targets robust growth in Japanese and Chinese markets led by expansion of the social media advertising market and utilization of the Company’s operational knowhow



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

We encourage readers to review our complete legal statement on “Disclaimer” page.

■ Company profile

Expanding from social big data collection and analytical tools into utilization support solution services

1. Company history

The Company was founded in June 2000 by President and Representative Director Koki Uchiyama with a mission of “establishing the infrastructure for a knowledge-recycling society to contribute to realizing a world in which everyone can feel ‘hotto’ (“hotto” means “relieved” in Japanese).” Mr. Uchiyama has been involved with development of technology from the beginning of the Internet market, including participation in the Japan Search Engine Development Project, one of Japan’s earliest search engines, while in graduate school in 1995.

The Company provided an analysis service based on articles posted on social media, including on personal blogs and 2channel, from the second half of 2000s, which was the start of the rapid spread of social media in the Internet industry. Starting from the analysis of blogs in 2005, it acquired the Dentsu Buzz Research Business (analysis of social big data) in 2008 from Gala Buzz Inc., and it started in earnest to provide its current mainstay service, the social media analysis tool BuzzSpreader powered by kuchikomi@kakaricho (kuchikomi@kakaricho).

In 2012, the Company made the e-mining social risk monitoring service Gala Buzz into a wholly-owned subsidiary, merging it in the same year and adding services to its lineup. However, in October 2018, the risk management-related businesses centered on this service were transferred to Relief Sign Co., Ltd., through a company split, and in December of the same year, the majority of its shares were sold to S. Front Inc. While the investment stake was 34% after selling the shares, it is currently at 24% due to additional sales in 2020. This does not change the status of equity-method affiliate.

As the Company had solidified its policy of developing its business centered on the “social and big data × marketing” area, it established Hotto Link Consulting (currently Trend EXPRESS) in 2013 and made a subsidiary of Effyis, which is a major social media distribution company that has access rights to the social data of major SNS and conduct sales in 2015 and has constructed a business foundation overseas. Also, as the number of tourists from China visiting Japan has been rapidly increasing, Trend EXPRESS (investment ratio, 57.3%) launched China Trend EXPRESS, which is a regular reporting service on inbound tourism consumption trends based on analysis of word-of mouth data (i.e., postings) from SNS in 2015. Since 2017, the Company has been successively launching services including Trend PR, a web promotion support service in the Chinese market and Cross-border EC X, a cross-border EC service for China, focusing on expanding business targeting the Chinese market. In January 2020, to further strengthen business development in the Chinese market, Trend EXPRESS’s Chinese subsidiary and business partner Husen (Shanghai) Commerce Consulting Co., Ltd. were merged to form Trend Express China as a new, wholly-owned subsidiary of Trend EXPRESS.

Hotto Link Inc. | 6-Oct.-2020
 3680 TSE Mothers | <https://www.hottolink.co.jp/english/>

Company profile

Company history

| Date | Major event |
|---------------|--|
| June 2000 | Hotto Link Inc. established in Yoyogi, Shibuya Ward, Tokyo (currently Chiyoda Ward, Tokyo) |
| November 2005 | Became a subsidiary of Opt Inc. |
| March 2008 | Acquired the Dentsu Buzz Research Business (analysis of social big data) from Gala Buzz Inc. |
| July 2008 | Officially launched the social media analysis tool kuchikomi@kakaricho |
| May 2012 | Acquired all shares and made a subsidiary of Gala Buzz Inc. (absorption merger in October 2012), which provides e-mining social risk monitoring services |
| October 2012 | Concluded an exclusive commercial usage licensing agreement for the information posted on the 2channel site with Tokyo Plus, Co., Ltd., which manages the 2channel site, and Mirai Kensaku Brazil, Co., Ltd. |
| November 2012 | Entered into a strategic business alliance with U.S. Gnip, Inc., a provider of social big data (acquired by Twitter in 2014), and acquired the rights to use Twitter data globally and at all times |
| March 2013 | Established Hotto Link Consulting Inc. as a consolidated subsidiary |
| December 2013 | Listed on the Tokyo Stock Exchange Mothers market |
| January 2014 | Entered into a strategic business alliance with Netyear Group Corporation |
| June 2014 | Entered into a business alliance with Effyis, Inc., a U.S. social media data distribution company and acquired exclusive agency rights for Sina Weibo in the Asia-Pacific, excluding China |
| July 2014 | Entered into a business alliance with PQ Shanghai Co., Ltd., which provides an integrated monitoring service of national brands in China, with the aim of developing and spreading the use of a social media analysis service |
| January 2015 | Made a subsidiary of U.S. Effyis, Inc. |
| May 2015 | Started to provide Visualized China Trend EXPRESS, a regular report specializing in inbound tourism consumption |
| November 2015 | Changed the name of Hotto Link Consulting, Inc. to Trend EXPRESS, Inc. Entered into a business alliance with Nightley Inc. |
| December 2015 | Acquired the shares of PQ Shanghai (ownership ratio: 19%) |
| June 2016 | Established Trend EXPRESS Tianjin Inc. and Hotto Link Hong Kong Limited |
| October 2016 | Trend EXPRESS, Inc. entered into businesses alliances with SINA Japan Synthesis Network Group Co., Ltd., SINA Japan Weibo, Co., Ltd., SINA Japan Property Co., Ltd., and SINA Japan Travel Co., Ltd. |
| May 2017 | U.S. subsidiary Effyis Inc., entered-into a business alliance with U.S. Reddit, Inc., which manages the global social news website "reddit" |
| June 2017 | Commenced sales of BuzzSpreader, a social media management support service |
| April 2018 | Trend EXPRESS Inc., started providing Cross-border EC X, a cross-border EC support service for China |
| October 2018 | The risk management-related businesses centered on "e-mining" were succeeded by Relief Sign Co., Ltd. through a company split, and the majority of its shares were sold in December 2018 and it became an equity method affiliate (investment ratio, 34%). |
| February 2019 | Trend EXPRESS Inc., started providing Trend MOVIE as a new service |
| March 2019 | Started a blockchain R&D project and as the first phase, concluded an investment agreement with SAMURAI Security Inc. |
| August 2019 | Renamed the social media analysis tool kuchikomi@kakaricho to BuzzSpreader powered by kuchikomi@kakaricho |
| November 2019 | Entered into a business tie-up with a dot co.,Ltd., and began providing SNS GROWTH PARTNER, a service which contributes to SNS growth |
| January 2020 | Formed through a merger of Husen (Shanghai) Commerce Consulting Co., Ltd. and Trend EXPRESS' Chinese subsidiary and acquired as wholly owned subsidiary Trend Express China |

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

Operates the SNS Marketing Support Business, the DaaS Business, and the Crossbound Business

2. Business description

The Company changed business segments in FY12/20 from SaaS Business, Solutions Business, and Crossbound Business previously to SNS Marketing Business, DaaS Business, and Crossbound Business. These changes reflect the decision in 2019 to make the SNS Marketing Support Business its main area in the business strategy for future growth and suspend development of new tools in the previous SaaS Business.

