Interspace
2122 TSE Mothers

26-Jan.-16

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at the end of this document.

FISCO Ltd. Analyst
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Increases in sales and profits forecast for FY9/16 and is once again entering a growth phase

Interspace <2122> (hereafter, also "the Company") operates an Internet Advertising (Affiliate) Business with a focus on affiliate advertising and a Media business, centered on the child-care support site "mamastadium." In addition, the Company has launched affiliate service businesses in Southeast Asian countries such as Indonesia, Thailand, and Vietnam, and plans to continue to focus on its overseas business in the future.

The consolidated FY9/15 results saw a 19.5% year-on-year (y-o-y) increase in sales to ¥20,065mn and a 55.4% decrease in operating profit to ¥348mn. The mainstay affiliate advertising achieved growth mainly in the finance and EC categories and once again achieved a record high for net sales. But affiliate advertising was affected by the higher costs to strengthen personnel and for advertising with an eye to growth in the future, and also by the slump in the game business, and as a result operating profit was down for the first time in six fiscal periods. But the results slightly exceeded the forecasts announced in August in the revised Company plan, and looking on a quarterly basis, operating profit in Q4 (July to September 2015) increased by double digits y-o-y, by 14.6%, and based on these results the Company can be said to have once again entered a growth phase. The background to this is thought to be the major results of the cost adjustments, including the reduction in costs in the slumping Media Business, and these results can be highly evaluated.

The outlook for FY9/16 is for increases in both sales and profit, with net sales forecast to increase 8.8% y-o-y to ¥21,826mn and operating profit to rise 72.2% to ¥600mn. In addition to the growth in affiliate advertising, native advertising will be fully launched as a new business. Also, the Company's policy is to improve profitability through raising the efficiency of advertising operations and keeping-down one part of SG&A expenses. Further, an unprofitable game subsidiary was sold in the previous fiscal year, which is expected to increase profits by slightly less than ¥200mn. With regards to the overseas business, at FISCO we think that although the forward-investment stage is set to continue, there is still potential for upside in the Company's conservative results forecasts.

In its medium-term business plan, the Company is targeting net sales of ¥25,000mn and operating profit of ¥1,500mn. It is aiming to achieve these targets by focusing on maximizing its existing businesses and improving profitability in the Internet Advertising (Affiliate) Business, maximizing the contribution to profit of the Media Business, and investing management resources in the overseas businesses and the native advertising business that have high growth potential.

Check Point

- Sales increased but profits declined in the FY9/15 full year, with net sales achieving a record high of ¥20bn
- The outlook for the FY9/16 results is for an increase in sales and a return to profitability with a major increase in profits
- Targets a dividend payout ratio of about 15-20% and the dividend for FY9/16 is expected to be ¥8.00

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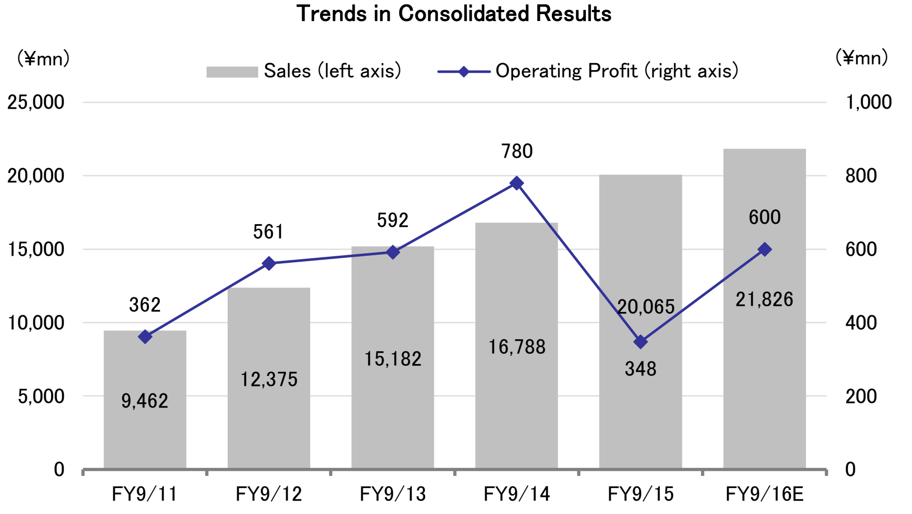
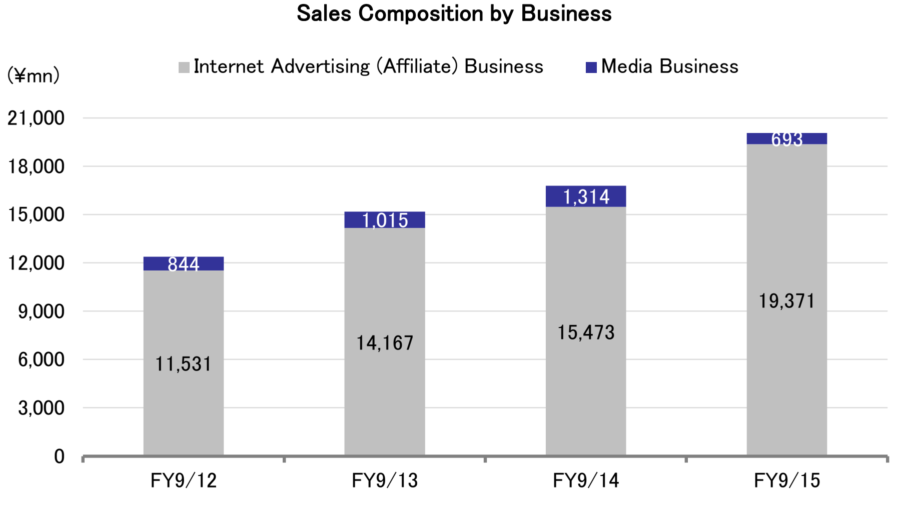


