Netyear Group Corporation

3622 TSE Mothers

10-Aug.-16

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Advancing collaborations with Konica Minolta Japan and in the digital solutions area

The Netyear Group <3622> (hereinafter, also the "the Group") operates a digital marketing support business utilizing Internet technologies. Its customers are primarily major companies and its subsidiary, Tribal Media House, is an industry leader in the social media analysis and consulting sector.

In the FY3/16 consolidated results, net sales decreased 6.0% year-on-year (y-o-y) to ¥6,801mn, and operating income fell 67.0% to ¥146mn. A factor behind the decline in sales was the conclusion in Q3 of an omni-channel related major project, while a factor behind the lower profits was that in Q4, there was a delay in delivering a specific project and so an allowance for a loss on orders of ¥135mn was recorded. However, in-house product net sales trended strongly, increasing 13% y-o-y, mainly from "rakumo" operated by a subsidiary.

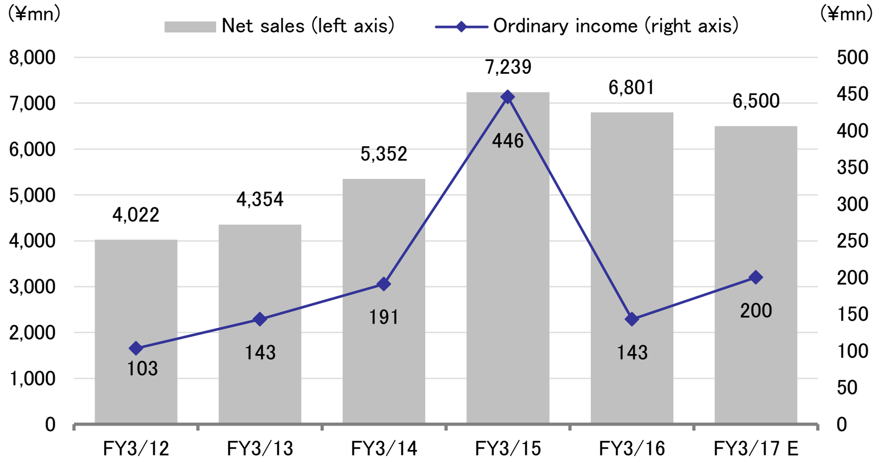
In FY3/17, while sales are expected to increase from a social media-related service operated by a subsidiary and from "rakumo," due to the decline in sales from omni-channel-related major projects and the ongoing effects of the adjustment of personnel for a delayed project, net sales are forecast to continue to decline, down 4.4% y-o-y to ¥6,500mn. But the outlook for profits is for operating income to increase 36.9% to ¥200mn due to the elimination of the allowance for a loss on orders.

In February 2016, the Group's largest shareholder changed from TIS Inc. to Konica Minolta Business Solutions Inc. (currently, Konica Minolta Japan Inc.), which is a Group company of Konica Minolta <4902>. Although there has been no trading relationship with TIS in terms of sales, going forward the Group plans to advance a collaboration with Konica Minolta Japan in the digital marketing solutions area. Further, in May 2016, it announced a collaboration with NTT Data <9613> with the objective of introducing the omni-channel into companies and promoting its use. The outcomes of these collaborations can be expected to contribute positively to the Group's results in the future.

Check Point

- Developing businesses to support the reforms required in the digital age
- The equity ratio and interest-bearing debt ratio are sound and it is strengthening its financial base
- Looking to develop "popurou" in the overseas market

Results trends



Business overview

Developing businesses to support the reforms required in the digital age

(1) Group profile

The Group's management mission is to "Create the future of business digitally and with users. Everything starts from the user experience." It is developing businesses to support companies and communities for the reforms required in the digital age. Specifically, this includes digital-marketing consulting, the planning and production of digital content, systems development, the planning and sales of marketing tools, the planning and sales of office tools on the Cloud, and co-creation of businesses with local communities.

The Group's subsidiaries are Netyear Craft (established 2006), which produces and manages websites; Tribal Media House (made into a subsidiary in 2009), which offers marketing support and analysis and consulting utilizing social media; and rakumo inc. (made into a subsidiary in 2013, company name changed from Nihon Gigei), which develops and sells a Cloud app. More than 85% of Netyear Craft's net sales are from the Group, but the other two subsidiaries are developing their businesses independently. Employee numbers are increasing year by year alongside the expansion in business scale and had reached 357 employees on a consolidated basis at the end of March 2016 (up 27 compared to the end of the previous fiscal year).