Company profile

Change in business segments

| New segments | Main businesses | Former segments |
|--------------------------------|-----------------|--------------------------------|
| SNS Marketing Support Business | Hotto Link | SaaS Business |
| DaaS Business | Effyis | Solutions Business |
| Crossbound Business | Trend EXPRESS | Crossbound Business |
| | | Domestic SNS Marketing Support |
| | | SNS data access right sales |

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

(1) SNS Marketing Support Business

This business, which is operated under Hotto Link, consists of domestic SNS marketing support service and the kuchikomi@kakaricho SNS analysis tool. Sales breakdown in FY12/20 1H was domestic SNS marketing support service at 62% and kuchikomi@kakaricho at 38%. The Company expects an upward trend in the domestic SNS marketing support service share.

In the SNS Marketing Support Business, the Company mainly provides marketing support services utilizing Twitter (SNS advertising agent sales and management consulting service). Management consulting implements measures through Twitter and other places to raise awareness of products from customer companies and lift sales utilizing social big data it holds and knowhow and unique methods accumulated over many years. Currently, advertising sales account for the majority of sales, but the profit margin is low, and the business model is one that seeks to earn profits via consulting services. In ordinary cases, the order price begins at a few hundred million yen per project. It is possible to increase annual transaction value to over ¥100mn by adding more handled products if efficacy is confirmed.

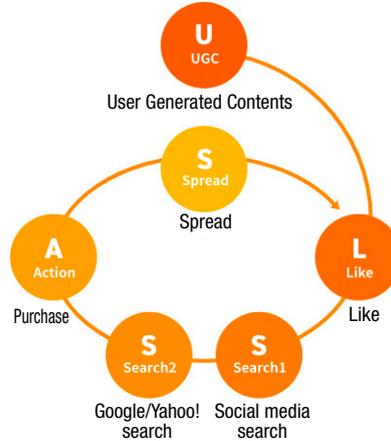
Customer companies cover a wide range of industries, though mainly B2C businesses, such as food and beverages, beauty and cosmetics, and online learning site operators. Many companies have sales in the ¥100bn range. Large companies, meanwhile, utilize TV commercials and other media and already have relationships with major advertising firms. This presents a tough hurdle for market entry. Nevertheless, SNS advertising management achieves stronger performance than major advertising agents, and the Company has secured orders from leading automakers in some cases.

As a promotional measure using SNS, the Company thinks it is important to devise ways to increase User Generated Contents (UGC; word-of-mouth and other contents from users) and systematizes the purchasing-behavior process of consumers related to UGC as ULSSAS. Specifically, a follower that sees a starting-point UGC (Twitter submission) adds a Like. The next step is search within the SNS (Search1) or use of Google or some other search engine to confirm the product (Search2) and buying the product (Action). After that is dissemination on Twitter (Spread). By driving this process cycle, the Company boosts sales of the customer company's product.

Unique methods devised by the Company from success patterns accumulated over many years are vital to efficiently build the process cycle and serve as a factor to differentiate the Company from competitors. For example, the Company conducts an analysis that brings together not only information collected from Twitter but also a variety of data including blogs and other word-of-mouth sites and distributes advertisements for the product being promoted to the ideal UGC source extracted automatically using AI. This capability has boosted interest in the Company's marketing support service as a service with high cost efficacy and supports an impressive repeat usage ratio of over 70%. Hotto Link is an established brand in Twitter marketing.

Company profile

ULSSAS, an SNS era purchasing-behavior process



Source: The Company's results briefing materials

Meanwhile, kuchikomi@kakaricho, an SNS analysis tool, has the following features. It possesses Japan's largest social media coverage and it is easy to operate and to perform real-time searches, such as trend analysis and attribute analysis. It also has functions such as cross-media analysis spanning television, news websites, and other media, plus a data import analysis function to perform text mining of data held internally by corporate customers (questionnaires, call logs, etc.). Notably, for social media analysis, the Company has a dominant advantage in Japan in terms of the sheer volume of social data it possesses, a key strength, and it covers approximately 90% of all blogs in Japan. In addition, the Company holds all historical data on the 5channel bulletin board site and gathers worldwide Twitter data based on the agreements it has entered with these partners.

Customer companies use kuchikomi@kakaricho to analyze social big data and apply results to product development, sales promotion activities, and comparisons with rivals and other surveys. The initial deployment fee is ¥100,000, and monthly charges begin at ¥130,000. Customers pay extra fees based on the number of certified user IDs, coverage media, data capacity, and other aspects. Among major users, some companies pay a monthly fee of about ¥1mn. More than 1,000 companies have cumulatively deployed the service, and about 300 of these companies are currently active users. Roughly 80% of users are large companies. The customer base covers a wide range of industries, including consumer goods manufacturers, services firms, and financial institutions.

(2) DaaS Business

DaaS Business is the business run by Effyis that sells access rights to data from social media with global operations (under the Socialgist brand name). Effyis concludes sales contracts for data access rights to social media (blogs, bulletin boards, Q&A, review sites, etc.) with open SNS operators worldwide other than Twitter and sells rights to global IT companies (social big data analysis, marketing platforms, and BI and other tool vendors). In other words, it is a distributor of social big data and holds a position as one of the largest firms worldwide in this market. Besides main customers such as Salesforce.com <CRM> and IBM <IBM>, this service caters to financial institutions, government entities, venture IT companies that operate SaaS and other businesses, and many other companies.