Business Description

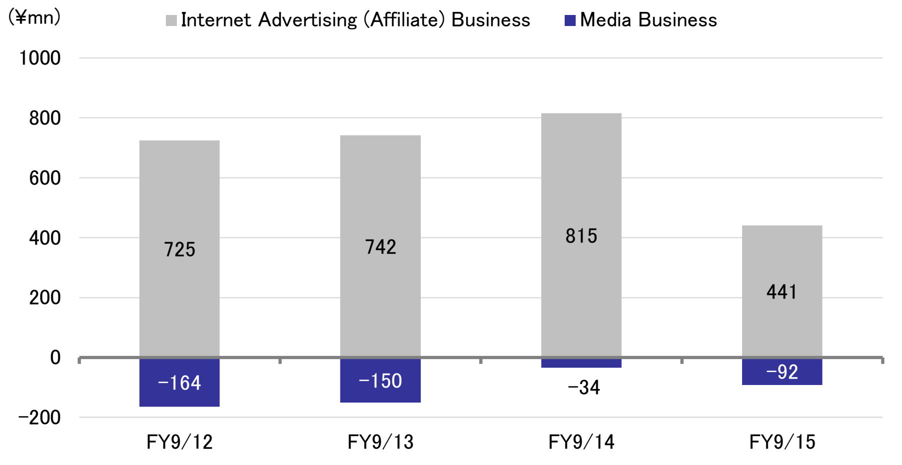
The Internet Advertising (Affiliate) Business is the main income pillar, while the affiliate advertising business is being developed overseas also

The Company's businesses are divided into the Internet Advertising (Affiliate) Business, focusing on affiliate advertising, and the Media Business. Looking at sales and operating profit by segment, over 90% of total sales were provided by the Internet Advertising (Affiliate) Business. In addition, operating profit earned by the Internet Advertising (Affiliate) Business is able to continuously absorb Media Business losses.

The Interspace Group consists of six subsidiaries, which is one less than the previous fiscal year following the sale in September 2015 of more games Co., Ltd., which operates a social media app business. Among the subsidiaries, three are domestic companies–Denno Advertisement Co., Ltd., Ciagram Co., Ltd., and Interspace Global Co., Ltd.–and three are overseas companies (in China, Indonesia, and Thailand). Also, in April 2015 the Company partnered with a local company in Vietnam to establish an Internet advertising joint-venture company as an equity-method affiliate, (capital contribution ratio, 49%). Among the subsidiaries, the companies in Indonesia, Thailand and Vietnam are undertaking affiliate advertising businesses.



Operating Profit by Business



Internet advertising business accounts for a major share of the affiliate advertising market

(1) Internet Advertising (Affiliate) Business

The Company's Internet Advertising (Affiliate) Business is mainly engaged in affiliate advertising, and in addition to offering listing advertising, and DSP*1 advertising, it recently started offering native advertising*2. With most of its sales coming from affiliate advertising, the Company has become a major player in the affiliate service provider.

Affiliate advertising uses pay-per-click-based Internet advertising that enables advertisers to compensate operators for the number of final product purchases, document requests and other sales from advertisements posted on its websites (partner sites), email magazines and other electronic media. In affiliate advertising, the Company provides affiliate programs in its role as an intermediary between advertisers and website operators. The Company records advertising fees provided by advertisers as sales. These include commission fees received by the Company's partner sites, which are posted as sales costs.

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Affiliate Advertising

Source: Company materials

Affiliate programs are easy-to-use tools provided by companies that enable operators to place advertisements on their own websites. The Company developed "ACCESSTRADE" in 2001 and as of the end of September 2015, it was being used on more than 430,000 partner sites and was handling around 16,000 advertising programs.

Also, one of the characteristics of the Company is that Store Front Affiliates (SFA) account for approximately 20% of net sales in the Internet Advertising (Affiliate) Business. SFA is an affiliate advertising service marketed to brick-and-mortar stores. Provided primarily to mobile phone retail outlets, SFA services enable sales staff to recommend advertiser-provided content apps and services to mobile phone purchasers, for which commissions are paid when these apps are downloaded or services commenced. The ability of sales staff to offer products directly to customers makes SFA a highly cost-effective advertising service for advertisers. The Company's services form an industry leading network with about 13,000 stores contracted. It should be noted that SFA sales are closely correlated with sales trends of mobile phones.