Up until February 2016, the Group's largest shareholder was TIS with a shareholding ratio of 31.0%, but it sold all of its shares to Konica Minolta Business Solutions (currently, Konica Minolta Japan), thereby changing the largest shareholder.

Consolidated subsidiaries (business description, capital contribution ratio)

Name	Capital contribution ratio (%)	Main business
Netyear Craft	100.0	Website production and management
Tribal Media House	92.6	Social media marketing support
rakumo	51.0	Cloud applications development and sales

(2) Business description

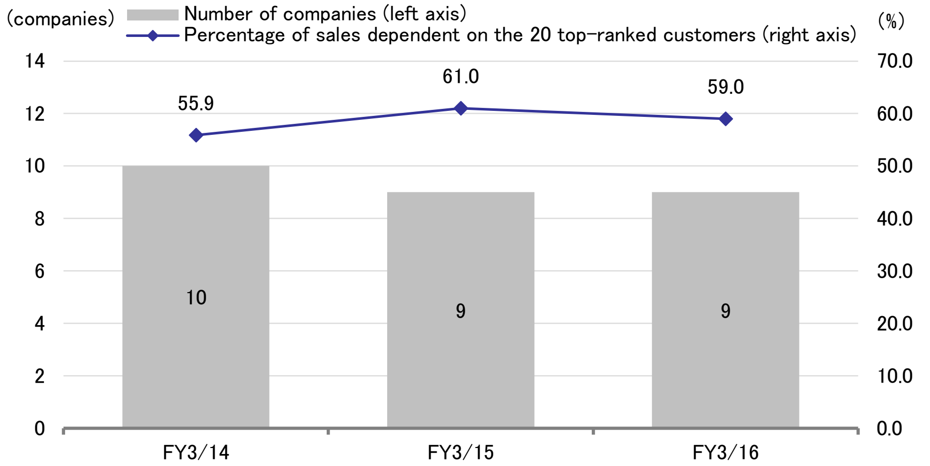
The Group's business area is digital marketing, which refers to the marketing techniques in corporate activities that are centered on the website of the client company and that are coordinated with elements such as existing media, marketing, call centers, and stores. These services are for clients such as companies and local governments, and propose and implement new digital marketing strategies to produce the outcomes that the clients want, including improved brand value, sales growth, and the promotion of business transformations.

A characteristic of the Group is that it is engaged in systems development and design with the focus on improving the "user experience (UX)" on the Internet. Here, "user experience" does not refer to the standard meaning in English, but rather indicates "what users experience when they visit a company's website, and what they become interested in after experiencing that site." Therefore, the final goal is to improve the "user experience" in order to get customers to purchase products or to become fans of that company.

With the arrival of the digital information society and people being able to obtain the information they need at any place and any time via the Internet, heightening the "user experience" on companies' own websites, which have become customer points-of-contact, has today become more important than ever before. Furthermore, these websites also occupy an important position in terms of promoting companies' marketing strategies and brand strategies. As the methods of effectively improving "the user experience" change depending on the nature of the client's business, systems development has come to be carried out through customized projects. Generally, the development period is about three months and even a long development period is about one year. The majority of the systems development part of a project is outsourced, with the unit price of orders varying depending on the content of the project, ranging from ¥100,000 yen at the low end to more than ¥100 million yen at the top end. Recently, however, demand for marketing techniques incorporating "data analysis and utilization" has been increasing and the unit price of projects has been rising.

The strengths of the Group include its many staff with strong planning abilities and progressive sensibilities toward marketing. Furthermore, its customers highly evaluate its project management capabilities and strengths such as the stability and reliability of its systems. The number of customers that have an annual transaction total in excess of ¥100 million, which is a key performance indicator (KPI) for the Group, was unchanged in FY3/16 at 9 companies, while the percentage of sales dependent on the 20 top-ranked customers was 59%.