Company profile

(3) Crossbound Business

Crossbound Business, which is operated by subsidiary Trend EXPRESS, offers reporting service that analyzes crossbound consumption trends mainly utilizing social big data, web promotion support for the Chinese market (Trend PR) launched in 2017, cross-border EC support service for the Chinese market (Cross-border EC X), and other services. Reporting service delivers China Trend Express (¥80,000 per month), a regular report that analyzes consumption trends of foreign visitors to Japan, and customized research service tailored to customer needs. Going forward, the Company plans to focus on promotion support for the Chinese market and cross-border EC support service in the Crossbound Business.

Trend PR is a service that provides highly cost-effective marketing support to meet customer needs, of developing name awareness of companies' own products and brands in the Chinese market and thereby expanding sales. Specifically, based on the analysis of social big data in the Chinese market, which is one of the Company's strengths, it turns the PDCA cycle, from the planning (creating online articles that are attractive to Chinese people and optimal exposure to web media) and execution of the optimal marketing measures to the subsequent measurement of effects and proposals for improvements. With this approach, it helps customers increase sales in the Chinese market. If seen from the customer side, it makes all the data visible, so it is clearly cost effective and makes it easier to create a budget for promotion measures. The fees for a single order (single PDCA cycle) vary according to the order, but the average is around ¥3mn to ¥5mn. Many clients are B2C companies such as cosmetics, daily goods, and healthcare product manufacturers.

On the other hand, Cross-border EC X is a service that effectively improves name recognition and realizes higher sales in the Chinese market through partnerships, including those with leading stores that have opened on Taobao, which is a major EC site; the individual stores of key opinion leaders (KOL); and Weidian, which is a network of about 70 million social buyers including those operating about 450,000 stores between Japan and China. It provides one-stop service from customer acquisition through to customer support. The business model is one in which the Company obtains performed-based fees according to the sales of the targeted product. Therefore, if the targeted product becomes a major hit and its sales explode during the promotions period, its contribution to earnings also increases.

The Company's strength is having built one of the world's largest platforms for collecting, analyzing, and utilizing social media data

3. Hotto Link's strength

The Company's strength lies in having established its position as one of the world's leading social media distribution companies through making Effyis a subsidiary. In addition, by combining its world-class big data analysis technologies with Effyis' advanced data streaming technologies, it has put in place a system for providing even more rapid and advanced analysis services as well as for developing solution services (marketing support) that utilize big data by gathering and analyzing it.

Company profile

There are many competitor companies providing services to collect and analyze social big data, but within them, quite a few provide a service to crawl and collect only social media open data. While gathering data in this way without incurring costs increases the profit margin, the Company thinks it will become difficult to gather data in this way in the future. In fact, in February 2017, Twitter announced its intention to prohibit the unauthorized gathering of open data, while Facebook also prohibits the external sale of data. In Europe, the handling of personal information is becoming more strictly regulated by the introduction of GDPR*. Due to these changes to the market environment, in the future the value of social media data is expected to increase even more. From the viewpoint of the quality of services, these series of developments signify that a gap will open up between the Company and its competitors. Considering that Effyis, which holds data access rights to major social media platforms around the world, is a subsidiary of the Company, at FISCO we think recent developments will be advantageous for the Company.

* GDPR (General Data Protection Regulation): a law that regulates the protection of personal information within the EU that was adopted by the European Parliament and the European Council in April 2016. After a two-year transition period, it started being applied from May 2018.

Results trends

Achieved all-time high sales in FY12/20 1H and narrowed operating losses through implementation of business structural reforms

1. Overview of the FY12/20 1H results

In FY12/20 1H, the Company's consolidated results were ¥1,897mn in net sales (+15.8% YoY), ¥121mn in operating loss (vs. a loss of ¥408mn a year earlier), ¥155mn in loss before taxes (vs. a loss of ¥421mn), and ¥66mn in loss attributable to owners of the parent (vs. a loss of ¥348mn). Despite cancellations and delays of some promotions in Japan and China due to the COVID-19 outbreak, domestic SNS marketing support service demand was vibrant, and net sales reached a new all-time high for 1H. In profits, the Company narrowed losses YoY thanks to benefits from higher sales, cost savings from business structural reforms implemented since FY12/19, and special factors such as a tax refund (+¥24mn) and compensation related to the COVID-19 situation at the U.S. subsidiary (+¥55mn).

FY12/20 1H results (consolidated)

| | FY12/19 1H | | FY12/20 1H | | | |
|---|------------|------------|------------|------------|-------------------|--------------------|
| | Results | % of sales | Results | % of sales | Change rate (YoY) | Change value (YoY) |
| Net sales | 1,638 | - | 1,897 | - | 15.8% | 258 |
| Cost of goods sold | 1,093 | 66.7% | 1,232 | 65.0% | 12.7% | 139 |
| SG&A expenses | 954 | 58.3% | 811 | 42.7% | -15.1% | -143 |
| Other income | 0 | 0.0% | 24 | 1.3% | - | 23 |
| Operating profit (loss) | -408 | -24.9% | -121 | -6.4% | - | 287 |
| Profit (loss) before tax | -421 | -25.7% | -155 | -8.2% | - | 266 |
| Profit (loss) for the period attributable to owners of the parent | -348 | -21.2% | -66 | -3.5% | - | 281 |
| EBITDA | -151 | -9.2% | 97 | 5.1% | - | 248 |

Note: EBITDA is operating profit (loss) + depreciation costs

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

Results trends

(1) Main business structural reforms

The following content covers business structural reforms implemented since FY12/19. In the SNS Marketing Support Business, the Company halted new tool development in the SaaS business during FY12/19 and optimized personnel in the development division by moving a full team of 11 people from this division to an attractive company with potential to utilize the technology on May 11, 2020. Savings from cutbacks in personnel costs for the development division hence should fully contribute in FY12/20 3Q. The Company also lowered depreciation costs on in FY12/20 1H by ¥37mn YoY following write-off charges on existing assets for new tools in FY12/19 4Q (it booked retirement losses totaling ¥178mn). It previously developed new tools utilizing AI with the aim of selling them external. However, management changed the policy due to its conclusion that use in the Company's own SNS Marketing Support Business and improvement in operational productivity should be more effective in driving business growth. The Company intends to continue development of AI tools and wants to utilize them to achieve further improvement in productivity.

In the DaaS Business, a downward trend in Effyis profits in FY12/19 led to tougher selectivity and suspensions in new businesses and cutbacks in personnel levels besides focus areas in the FY12/19 2H. The number of employee as of the end of FY12/19 was 52 people, down 67 people compared to the end of FY12/18. This Business returned to profitability from FY12/20 1Q on personnel cost savings and further efforts to improve system and data center efficiency in 1H.