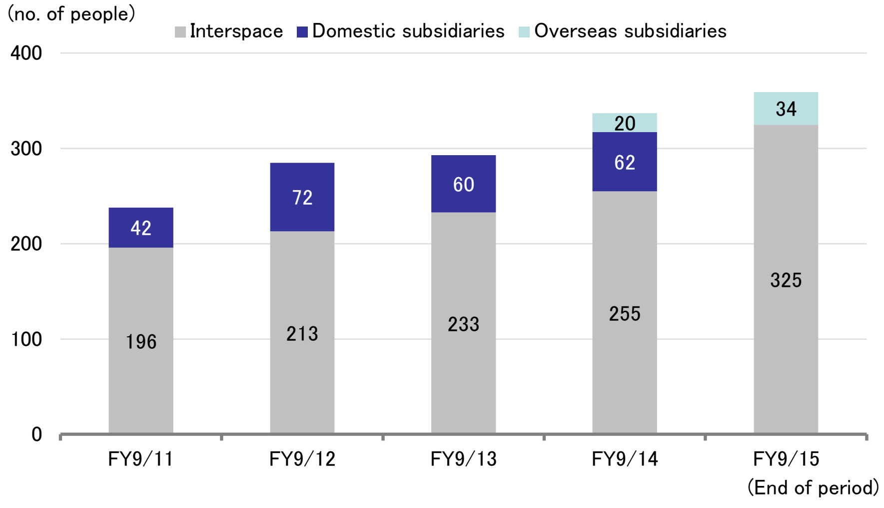
The Media Business is managed by the Company itself, such as its community site for mothers

(2) Media Business

The Media Business is comprised of the media advertising business that sells advertising space on the company-operated community site for mothers, "mamastadium," and the social media app business that develops and sells game content. The Company sold its social media app business subsidiary, more games Co., Ltd, but it rehired some of this company's staff and is continuing this business for some developed game titles. By refraining from developing new content in-house, the Company is reducing business risk and it is purchasing content for which demand is expected for its previously released mobile-phone games and has converted its business model to focus on smartphones. The Company is also developing native apps.

At the end of September 2015 on a consolidated basis, the Company had 359 employees, which is an increase of 22 people y-o-y. Within this increase, the number of employees in the Company itself increased by 70 people, but of these 20 people were transferred from more games Co., Ltd. Therefore, the actual increase in the Company was 50 employees. Employee numbers have increased at a rate of around 20 people per year in the last few years, but in FY9/15 the Company actively recruited new employees in order to increase its medium-term growth potential, which is the reason for this greater-than-usual increase. The recruitment plan for FY9/16 is expected to return to the previous pace and between 20 to 30 people to be recruited.

Trend in Employee Numbers



■ Results Trends

Sales increased but profits declined in the FY9/15 full year, with net sales achieving a record high

(1) Results for FY9/15

The consolidated results for FY9/15 announced on November 10 were an increase in sales but a decrease in profits, with sales of ¥20,065mn, up 19.5% y-o-y, operating profit of ¥348mn, down 55.4%, recurring profit of ¥346mn, down 56.2%, and net profit of ¥302mn, down 21.6%.

FY9/15 Consolidated Results

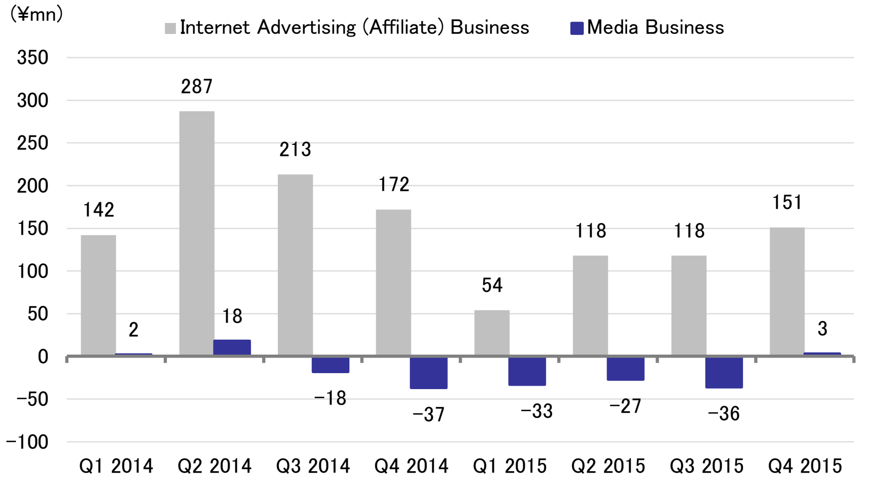
(Unit: ¥mn)