Number of customers that have an annual transaction total in excess of ¥100 million and the percentage of sales dependent on the 20 top-ranked customers



Other than support services for the introduction of customized projects, the Group is focusing on the sales of the products it develops in-house. These include Tribal Media House's social media integrated management tool "Engage Manager," its co-creation marketing platform "cocosquare," and also "rakumo," the business-use groupware software of rakumo, which was made into a subsidiary in August 2013. It also sells and provides installation support for the product line-ups of third parties, including the marketing automation tools of U.S. companies like Salceforce.com and Oracle, and the access analysis tools of Google and Adobe. The business model for the products it develops in-house is a stock-type model with monthly billing, and the percentage of total sales provided by these products in FY3/16 was approximately 11%. However, the Group is aiming to raise this to around 50% in the future.

List of services covering all points of contact with customers

Source: the Group's financial results briefing materials

The Group has clients in a wide range of industries, including retail, manufacturing, finance, and information and communication services, and it has in excess of 1,000 customer companies. These include more than 250 customers in its digital marketing support business, centered on major companies that are representative of Japan, and also a wide-range of customers, ranging from major companies to SMEs, for its in-house developed products, particularly for "rakumo."

Results overview

Operating income fell for the first time in seven fiscal years

(1) FY3/16 results overview

In the FY3/16 consolidated results announced on May 10, net sales declined 6.0% y-o-y to ¥6,801mn, operating income fell 67.0% to ¥146mn, ordinary income decreased 67.8% to ¥143mn, and net income attributable to the owners of the parent company (hereafter, net income) increased 1.0% to ¥74mn. This was the first time that operating income had fallen in seven fiscal years, with the main factor being, following the completion of a round of major projects, the major declines in the non-consolidated results, with net sales falling 15.3% to ¥4,888mn and operating income down 94.0% to ¥27mn.

Specifically, continuously over 2 fiscal years from FY3/15, an omni-channel related major project largely concluded on Q3, and the net sales from the same project declined from ¥1,794mn in the previous fiscal year to ¥1,533mn. Another factor behind the decline in profits was that in Q4, development-related problems occurred for a different major project (worth in excess of ¥100mn), and an allowance for a loss on orders of ¥135mn was recorded.

Breaking down by item the factors behind the change to operating income, the decline in sales reduced it by approximately ¥90mn, the increase in the allowance for a loss on orders by ¥90mn, and the higher costs to develop new services and establish new bases by ¥100mn. With regards to the new services, development costs for the "popurou" specialist app for stores, and also the costs to establish a Vietnamese development subsidiary for the subsidiary Tribal Media House as the costs to establish a new base, were both recorded. Despite this, net income increased slightly following the elimination of an impairment loss of ¥187mn recorded in the previous fiscal year.

FY3/16 results

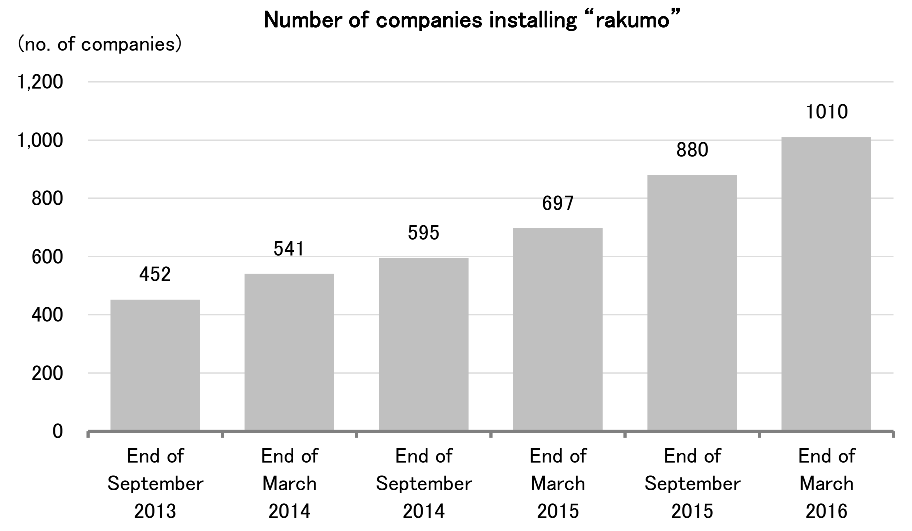
(¥mn)