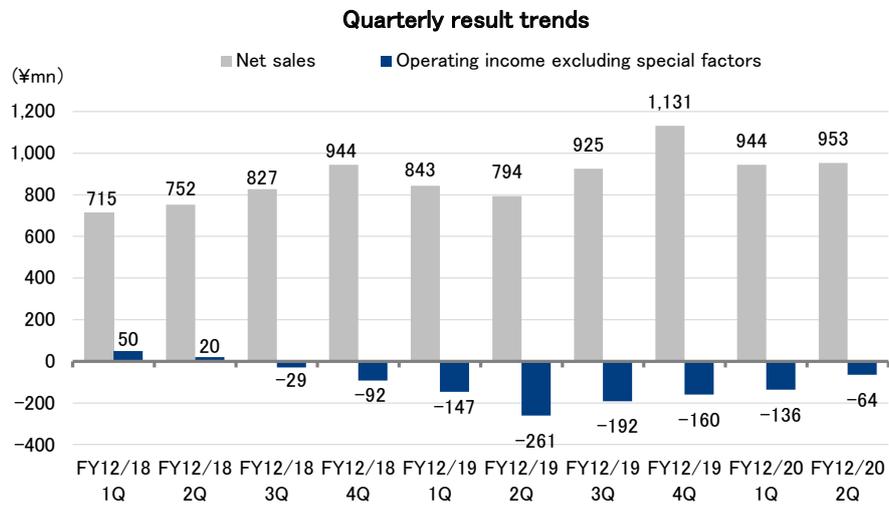
In the Crossbound Business, inclusion of external partner China-based Husen in the Group from January 2020 is lowering unit costs (through reduction of outsourcing expenses).

(2) Changes in SG&A expenses

The Company reduced SG&A expenses by 15.1% YoY to ¥811mn. Main changes were a rise in personnel costs due to increasing the number of sales people by 6 people compared to the end of FY12/19 to 25 people accompanying broader business scope in the SNS Marketing Support Business and lower business outsourcing costs, advertising and promotional costs, and depreciation costs related to cost cutback measures and decline in travel and transportation costs with telework and curtailment of business travel in the COVID-19 environment.

Since the Company implemented business structural reforms from FY12/18 4Q onward, its operating profit (loss) includes temporary changes. Looking at the quarterly trend without these special factors, the operating loss has been steadily narrowing from a bottom in FY12/19 2Q and shrunk to ¥64mn in FY12/20 2Q amid COVID-19 conditions. Despite fundamentally switching to telework, productivity has not declined in the majority of the Company's work and even improved in some areas. These trends helped in narrowing the loss.

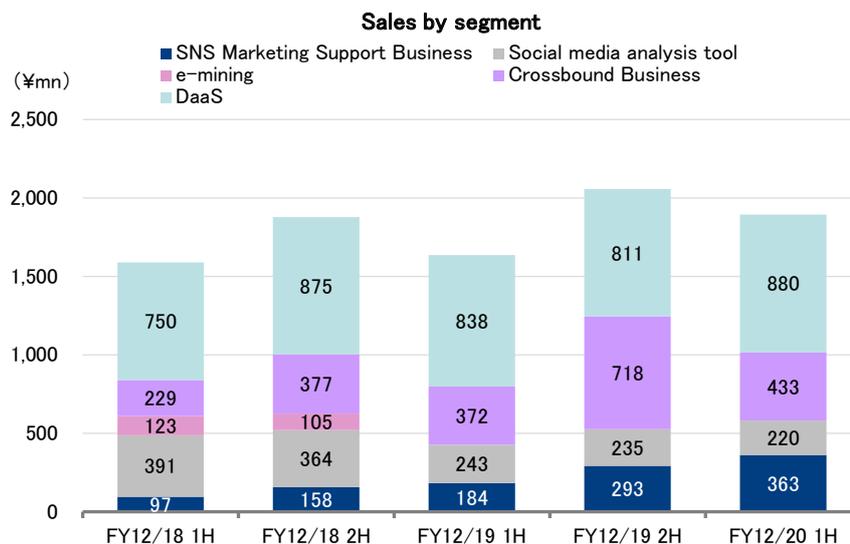
Results trends



Note: FY12/18 4Q: e-mining transfer profit +¥378mn, FY12/19 3Q: Effyis goodwill impairment charge -¥759mn, FY12/19 4Q: Disposal of existing assets for SaaS new tools -¥178mn, FY12/20 1Q: Tax refund from FY12/19 +¥24 mn, FY12/20 2Q: COVID-19 compensation return exemption in the U.S. +¥55mn
 Source: Prepared by FISCO from the Company's results briefing materials

Marketing support service utilizing SNS achieved high growth worldwide

2. Trends by business segments



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

Results trends

(1) SNS Marketing Support Business

In the SNS Marketing Support Business, net sales rose 36.3% YoY to ¥583mn, including a steep 96.7% increase in marketing support service sales to ¥363mn. Despite project delays and cancellations in certain industries such as travel, events, and restaurants due to COVID-19, efforts to generate new demand in a COVID-19 environment using SNS marketing picked more than previously with contract volume expanding 2.2-fold YoY. On a quarterly basis, net sales in 2Q were ¥166mn, down 15.6% compared to 1Q's ¥196mn due to temporary setback in Apr-May 2020 sales with COVID-19, though rebounded to an upward trend from June.

In response to vibrant SNS marketing demand, the Company reinforced the SNS advertising/SNS management consulting sales staff with an addition of six people compared to the end of FY12/19 to 25 people and pursued higher operational efficiency with deployment of proprietary tools containing AI (it deployed the advertisement submission system in 2Q). These measures contributed to robust growth. The Company is also broadening the service line-up with unique solutions. It began marketing support using Instagram in FY12/20 1Q as a new service. It launched a contents development service for women and provision of video solutions utilizing animation on Twitter as well. In 2Q, the Company released "talent at-home video production package," "SNS live commerce," "employee influencer development support service," and other services. To continue solidifying Hotto Link as an SNS marketing brand, the Company cooperates with contacts from various media sources and has published numerous books about SNS marketing written by employees.