	FY9/14		FY9/15				
	Result	Ratio to sales	Company plan	Result	Ratio to sales	y-o-y	Ratio to plan
Sales	16,788	100.0%	18,630	20,065	100.0%	19.5%	7.7%
Cost of sales	13,475	80.3%	15,470	16,661	83.0%	23.6%	7.7%
SG&A expenses	2,531	15.1%	2,836	3,055	15.2%	20.7%	7.7%
Operating profit	780	4.7%	323	348	1.7%	-55.4%	7.7%
Recurring profit	790	4.7%	340	346	1.7%	-56.2%	1.8%
Net profit	386	2.3%	348	302	1.5%	-21.6%	-13.2%

Note: the Company plan was as of August 2015

Net sales trended strongly in affiliate advertising and achieved a record high, but operating profit declined for the first time in six fiscal periods due to the increases in HR costs to strengthen personnel (up ¥258mn) with an eye to medium-term growth and in advertising costs (up ¥102mn), and also because of the higher financial burden from the launch of an overseas business and the downturn in the game business. However, each of net sales, operating profit, and recurring profit slightly exceeded the targets announced in August in the revised Company plan, and on a quarterly basis also, operating profit in Q4 (July to September 2015) increased 14.6% y-o-y. So it can be said that results are once again on a growth track. Only net profit was below the target, but this was mainly due to the recording of an extraordinary loss of ¥61mn, which included a loss on the valuation of investment securities and an impairment loss. The results trends by business segment are shown below.

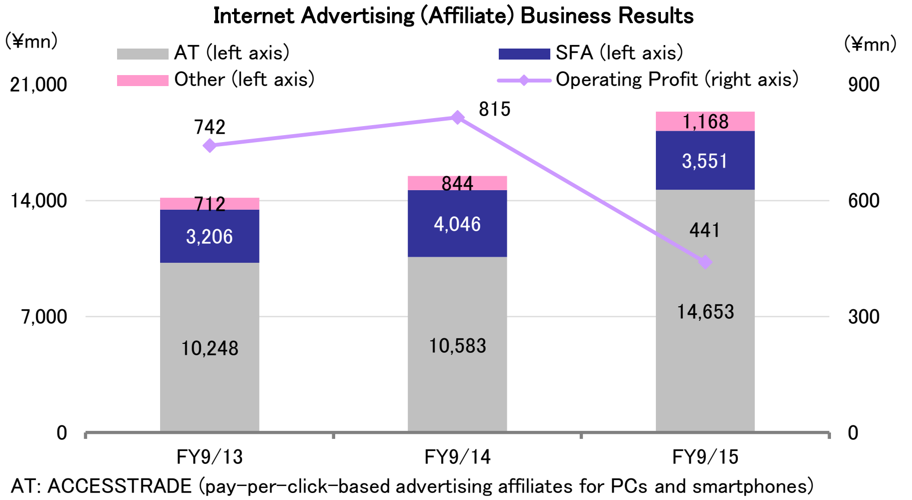
Operating Profit by Segment (Quarterly)



○ **Internet Advertising (Affiliate) Business**

In the Internet Advertising (Affiliate) Business, sales increased 25.2% y-o-y to ¥19,371mn and operating profit fell 45.9% to ¥441mn. Net sales in the main affiliate advertising business greatly increased by 38.4%, mainly for sales for the e-commerce, finance, and service categories, and once again a record high was achieved. Looking at sales trends by client category, net sales for e-commerce increased by 77%, mainly for cosmetics and health foods; increased by 19% for finance, primarily for FX and card loans; increased by 47% for services, mainly for beauty and HR services; and increased by 14% for entertainment, primarily for video distribution services. So net sales grew by double digits in each of these categories.

Internet Advertising (Affiliate) Business Results



AT: ACCESSTRADE (pay-per-click-based advertising affiliates for PCs and smartphones)
SFA: Store Front Affiliate (pay-per-click-based advertising for stores)
Other: sales of other advertising products (listing advertising, ADNW, etc.)

Conversely, SFA net sales slumped, down 12.2% y-o-y, because of the effects of the declines in sales of mobile phones. However, the Company has been improving its relations with mobile phone stores, increasing the rate of operations for projects and reviewing the commission fee, and also further expanding its sales network, including into regional areas, and consequentially in Q4, the results recovered and increased 13% y-o-y. Moreover in other advertising services, in addition to increases in sales from listing advertising and ad network advertising, the newly launched native advertising contributed to the results and net sales increased 38.4%.