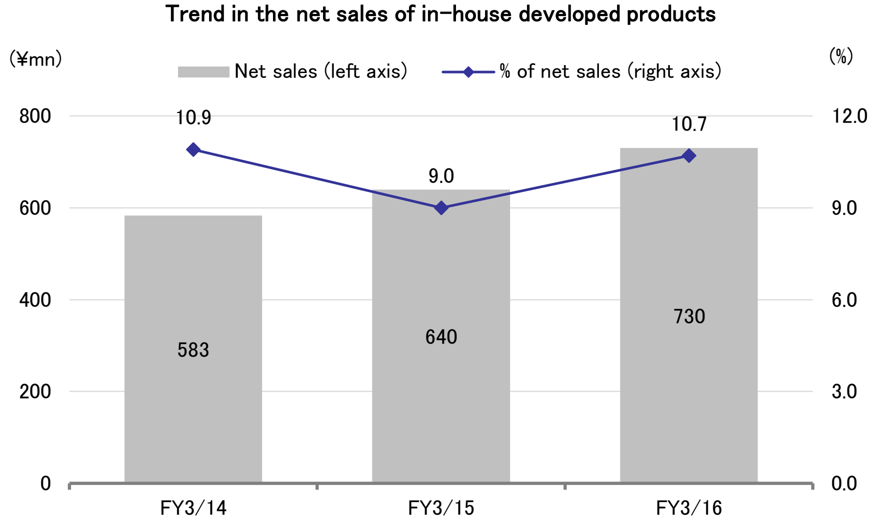
	FY3/15		FY3/16		
	Result	% of sales	Result	% of sales	y-o-y
Net sales	7,239	-	6,801	-	-6.0%
Cost of sales	5,744	79.3%	5,636	82.9%	-1.9%
SG&A expenses	1,051	14.5%	1,019	15.0%	-3.1%
Operating income	442	6.1%	146	2.1%	-67.0%
Ordinary income	446	6.2%	143	2.1%	-67.8%
Net income	73	1.0%	74	1.1%	1.0%
(non-consolidated results)					
Net sales	5,772	-	4,888	-	-15.3%
Operating income	452	7.8%	27	0.6%	-94.0%

For the subsidiaries, the results of Tribal Media House and rakumo both trended strongly in the context of the activation of companies' intentions to invest in marketing strategies utilizing social media. Tribal Media House is steadily increasing the number of companies introducing its independent services, which are the co-creation marketing tool "cocosquare" and "Engage Manager" (a social media comprehensive management tool), and its net sales increased 30% y-o-y.

In rakumo, the number of companies installing the groupware software "rakumo"*1 that it provides as a Cloud service topped 1,000 companies (compared to 697 at the end of the previous fiscal year) and net sales increased 50% y-o-y, and it recorded a profit in operating income for the first time since it became a subsidiary in 2013. "rakumo" provides various functions and services that contribute to improving productivity for customers' indirect operations, such as a settlement function for transportation expenses and other expenses and a scheduler function, and the number of companies installing it is increasing year by year.

As a result of the strong sales at these subsidiaries, net sales of in-house products increased 13% y-o-y to ¥730mn, and their percentage of consolidated net sales rose from 9.0% in the previous fiscal year to 10.7%.





The equity ratio and interest-bearing debt ratio are sound and it is strengthening its financial base

(2) Financial position and management indicators

Looking at the financial position at the end of March 2016, total assets decreased ¥176mn compared to the end of the previous fiscal year to ¥3,176mn. The main reasons for this were that the increases in work-in-process of ¥150mn and software of ¥26mn were exceeded by the decreases in cash and deposits of ¥243mn and trade receivables of ¥154mn.

Liabilities decreased ¥246mn compared to the end of the previous fiscal year to ¥1,134mn. This was mainly because although the allowance for a loss on orders and advances received increased ¥91mn and ¥63mn respectively, interest-bearing debt decreased ¥86mn, income taxes payable fell ¥100mn, and consumption tax payable declined ¥116mn. Net assets increased ¥69mn compared to the end of the previous fiscal year to ¥2,042mn, and retained earnings rose ¥52mn, mainly due to the recording of net income.

Looking next at the management indicators, the Group continues to repay the interest-bearing debt it procured to fund the acquisition of shares in rakumo in FY3/14, and the interest-bearing debt ratio fell from 13.6% in the previous fiscal year to 8.9%. Conversely, the equity ratio rose from 58.4% to 63.7%, and the Group can be said to be strengthening its financial base.