SNS analysis tool sales, meanwhile, dropped 9.5% YoY to ¥220mn. This mainly stemmed from decline in new contract volume amid heavy allocation of sales people to SNS advertising/SNS management consulting. The Company expects this trend to bottom out from FY12/20 3Q.

(2) DaaS Business

In the DaaS Business, net sales increased 5.1% YoY to ¥880mn with support from upbeat sales of access rights to data from major SNS operators worldwide. While profits weakened in FY12/19 because of less favorable sales mix and other adverse trends, operating profit restored profit thanks to savings from business structure reforms. The Company explains that the strongest growth driver for data sales is business with risk management customers.

After concluding a sales contract for exclusive data access right to Quora, one of the largest knowledge-sharing platforms worldwide (with about 300mn monthly visitors), in May 2020, Effyis already booked an order for its first deal and expects sales contribution from FY12/20 3Q. It plans to conclude new data access right sales contracts with other major SNS companies worldwide too and steadily broaden the product line-up.

As a new initiative, Effyis has started experimental sales in preparation for commercializing a dark web data product that is likely to attract demand in the digital risk management field. The dark web is beyond the reach of ordinary search engines, browsers, and other tools, and special technology must be used to obtain data. Effyis has achieved this with its knowhow. Since it acquires data through crawling, the technology does not require extra costs and this should support a product with high profitability.

The industry has adopted stricter rules on managing personal information from the Internet over the past few years, and at FISCO, we believe this is a positive trend for Effyis, which holds legitimate data access rights, and this will help to improve Effyis' competitiveness of over the medium to long term.

(3) Crossbound Business

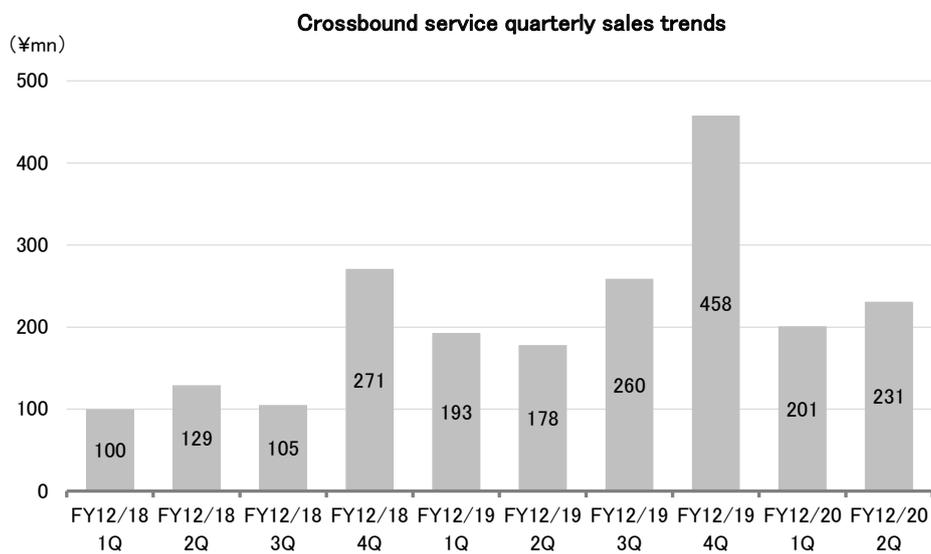
In the Crossbound Business, net sales increased significantly, up 16.4% YoY to ¥433mn. Despite cancellations and postponements of promotional deals worth about ¥200mn in the Chinese market in FY12/20 1Q because of COVID-19 impact, promotion activity recovered from 2Q on easing of movement constraints in China.

Results trends

While net sales breakdown in this business up until FY12/19 was about 60% in inbound promotions (targeting travelers from China) and about 40% in outbound promotions (targeting the Chinese market), inbound deals have disappeared since FY12/20 2Q because of restrictions on travel from China, and management does not expect recovery at least for the rest of this year. The Company therefore intends to offset decline in inbound promotions with recruitment of outbound deals.

In Cross-border EC X business, while scale remains small, sales are proceeding as planned. Considering strong needs at smaller companies pursuing cross-border EC opportunities, the Company aims to expand the number of users by revising the system to make it easier to use, including sales pricing.

In profits, even though the business is still incurring losses due to being in the early investment phase, the loss appears to have modestly narrowed on savings from bringing an outsourcing partner into the Group.



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

Possesses three year's worth of operating funds and maintains sound finances

3. Financial position and financial indicators

Looking at the financial position at the end of FY12/20 1H, total assets declined ¥55mn YoY to ¥5,329mn. Looking at main changes, trade and other receivables dropped ¥169mn in current assets, while goodwill rose ¥323mn on inclusion of the Husen business under the Crossbound Business. Meanwhile, investments accounted for using equity method fell ¥66mn on partial sales of Reliefsign Co., Ltd. shares and other financial assets were down ¥25mn due to repayment of long-term loans to Reliefsign under non-current assets.

Results trends

Total liabilities increased ¥71mn YoY to ¥2,403mn. Interest-bearing debt declined ¥29mn, and trade and other payables fell ¥160mn. Meanwhile, other non-current liabilities rose ¥150mn due to unpaid portion of the Husen business transfer value and income taxes payable increased ¥26mn. Total equity declined ¥127mn compared to the end of FY12/19 to ¥2,925mn. This was mainly due to decreases of ¥66mn in retained profit and ¥51mn in non-controlling interest following the posting of a loss for the period attributable to owners of the parent of ¥144mn.

Looking at management indicators, the ratio of equity attributable to the owners of the parents, which indicates management stability, declined from 52.5% to 51.6%, although it was maintained above the 50% level. Furthermore, the interest-bearing debt ratio was at just 21.3% and net cash (cash and cash equivalents – interest-bearing debt) remains positive. One can determine that the Company already has sufficient working capital even without sales growth in the next three years and is maintaining sound finances.