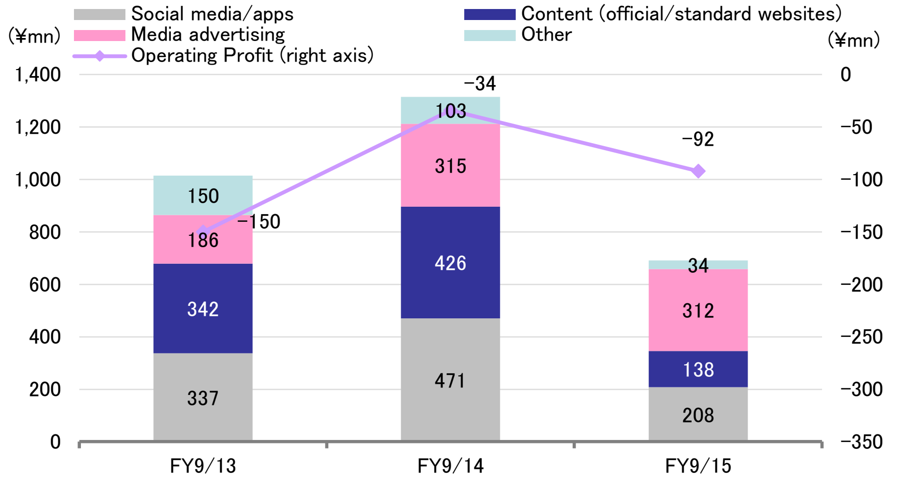
Overseas in the affiliate business, the businesses launched in 2013 in Indonesia and Thailand contributed combined net sales of ¥27mn and they are achieving steady growth. In addition, in April 2015 in Vietnam, the Company launched a joint-venture company (equity method affiliate) with MWORK CORPORATION, which has the largest advertising network in Vietnam. Recently, the joint-venture company's sales on a stand-alone monthly basis have overtaken those of the Indonesian subsidiary and its business is expanding faster than anticipated. As of the end of September 2015, the total number of affiliate partner sites for these three companies was approximately 8,000 sites, and the number of advertising programs they were handling was slightly less than 160. The advertising clients are mainly from the finance and e-commerce categories.

There were several overlapping reasons why profits declined despite the increase in sales, including the reduction in the gross profit margin due to the raising of the partner commission by some partners, for example in the finance category; the rise in HR costs following the strengthening of the personnel structure; the higher advertising costs in order to support partners; and the greater financial burden for the launch of an overseas business. Among these items, the loss in the overseas business (the total for the overseas subsidiaries) is considered to have grown from approximately ¥40mn in FY9/13 to around ¥90mn.

○ **Media Business**
In the Media Business, net sales declined 47.3% y-o-y to ¥693mn, and the operating loss was ¥92mn (compared to a loss of ¥34mn in the previous fiscal year). Breaking down net sales, media advertising sales slumped, falling 1% y-o-y to ¥312mn. The Company expanded content on the mainstay "mamastadium" site, such as columns by celebrities, and also focused on delivering articles to partner media and partnering with SNS. As a result, net sales continued to increase y-o-y alongside the improvement in its media value, including that the number of unique users exceeded 3.5 million people in September. However, results in Q3 were impacted by the temporary fall in sales following changes to the advertising delivery regulations and also by a decline in revenue from other media sites.

Conversely, in social media apps, as was previously explained the subsidiary more games Co., Ltd. was sold so the business contracted in scale, and therefore income greatly decreased, by 56% y-o-y. In addition, net sales of content to mobile carriers also declined significantly, by 68%. Looking solely at these game-related businesses, the operating loss was around ¥180mn.

Sales trends by Media Business service



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Financial position is sound, with no interest-bearing debt and a high current ratio

(2) Financial position and management indicators

The Company's financial position at the end of September 2015 was that the balance of total assets increased by ¥748mn from the end of the previous fiscal year to ¥6,343mn. Within this amount, current assets increased ¥557mn, with the main reason being that the increases in sales receivables of ¥523mn and income tax receivable of ¥156mn exceeded the decrease in cash and deposits of ¥135mn. Fixed assets rose ¥191mn compared to the end of the previous fiscal year, primarily due to an increase in investments and other assets, particularly investment securities, of ¥165mn.

Total liabilities increased ¥473mn compared to the end of the previous fiscal year to ¥3,321mn. While on the one hand accounts payable rose ¥772mn, on the other hand interest-bearing debt became zero following the sale of the subsidiary, and in addition corporate tax payable declined ¥226mn. Additionally, net assets rose ¥274mn to ¥3,021mn, mainly because of increases in retained earnings of ¥248mn and in total accumulated other comprehensive income of ¥22mn, which included a valuation difference on other available-for-sales securities and a foreign currency translation adjustment.

Looking at the management indicators, the equity ratio fell slightly, from 49.1% to 47.6%, because of the increase in accounts payable following the expansion in the scale of sales up to the end of the fiscal period. But based on the fact that the Company has zero interest-bearing debt and a current ratio of more than 100%, it can be judged to be continuing to maintain a sound financial position. But on the other hand with regards to profitability, due to the decline in profits each of the indicators of ROA, ROE, and operating profit margin worsened. But if results recover from FY9/16 onwards, profitability can be expected to once again improve.