Profitability declined slightly in FY3/16 due to the completion of a round of major projects and the occurrence of a development delay. Orders for customized projects constitute the majority of the Group's profits, so the tendency for profitability to rise and fall according to the development trend for major projects can be expected to continue for the time being. However, sales of in-house developed products, which the Group is focusing on in order to stabilize profitability, are steadily increasing, so profitability is forecast to move in the direction of becoming more stable in the future.

Consolidated balance sheet

(¥mn)

	End of FY3/15	End of FY3/16	Change
Current assets	2,947	2,806	-141
(cash and deposits)	1,463	1,219	-243
Fixed assets	405	369	-35
Total assets	3,352	3,176	-176
Current liabilities	1,220	1,046	-173
Fixed liabilities	159	87	-72
(interest-bearing debt)	266	179	-86
Total liabilities	1,380	1,134	-246
Net assets	1,972	2,042	69
(stability)			
Current ratio	241.6%	268.2%	
Equity ratio	58.4%	63.7%	
Interest-bearing debt ratio	13.6%	8.9%	
(profitability)			
ROA (return on assets)	13.8%	4.4%	
ROE (return on equity)	3.8%	3.8%	
Operating income margin	6.1%	2.1%	

Future outlook

A decline in sales but increases in profits are expected in FY3/17

(1) The FY3/17 results outlook

The outlook for the FY3/17 consolidated results is for net sales to decrease 4.4% y-o-y to ¥6,500mn, operating income to increase 36.9% to ¥200mn, ordinary income to rise 39.1% to ¥200mn, and net income to climb 65.9% to ¥124mn, for a decrease in sales but increases in profits. The reasons for the fall in net sales are that while sales at the subsidiaries, including for a social media-related service and “rakumo,” are set to continue to rise, sales from omni-channel related major projects will fall even further, and in addition in the 1H, human resources will be concentrated as a priority on the convergence of a specific project whose development has been delayed. Therefore, net sales are expected to fall for the second consecutive fiscal year. Conversely, the factors behind the forecast increase in operating income are the higher profits at the subsidiaries and also the elimination of the ¥135mn allowance for a loss on orders. The Group is continuing to strengthen its personnel system, but it is shifting to a recruitment policy of quality over quantity, and so the outlook is for personnel-related expenses to increase only slightly y-o-y.

Looking to develop “popurou” in the overseas market

(2) New service trends

The Group's medium- to long-term strategy is to aim to raise the percentage of net sales provided by in-house products to around 50%, and in this fiscal year also, its policy will be to actively investment in developing new services.

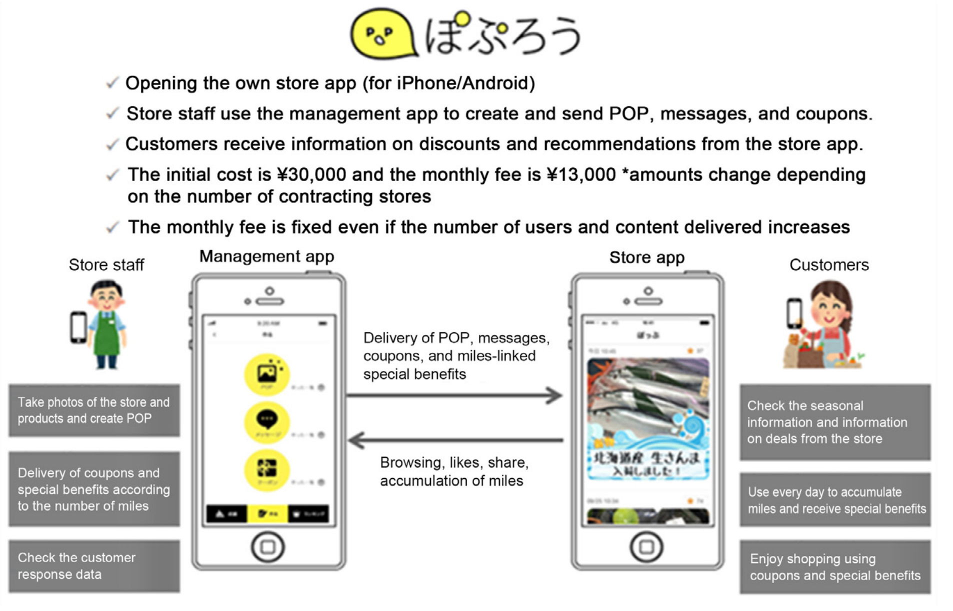
Tribal Media House plans to launch a new social media-related service during this fiscal year. Also, the “rakumo” service functions will be continued to be strengthened, with the focus placed on increasing the number of companies installing it and the unit price per contract. Also, an upgraded version of “popurou,” the specialist app for stores that was newly launched in September 2015, is scheduled to be released in this fiscal year.