Consolidated balance sheet

| | (¥mn) | | | | |
|---|---------|---------|---------|------------|--------|
| | FY12/17 | FY12/18 | FY12/19 | FY12/20 1H | Change |
| Current assets | 1,426 | 2,441 | 2,328 | 2,147 | -181 |
| (Cash and cash equivalents) | 1,074 | 1,976 | 1,700 | 1,711 | 11 |
| Non-current assets | 3,165 | 3,374 | 3,056 | 3,182 | 125 |
| (Goodwill) | 2,103 | 1,871 | 1,071 | 1,395 | 323 |
| Total assets | 4,591 | 5,815 | 5,385 | 5,329 | -55 |
| Total liabilities | 1,981 | 1,176 | 2,332 | 2,403 | 71 |
| (Interest-bearing debt) | 1,426 | 364 | 616 | 587 | -29 |
| Total equity | 2,610 | 4,638 | 3,053 | 2,925 | -127 |
| (Stability) | | | | | |
| Ratio of equity attributable to owners of the parents | 55.8% | 79.4% | 52.5% | 51.6% | -0.9pt |
| Interest-bearing debt ratio | 55.7% | 7.9% | 21.8% | 21.3% | -0.5pt |

Note: Based on IFRS

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

Outlook

FY12/20 results will be disclosed when it is possible to make reasonable estimates. However, the trend of net sales expansion is expected to continue.

1. Outlook for FY12/20

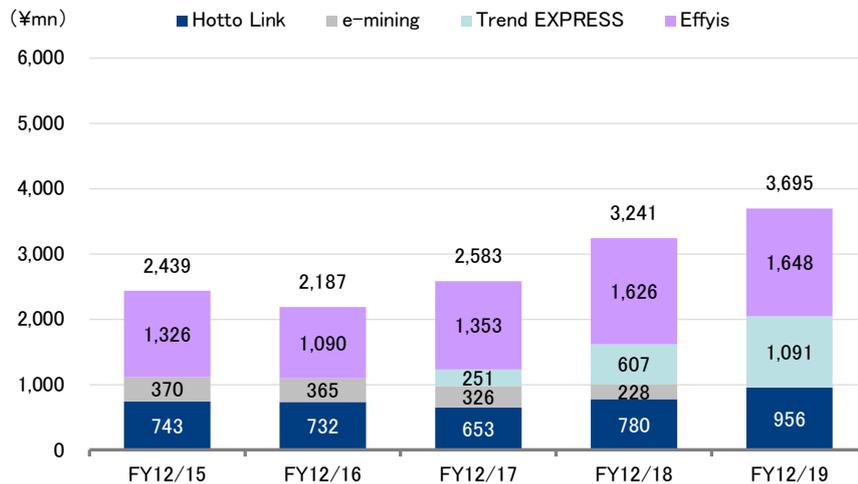
For the full year forecast for FY12/20, the outlook for impact by COVID-19 on business is still unclear, and the Company intends to promptly disclose it once reasonable estimates are available. Nevertheless, the SNS Marketing Support Business has recovered since June 2020 and shifted upward in monthly sales as mentioned above. Sales improved to a level above March sales in July. Amid sustained vibrant needs for SNS advertising and management consulting services, upward growth should continue from FY12/20 3Q. In the DaaS Business too, stable growth is likely to persist in the 2H with the launch of Quora data access right sales and other positive contributions. In the Crossbound Business, despite a difficult outlook for inbound sales, the Company already expects to at least match the previous-year result in outbound promotion business. The main question is the extent to which it can add to sales in the remaining time.

Outlook

In expenses, meanwhile, the Company intends to add another 6 sales people in the SNS Marketing Support Business in the 2H. However, total personnel costs might be flat to slightly lower considering the transfer of an 11-person development team in May 2020 and the absence of personnel addition plans at Effyis and Trend Express. At the quarterly level, FISCO hence expects a smaller operating loss and even the possibility of a profit in 4Q accompanying higher sales. While FY12/19 had an operating loss of ¥1,699mn, including the impact of conducting business structure reforms, the loss should narrow sharply in FY12/20.

The Company's business policy in FY12/20 focuses on three main themes – 1) establishment of Hotto Link as a brand synonymous with SNS marketing in the Japanese market, 2) establishment of Trend Express as a brand synonymous with China marketing in the Chinese market, and 3) establishment of Effyis' Socialgist as a brand in the SNS data distribution market. Management hopes to achieve dramatic growth from 2021 with these three businesses as its foundation.

Sales by individual companies



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

Targets robust growth in Japanese and Chinese markets led by expansion of the social media advertising market and utilization of the Company's operational knowhow

2. Growth strategy

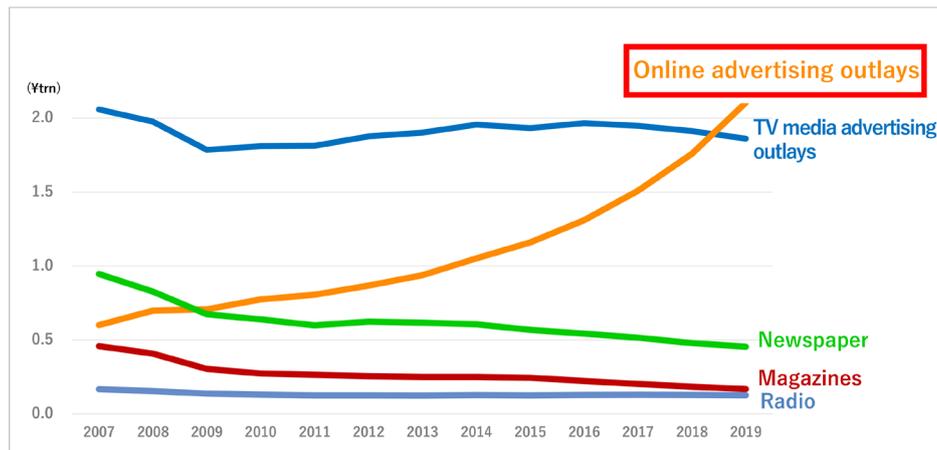
Through the business structure reforms conducted since 2019, the Company reorganized its business structure targeting dramatic growth. It aims to achieve strong growth through expansion of the customer base and increase in the average sales price per customer by delivering marketing support services with high cost efficacy in the social media advertising market with potential to drive rapid growth.

Outlook

(1) Outlook for the social media advertising market

The online advertising market in Japan has been sustaining growth at a double-digit annual pace and surpassed TV advertising for the first time in 2019. This trend reflects the ability to utilize the Internet at anytime and anywhere thanks to broad inroads by PCs and smartphones in society. A growing number of companies are utilizing this media as part of their promotional measures because of the ease of distributing advertisements to the target segment being pursued and digital visualization of cost efficacy that appeal to companies issuing advertisements.