Balance Sheet (Consolidated)

(Unit: ¥mn)

	FY9/12	FY9/13	FY9/14	FY9/15	Change
Current assets	3,928	4,098	4,670	5,227	557
(Cash and deposits)	2,366	2,387	2,471	2,335	-135
Fixed assets	616	810	924	1,115	191
Total assets	4,545	4,908	5,595	6,343	748
Current liabilities	2,164	2,371	2,759	3,263	503
Fixed liabilities	125	104	88	58	-29
(Interest-bearing debt)	100	86	58	-	-58
Total liabilities	2,290	2,476	2,847	3,321	473
Net assets	2,254	2,431	2,747	3,021	274
Main management indicators					
(Safety indices)					
Current ratio	181.5%	172.8%	169.2%	160.2%	
Equity ratio	49.5%	49.5%	49.1%	47.6%	
Interest-bearing debt ratio	4.4%	3.5%	2.1%	-	
(Profitability indices)					
ROA (recurring profit / total assets)	13.7%	12.6%	15.1%	5.8%	
ROE (net income/ equity)	7.7%	8.4%	14.9%	10.5%	
Operating profit margin	4.5%	3.9%	4.7%	1.7%	

Future Outlook

The outlook for the FY9/16 results is for an increase in sales and a return to profitability with a major increase in profits

(1) Company forecast for FY9/16

The outlook for the FY9/16 consolidated results are for net sales to increase 8.8% y-o-y to ¥21,826mn, operating profit to rise 72.2% to ¥600mn, recurring profit to grow 73.1% to ¥600mn, and net profit to increase ¥8.3% to ¥328mn. While the rate of increase of net profit is low, this is due to the normalization of the tax burden. The Internet Advertising (Affiliate) Business will continue to drive net sales. In terms of profits, in addition to a rise in gross profit as an effect of the higher sales, the main reasons why profits will grow is that the increases in HR costs and advertising costs will be stopped and profits in the Media Business will improve. The increase in the number of employees in FY9/16 will return to the former pace of between 20 to 30 people a year, compared to an increase of 40 people in the current fiscal year. In addition, advertising costs are expected to remain at around the same level as the previous fiscal year. Overall, we have the strong impression that the Company's forecasts are conservative.

FY9/16 Consolidated Results Forecasts

(Unit: ¥mn)

	FY9/15		FY9/16		
	Result	Ratio to sales	Company plan	Ratio to sales	y-o-y
Net sales	20,065	100.0%	21,826	100.0%	8.8%
Operating profit	348	1.7%	600	2.7%	72.2%
Recurring profit	346	1.7%	600	2.7%	73.1%
Net profit	302	1.5%	328	1.5%	8.3%

○ **Internet Advertising (Affiliate) Business**

In the Internet Advertising business, net sales are forecast to increase 9% y-o-y to ¥21.2bn. Within this amount, in affiliate advertising, demand for advertising from the e-commerce, financial, and services categories is expected to grow and sales to rise 7%. But as these net sales areestimated by nearly four times compared to the Q4 result in the previous fiscal year, at FISCO we think that if the results remain on this growth track, then as long as there are no major changes to the market environment, it is highly likely that the results will exceed the forecasts.

Conversely, for SFA net sales, it is difficult to expect growth in the mobile phones market and also the competition environment is becoming increasingly severe, so the forecast is for the result to be basically unchanged y-o-y. However, there are expectations for the contribution of native advertising in other advertising services. "X-lift (Cross Lift)," whose services were launched in August 2015, is a "content recommendation platform" that creates a database from the targeted articles in the listing media, as well as from user behavior analysis data, and provides advertising that is harmonized to each media site (which is known as native advertising). The Company has already introduced it into its own "mamastadium" site. Compared to conventional display-type advertising, with native advertising the matching rate between the media and the advertising is high, and users receive the information from the advertising with the sense that its content has been harmonized with the site. So demand for it is rapidly increasing from advertisers as a method of easily increase the effects of advertising. It is considered that the Company wants to develop the native advertising market so that this business becomes its second income pillar after affiliate advertising.

Also, net sales in the overseas business are forecast to increase by more than 3 times y-o-y to ¥90mn. In this fiscal period, the Company has been looking into establishing subsidiaries and affiliates in other countries, following on from those in Indonesia, Thailand, and Vietnam. In terms of profits, a loss of around ¥80mn is expected to continue in this fiscal year also. The sales scale that will be the break-even point will be annual net sales of around ¥100mn from Indonesia and Thailand. Also, sales have not yet reached the point where the HR costs are absorbed. The number of employees in subsidiaries at the end of previous fiscal year was 17 people in Thailand and 22 people in Indonesia. HR costs are low in Indonesia and if this business makes steady progress, it is possible that it will become profitable on a stand-alone monthly basis during this fiscal period.

Overseas, the gross margin in affiliate advertising benefits from the fact that the competitive environment is not that severe, and it is around 10% higher than in Japan, so going forward it is expected to contribute to profits alongside sales growth.