"popurou" is an O2O Cloud app service in which retail stores, such as food supermarkets, send information to consumers on daily campaigns and products. It is provided from a service for launching apps, and the service fees, for example for a small-size store such as a private store (annual sales of less than ¥30 million) entails an initial cost of ¥10,000 and then monthly fees of ¥7,800, which is inexpensive when compared to similar apps from the Group's industry peers. More than 10 stores had installed it as of the end of March 2016, including The Garden Jiyugaoka, a luxury foods supermarket. While the number of stores installing it is still small, its effects in terms of improving customer attraction and increasing product sales have already been confirmed, and there are major expectations for its growth in the future.

Its major differences with conventional flyer advertising apps in terms of its effects in increasing product sales include the point that even for products that usually do not sell all that well, the sending side can communicate to consumers easy-to-understand information on "why this is a good product" and "why is it worth buying" in a form they can freely choose, including utilizing photographs and text. There are examples of the sales of these sorts of products increasing remarkably through the use of "popurou," and its use may expand in the future as a new marketing tool for retail stores.

As its sales strategy, the Group's policy is to increase the app's installation at both individual stores and chain stores and for the future, it is thought that it wants to efficiently increase the number of stores installing it while utilizing sales agencies, aiming for it to be installed into thousands of stores. It is also looking to develop "popurou" in the overseas market and is currently at the stage of carrying out market research.

The O2O tool "popurou"



Source: the Group's homepage

While it is the product of another company, sales of Salesforce Marketing Cloud*, which is the marketing automation tool of Salesforce.com, Inc., were also begun from FY3/16. Demand is from customers (major to medium-sized companies) that are considering investing in the omni-channel, but because a fully-fledged investment in it would be too costly, they want to first install a simple automation tool and analyze its effects. While the number of companies installing it is still small, companies' marketing strategies are becoming more and more diverse, such as from the spread in the use of SNS, and so demand for marketing automation tools leading to improved operational efficiency is forecast to increase in the future. When additionally considering the Group's in-house consulting capabilities in the digital marketing area, sales of its app can be expected to increase in the future.

* A marketing automation tool that has been installed by more than10,000 companies around the world and that has the leading market share. Users can communicate one-to-one with customers via various channels, including email, the Internet, and SNS. By setting in advance the sales promotion scenarios for customers, companies can deliver sales promotion content, with the optimum channel and on the optimum timing being selected automatically.

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Advancing collaborations with Konica Minolta Japan and NTT Data

(3) A new strategy for collaborations

The Group announced that it is collaborating with Konica Minolta Japan, which has newly become its largest shareholder, and NTT Data. The details of the measures for the respective collaborations are described below.

a) Collaboration with Konica Minolta Japan
The main business of this company, which is a wholly-owned subsidiary of Konica Minolta, are sales within Japan of office equipment, healthcare equipment, industrial measuring instruments, and related consumables, and it is also developing business solutions services, including a marketing management service. This business collaboration was announced in February 2016 on the occasion of it becoming the Group's largest shareholder.

They will collaborate for the following four points.

1) They will combine the Group's strength of providing a digital marketing service, and Konica Minolta Japan's strength of providing a strategic corporate website construction service, and also real marketing services, to create new value for the marketing services that they will provide to both their customers.
2) By each providing their services to the other's customers, they will mutually expand their businesses and business areas.
3) They will jointly construct a next generation marketing platform for corporate customers, and based on this platform, aim to improve the economy of their businesses by increasing customer numbers.
4) They will carry out joint research and development in the field of digital technology, including on the Internet of Things (IoT).

In terms of the practical aspects, already two Konica Minolta Japan employees have been seconded to the Group and a specialist team is being newly organized in order to implement the collaboration, while at the same time a working group has also been created. Cross sales will be carried out through this collaboration, which for the Group will result in an instant expansion of the domestic sales channels for its in-house developed products of "popurou" and rakumo," and which could also lead to it utilizing Konica Minolta's overseas sales network. Up until now, one management issue facing the Group has been expanding its sales channels, so it seems that through this collaboration, its growth potential has risen to the next level.

b) Collaboration with NTT Data
In May 2016, the Group announced a collaboration with NTT Data with the objective of promoting omni-channel installations. Omni-channel refers to a mechanism to realize improved convenience for both the companies installing it and their customers through the integrated management of information on customers, products, and inventory across both EC and real stores, including by implementing inventory optimization and appropriate promotional measures tailored to, for example, customer preferences.