Changes in the domestic advertising market



Source: Prepared by FISCO from Dentsu's "Advertising Outlays in Japan 2019"

Source: The Company's results briefing materials

Social media advertisements appear likely to become the main battlefield in the online advertising market. Twitter, Facebook, YouTube, and other social media have rapidly spread in the past few years, and usage time per day by social media users is increasing. Furthermore, user comments on products and other messages submitted by users on Twitter service spontaneously amplify the spread of information and thereby achieve a promotion effect with robust cost performance. This aspect is boosting interest in social media advertisements.

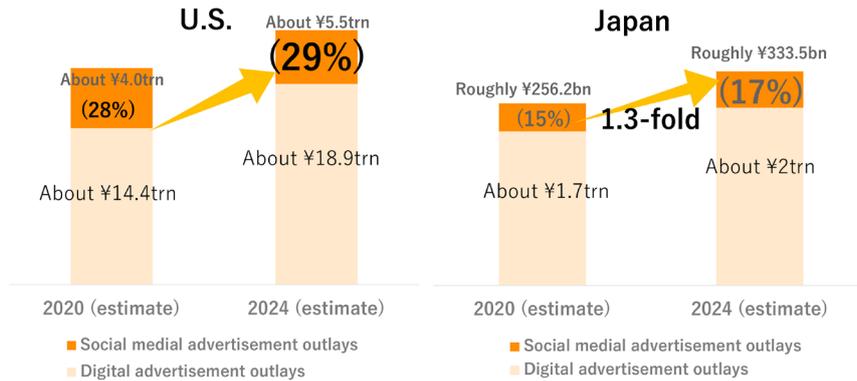
According to the Company's materials, the digital advertising market in the U.S. could expand from about ¥14.4trn in 2020 to roughly ¥18.9trn in 2024, including a rise in the share of social media advertising from 28% in 2020 to 29% in 2024. Japan's digital advertising market, meanwhile, could increase from about ¥1.7trn in 2020 to about ¥2trn in 2024, including an increase in the social media advertising share from 15% in 2020 to 17% in 2024. The social media advertising market in Japan hence offers the prospect of growing from roughly ¥256.2bn in 2020 to about ¥333.5bn in 2024, which works out to an annualized rate of roughly 7%. An important point is Japan's overly small market scale for digital advertising, compared to the U.S. FISCO thinks Japan's digital advertising market has significant growth potential considering market size in the U.S. and expects continuation of double-digit annual growth. Social media advertising, in particular, is fairly low in Japan at just 15% of the digital advertising market, versus the U.S. We believe Japan has potential to expand to the same level as the U.S. based on current inroads by social media, and this provides the basis for our outlook that the social media advertising market in Japan has a strong possibility of achieving robust growth.

Outlook

Growth in the social media advertising market

Outlook for SNS advertising outlays in the leading U.S. market to increase to 29% of online advertising spend!

Japan's outlays are likely to expand 1.3-fold by 2024 (to a 17% share) and still has room for further expansion from 17% to 29%



Source: Prepared by FISCO from Statista data for July 2020 (including COVID-19 impact)

Source: The Company's results briefing materials

(2) Media types in digital marketing and Hotto Link's position

Media used in digital marketing consists of "owned media" that is directly owned by a company, "paid media" that is owned by a different company and provides exposure through payment of advertising fees, and "earned media" that reflects comments by consumers and cannot be controlled by a company. While marketing methods differ depending on the respective media categories, concerns have risen about decline in the precision of targeting advertisements by paid media, which has driven growth in the online advertising market up to now, due to recent efforts to protect personal information worldwide. Marketing methods that use earned media have started attracting interest as an alternative.

* Examples include GDPR regulations in Europe, the California Consumer Privacy Act (U.S.), Apple's advertisement tracking regulations, and Cookie regulations

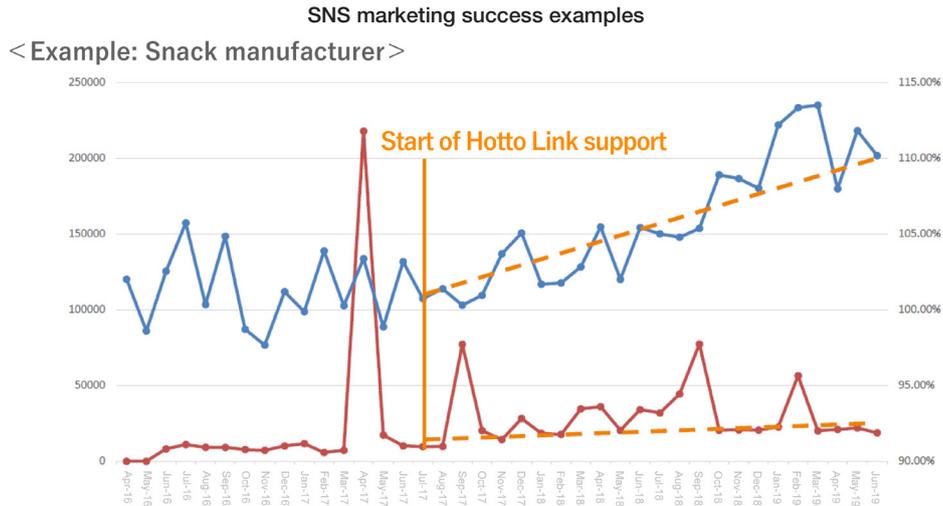
Digital marketing features by media type and marketing methods

| Media types | Marketing method | Features | Supporting company | |
|---------------------|---|---|--|-------------------|
| Owned media | Media directly owned by a company (Website, Twitter account, and other SNS) | Information distributed by SEO, company web page, Twitter account, etc. | <ul style="list-style-type: none"> Fully controlled by the company but has limited information reach | Many |
| Paid media | Media owned by a different company and provides exposure through payment of advertising fees (search engine advertisements, SNS advertisements, news sites, etc.) | Search engine advertisements, SNS advertisements | <ul style="list-style-type: none"> Partially controlled by the company Information reach depends on invested advertising fees | Many |
| | | Information distribution via influencers | <ul style="list-style-type: none"> Partially controlled by the company Information reach depends on influencer selection | Few |
| Earned media | Media that reflects comments by consumers and cannot be controlled by a company (consumer blogs, Twitter accounts, and other SNS) | Amplification of comments by individuals, spontaneous creation of comments by consumers | <ul style="list-style-type: none"> Cannot be controlled by the company Significant information reach and persuasiveness depending on use | Rare (Hotto Link) |

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

Outlook

However, since a company cannot control earned media, cost performance differs depending on the extent to which it can get optimal users to transmit information and achieve effective dissemination. The role of a marketing support company tends to make a difference in this segment. Leveraging strengths of social big data analysis capabilities accumulated since its founding and social data collection capabilities owned by Effyis, the Company established a management method using the ULSSAS purchasing-behavior process based on SNS it devised. This approach has succeeded in achieving high performance.