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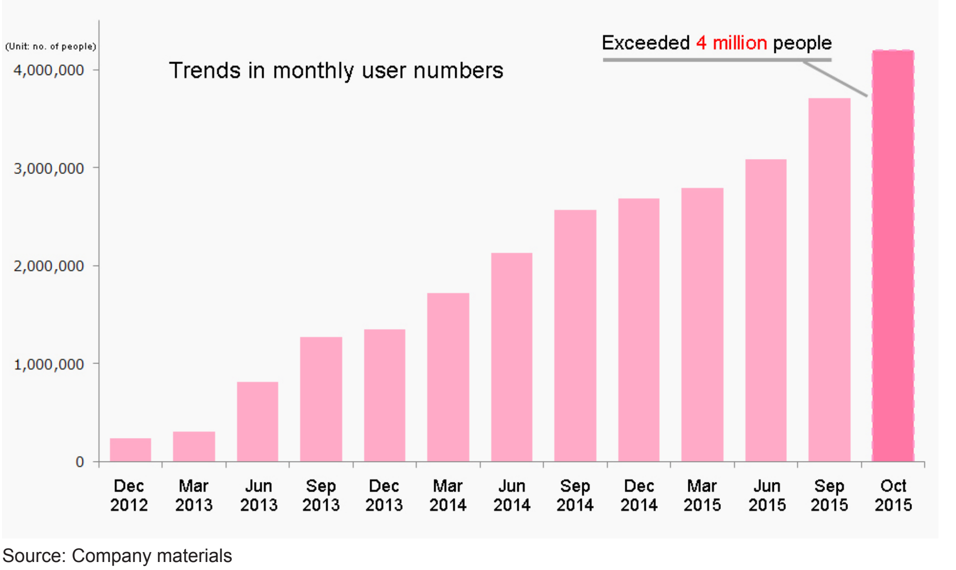
○ **Media Business**
In the Media Business, the forecast is for net sales to fall 9% y-o-y to ¥630mn. This is because although an increase in sales is expected from media advertising, the scale of the social media app business will continue to contract. Operating profit of around ¥10mn is forecast, meaning the business will be profitable. It seems entirely possible that this level will be achieved, as profits of ¥3mn were already recorded in Q4 of the previous fiscal year.

The results will be centered on revenue from media advertising, particularly from "mamastadium," which is the largest child-care support site in the industry. The number of "mamastadium" monthly unique users is 3.5 million people, but as there are 8 million households with children aged from 0 to 9 years, there still remains room for this number to grow. In fact, the number of unique users in October reached 4 million people and going forward, advertising revenue is expected to continue to increase alongside the rise in its media value.

Number of "mamastadium" users



Source: Company materials

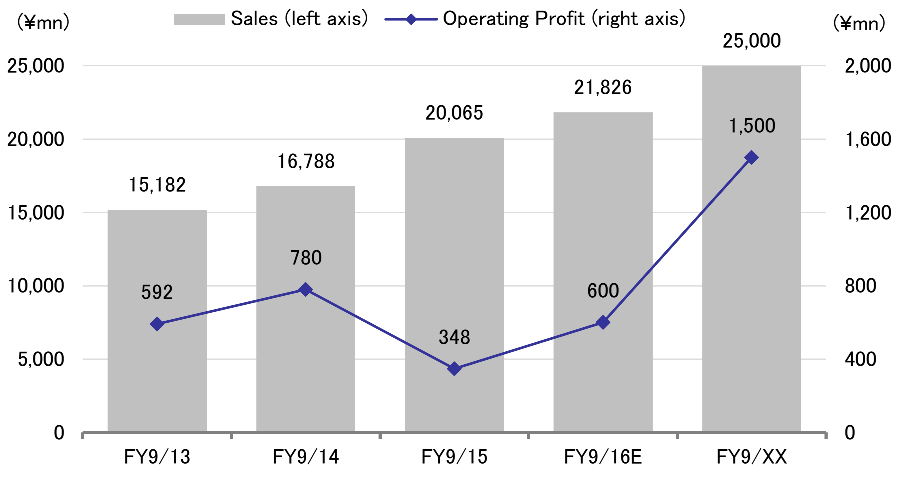
The Company is also developing new media. From this summer onwards, it has been releasing "Grouta" which is a news-curation app, "mofmo" which is a curation app targeting dog and cat lovers; and "KOIMEMO" which is a romance-based curation app. As these apps have practically no development costs, if their number of unique users increase, they can start contributing to profits at any early stage. Sales of native advertising through these media sites are also expected to increase.

The medium-term business targets are net sales of ¥25bn and operating profit of ¥1.5bn

(2) Medium-term business plan

The Company's medium-term business targets are consolidated sales of ¥25bn and operating profit of ¥1.5bn. We believe that if the Company continues its current growth, it will achieve them in 3 to 4 years.

Medium-term Plan Targets



The driving force behind the Company's revenue is the domestic Internet Advertising (Affiliate) Business, and in addition to increasing its market share in affiliate services by strengthening sales, the Company will expand its business by strengthening new services such as native advertising. In addition, in the Media Business, the Company aims to continue to develop and grow new media following on from "mamastadium" while building a stable earnings structure.

With regards to the overseas business, it is considered that the Company is aiming to acquire the number one market share in each country where it provides affiliate services and that its current goal is for this business to become profitable within three years. The e-commerce market in South East Asia is expected to achieve high growth in the future, so affiliate advertising has significant growth potential. Problems include developing client companies and affiliate partners at the same time as implementing fraud-prevention measures, but the Company already has experience of addressing these problems in Japan, so we think it will be able to overcome them. While currently the scale of this business is still small, in the medium- to long-term it is expected to grow to become a major business that will drive the Company's earnings.