The term omni-channel has come to be in widespread use in the last two to three years, and while interest in it is rising, particularly in distribution companies, because it spans a diverse range and it is complex, the current situation is that it has not yet reached the stage of companies actually installing into their systems. In Japan, Seven & i Holdings <3382> was the pioneer, starting its introduction from FY14, and the Group and NTT Data have been jointly constructing the "omni7" system, which provided the opportunity for this collaboration.

By combining the Group's strength, of "The ability to support the reforms required for the digital age through the user experience," with NTT Data's strength of "Comprehensive management capabilities and systems development capabilities cultivated through a number of critical-system developments," they plan to collaborate to support the introduction of the omni-channel into companies.

The sequence of events up to the introduction of the omni-channel can be divided into three phases: "the preparation phase," "the basic concept phase," and "the introduction and management phase." In the "preparation phase," various types of seminars and workshops are held in order to deepen companies' essential understanding of the omni-channel and to create a shared awareness on it between management and the stakeholders.

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Next, in the "basic concept phase," to support the creation of a consensus on companies' image of an omni-channel strategy in the future and the installation story, support is provided in order to depict from the customers' perspective the ideal image of what kind of experiences do the companies want to provide for their products and services and at the points-of-contact with customers. In addition, support is provided on formulating the specific methods and plans in order to realize this ideal image.

In the "the introduction and management phase," based on the plan formulated in the basic concept phase, an optimum solution is provided and systems development carried out. Also, in the management phase, further improvements are proposed while carrying out the access analysis.

The roles planned for the Group in the preparation and basic concept phrases are to consult with companies on creating the ideal image toward achieving their goals through the optimum user experience based on the users' perspective. Then in the introduction and management phase, its role will include aspects such as EC design, and support for access analysis and website management.

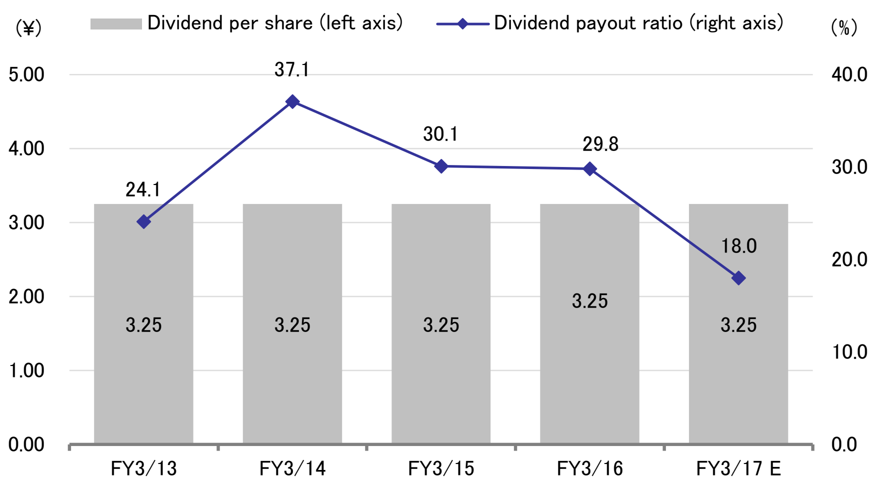
Omni-channel systems will be customized projects that reflect each individual company's needs, so going forward the Group to a certain extent plans to develop standardized functions for each industry (retail distribution, finance, manufacturing, etc.) and provide them with package services.

Returning Profits to Shareholders

Stably and continuously pays dividends while retaining internal reserves

The Group pays dividends in order to return profits to shareholders. Its basic dividend policy is to stably and continuously pay dividends while ensuring it retains the internal reserves necessary to develop its businesses in the future and to strengthen its business structures. For this reason, from FY3/08 onward it has fixed dividends per share at ¥3.25. However, the Group intends to introduce performance-linked dividends in the future if it further supplements its internal reserves and obtains a stable cash flow in each fiscal period.

Dividend per share and dividend payout ratio



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