Source: The Company's results briefing materials

The repeat ratio for SNS management consulting service is strong at more than 70%. Along with customer recruitment, the Company aims to steadily accumulate success examples as the basis for initiatives that increase spending per customer via cross-selling and up-selling. It already has examples of rising transaction value at some customers. FISCO thinks SNS marketing is likely to be even more important after COVID-19 and sees an excellent opportunity for substantial growth from 2021. Profitability remains low at this point because advertisement sales are the majority of overall sales and the SG&A expenses ratio is high. However, we expect an upward trend in profitability led by increase in the sales ratio of management consulting services with high added value and decline in the SG&A expenses ratio as sales expand.

In the Crossbound Business, meanwhile, despite the lack of inbound demand prospects, outbound promotion support might expand significantly in the Chinese market, including cross-border EC support service. The Company is developing a new service for China at the Chinese subsidiary and is currently conducting test marketing. It hopes to realize strong growth through recruitment of business in the Chinese market that has consumption worth ¥600trn annually while expanding the service line-up. Trend Express aims to achieve an operating profit in FY12/21.

In the DaaS Business, Effyis continues to recruit data access rights from major SNS operators. It is also commercializing a dark web data product and intends to add value through proprietary analysis (provision of highly useful data using translation and other data processing). The DaaS Business is likely to sustain stable growth in the 10% range annually and targets roughly 10% operating margin at Effyis.

Contribute to bringing people and information together and realizing a society that can be “hotto,” and raise corporate value

3. SDGs initiatives

As SDG initiatives, the Company promotes the following measures aimed at realizing a society that can be “hotto” – (1) actively recommends that employees participate in activities that contribute to society, (2) gives aid as a company to realization of gender equality outside of the company and activities aimed at removing inequality, and (3) promotes revisions to company rules and establishment of an environment that is welcoming to LGBT people.

For (1), CEO Uchiyama serves as project leader of Japan Association of New Economy's SOGI Empowerment PT that aims to create a work environment that welcomes LGBT people and other sexual minorities and engages in awareness-raising activities. Additionally, employees cooperate in the Famiee project that seeks to realize a society that accepts diverse family formats. For (2), the Company donates operating funds and office space to the Famiee project. For (3), the Company plans to adopt a program that allows use of a “partnership certificate” for homosexual couples as a certificate of family relations that NPO Famiee started issuing in September 2020 in applying to internal welfare and benefit services.

Shareholder return policy and business risks

Still in the upfront investment period, so payment of dividends is not planned

1. Shareholder return policy

The Company plans to return profits to shareholders in the future by paying dividends. But at the current point in time, to actively allocate funds, such as to business investment and the recruitment and training of human resources, it is aiming to improve its corporate value (increase its share price) through growing earnings, which it considers will maximize returns to shareholders in the future. Therefore, continuing from previously, it does not plan to pay a dividend in FY12/20.

2. Business risks

Looking at business risks, changes in management policy by companies from which the Company purchases social media data could lead to cancellations of license agreements or changes in government policies or the like in each country could prevent the delivery of social media and this could have an impact on the Company's financial results. That said, looking only at its relationships with the companies Hotto Link buys from, it already has many corporate customers that utilize social media worldwide. Furthermore, the amount of data purchased is expected to continue to increase in the future, including from the growth of the Crossbound Business. Therefore, at FISCO, we believe that the likelihood that license agreements will be cancelled is extremely low.

Shareholder return policy and business risks

Also, overseas sales accounted for about 45% of the total sales in FY12/19, so it is necessary to be aware of the risk from exchange-rate fluctuations. At the current time, overseas sales are only from Effyis, so should the yen strengthen, the results from Effyis would be reduced on being converted into yen. In addition, for the sales promotion support service for Chinese market, if the economic situation in China should worsen or its legal system change, this may impact the sales of Trend PR and Cross-border EC X, so these are risk factors.

■ Information security measures

The services offered by the Company and its group companies depend on large server farms and Internet connections, so management takes information security very seriously. To prevent system failures or outages caused by cyber-attacks that would interfere with the performance of services for customers, the Company constantly monitors system operations, maintains backup systems, and uses cybersecurity measures to thwart malware and other cyber-threats.



Disclaimer

FISCO Ltd. ("FISCO") offer stock price and index information for use under the approval of the Tokyo Stock Exchange, the Osaka Stock Exchange and Nikkei Inc.

This report is provided solely for the purpose of offering information, and is not a solicitation of investment nor any other act or action.

FISCO prepared and published this report based on information which it considered reliable; however, FISCO does not warrant the accuracy, completeness, fitness nor reliability of the contents of this report or the said information.

The issuers' securities, currencies, commodities, securities and other financial instruments mentioned in this report may increase or decrease in value or lose their value due to influence from corporate activities, economic policies, world affairs and other factors. This report does not make any promises regarding any future outcomes. If you use this report or any information mentioned herein, regardless of the purpose therefor, such use shall be made based on your judgment and responsibility, and FISCO shall not be liable for any damage incurred by you as a result of such use, irrespective of the reason.

This report has been prepared at the request of the company subject hereto based on the provision of information by such company through telephone interviews and the like. However, the hypotheses, conclusions and all other contents contained herein are based on analysis by FISCO. The contents of this report are as of the time of the preparation hereof, and are subject to change without notice. FISCO is not obligated to update this report.

The intellectual property rights, including the copyrights to the main text hereof, the data and the like, belong to FISCO, and any revision, reprocessing, reproduction, transmission, distribution or the like of this report and any duplicate hereof without the permission of FISCO is strictly prohibited.

FISCO and its affiliated companies, as well as the directors, officers and employees thereof, may currently or in the future trade or hold the financial instruments or the securities of issuers that are mentioned in this report.

Please use the information in this report upon accepting the above points.

■ For inquiry, please contact: ■

FISCO Ltd.

5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062

Phone: 03-5774-2443 (Financial information Dept.)

Email: support@fisco.co.jp