Comparison with Industry Peers and Policy of Returning Profits to Shareholders

The difference in profitability with industry peers, each of which have their own respective features, is expected to gradually become smaller

(1) Comparison with industry peers

There are four other major affiliate management companies besides Interspace: F@N Communications, Inc. <2461>, Adways Inc. <2489>, ValueCommerce Co., Ltd. <2491>, and LinkShare Japan K.K. (unlisted, a subsidiary of Rakuten <4755>.) Their sales are around ¥10bn to ¥40bn. These five companies, including Interspace, hold an industry market share of about 60%.

Looking at the features of each company, F@N Communications is the largest industry player with about 2 million affiliate sites. It has been engaged for many years in the advertising business for SMEs and its dependence on e-commerce is relatively high. Adways is about 50% dependent on the mobile Internet (compared to domestic advertising sales) and is strong in games. Because of its heavy dependence on the mobile Internet, its profit margin is relatively low. ValueCommerce, a subsidiary of Yahoo! <4689>, obtains an overwhelmingly high percentage of its sales from the PC advertising business at around 70% (on a project basis), and while on a category basis its services for finance constitute nearly 50% of sales. Alongside F@N Communications, it remains highly profitable.

The reason that Interspace has a lower profit margin than the above listed companies is that, in addition to the low profitability of the Media Business, the Company has high staff levels for partner sites and advertiser development, even in the Internet Advertising (Affiliate) Business, so personnel expenses as a percentage of sales are relatively high. However, in the Media Business it has set its sights on improving earnings, such as through the sale of a subsidiary, and in the Internet Advertising (Affiliate) Business also, the effects of its strengthening of the HR structure will be felt in the future. Therefore, we forecast that the difference in profitability between the Company and its industry peers will gradually become smaller.

Comparison with Industry Peers

(Unit: ¥mn, %, Multiple)

	FY	Sales	Growth rate	Recurring profit	Growth rate	RP margin	EPS	DPS	PER
Interspace Co., Ltd. <2122>	FY9/15	20,065	19.5	346	-56.2	1.7	44.7	8.0	
	FY9/16E	21,826	8.8	600	73.1	2.7	48.4	8.0	16.7
F@N Communications Inc. <2461>	FY12/14	31,990	40.8	5,948	44.2	18.6	47.1	15.0	
	FY12/15E	36,500	14.1	6,570	10.4	18.0	54.4	17.0	12.8
Adways Inc. <2489>	FY3/15	35,890	13.9	1,197	42.4	3.3	16.8	3.36	
	FY3/16E	-	-	-	-	-	-	-	-
ValueCommerce Co., Ltd. <2491>	FY12/14	13,373	11.3	1,647	8.3	12.3	28.9	11.0	
	FY12/15E	15,900	18.9	1,590	-3.5	10.0	31.0	10.0	15.8

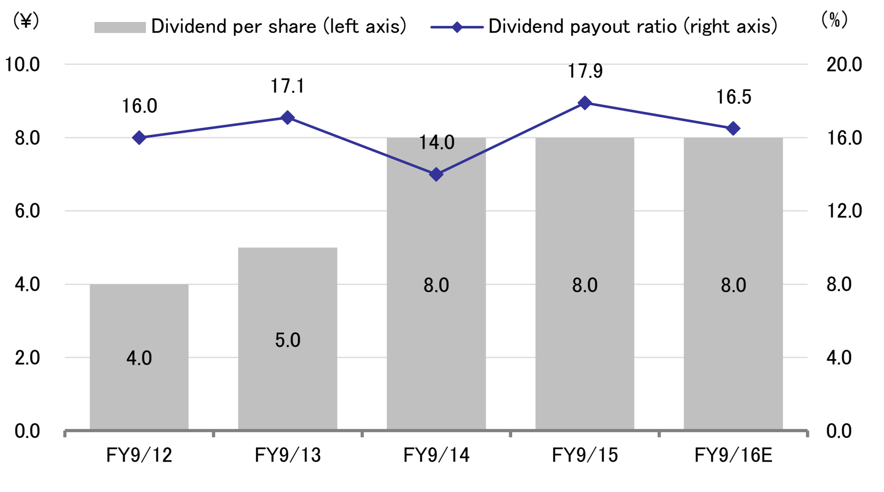
Note: Forecast PER was calculated based on the closing price on January 7, 2016, and forecasts for Adways for FY3/16 have not been published.

The Company targets a dividend payout ratio of about 20%, and the dividend for FY9/16 is expected to be ¥8.00

(2) Policy of returning profits to shareholders

The Company determines dividends by taking into account factors such as earnings trends, financing needs and internal reserves for future business development in a comprehensive manner. The Company targets a dividend payout ratio (consolidated) of about 20%, and the dividend for FY9/16 is expected to be ¥8.00, the same as in the previous fiscal year.

Dividend and Dividend Payout Ratio (consolidated)



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