COMPANY RESEARCH AND ANALYSIS REPORT

Trust Tech Inc.

2154

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Index

Summary

Sustaining healthy growth in Japan and overseas on success with "region x field" growth strategy, new mid-term plan targets prompt attainment of ¥10bn in operating income

Trust Tech Inc. <2154> (hereafter, also "the Company") is a staffing company that mainly dispatches engineers and manufacturing staff and handles subcontracting for development, design, and production. Its core strength is dispatching/subcontracting engineers, and Trust Tech stands out among listed companies in the technology staffing industry with its aggressive pursuit of overseas opportunities.

1. Steep sales and profit gains in FY6/18, continues healthy broadening in domestic and overseas businesses

The Company posted steep sales and profit gains in FY6/18 with net sales at ¥65,363mn (+51.9% YoY), operating income at ¥4,297mn (+33.4%), and EBITDA at ¥5,332mn (+33.0%). While contribution from UK-based GAP Personnel Holdings Limited, which was acquired as a subsidiary in December 2017, for nine months provided a large boost to sales, the domestic engineering field, a core business, sustained strong growth with a 27.5% YoY increase. Profitability improved in engineering and manufacturing fields due to higher dispatching prices and additional employees, and EBITDA sharply increased. The overseas field booked a YoY gain in EBITDA, despite decline in EBITDA margin versus the previous year because of one-time costs at MTrec and weaker mix from the acquisition of GAP as a subsidiary.

2. New mid-term plan targets ¥10bn in operating income through faster personnel additions and "Region x Field" strategy

The newly announced three-year mid-term business plan covering FY6/19-21 calls for ¥10bn in operating income as a medium-term goal. While the plan does not specify attainment timing, we think the Company hopes to reach the goal promptly in FY6/21. Policies for realizing the goal continue along the existing paths of "region" and "field" growth. In region strategy, the focus is the next acquisition after the purchases of three UK companies. The start of profit contributions from Asian companies also deserves attention. In field strategy, a key initiative is broadening IT and software areas in the domestic engineering field. The Company targets ¥10bn in FY6/19 and is aiming for further expansion. It intends to accelerate personnel additions in order to realize mid-term plan goals. Specifically, it already ramped up mid-career hires and is preparing to hire 900 new university graduates in April 2019.

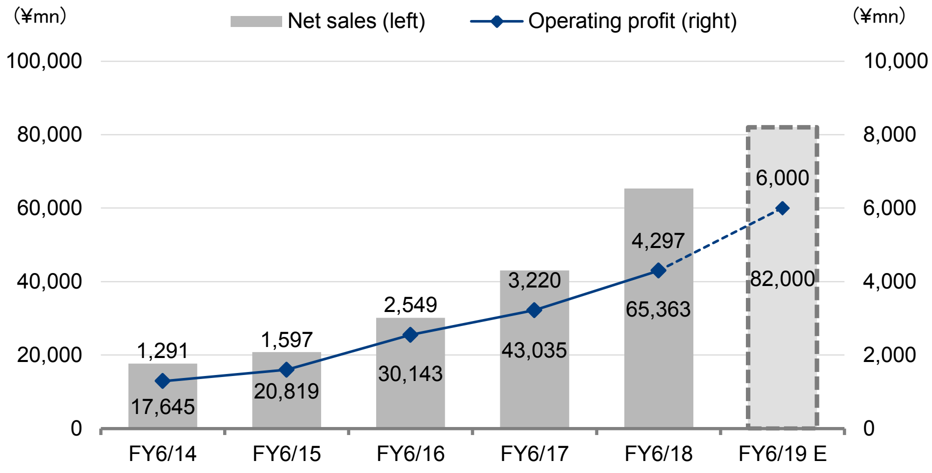
3. Targeting steep sales and profit gains in FY6/19 too with additions to domestic personnel, higher pricing, and overseas M&A as drivers

The Company expects continuation of steep sales and profit gains in FY6/19 at ¥82,000mn in net sales (+25.5% YoY), ¥6,000mn in operating income (+39.6%), and ¥7,048mn in EBITDA (+32.2%). In Japan, it plans to increase sales in the engineering field by just over 20% and the manufacturing field by just over 10% on additional personnel and higher prices. In the overseas field, it targets sales growth of just over 30% with a full-year contribution from GAP and new income from Quattro Group Holdings Limited (nine-months' worth) acquired as a subsidiary in August 2018. The Company aims for earnings growth of just over 30% YoY with improved profitability from increased volume and higher pricing in the mainstay engineering field. Furthermore, it expects profit growth of over 50% YoY in the overseas field on stronger profitability from removal of one-time costs and more favorable business mix. We see upside room in overseas field sales.

Key Points

- Announced a new mid-term business plan, aiming for prompt attainment of ¥10bn in operating income
- Targets operations with 10,000 engineers and 15% operating margin in the engineering field driven by higher pricing and expansion and momentum in IT area
- Overseas field sales at the ¥30bn level, seeking further expansion with emphasis on earnings

Results trend



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

Company profile

Currently sustaining robust growth with multiple acquisitions in Japan and abroad

1. History

Sanei Shoji Inc. and others established Kyousei Sangyou Inc. (Trust Tech's predecessor) in 1997 as a special subsidiary based on the Act on Employment Promotion etc. of Persons with Disabilities. Amuse Capital acquired all of the company's shares and changed its name to Trust Works Sanei Inc. in 2004 and also expanded business scope to dispatching services (specified worker dispatching business) and other areas. Trust Works Sanei acquired all shares in former Trust Tech Inc., which was a company under Amuse Capital, in 2005 and entered the engineer dispatching business. It merged with former Trust Tech in 2008 and changed its name to Trust Tech Inc., completing the foundation of current operations.

Trust Tech subsequently pursued M&A deals to broaden its business scope, including rapid acquisitions as subsidiaries of PLM (now, consolidated subsidiary TTM Inc.) in 2009, International Dispatching Human Resources Limited (now, consolidated subsidiary HKTT Limited) in 2010, and Freedom Co., Ltd. (now, TRUST NEXT SOLUTIONS Inc.) and Kanamoto Engineering (changed its name to Trial but was absorbed into Trust Tech in October 2016) in 2015. It acquired UK-based dispatching firm MTrec as a subsidiary in August 2016, giving it a foothold to promote full-fledged overseas initiatives, and then purchased UK-based GAP as a subsidiary in December 2017 (this deal involved direct acquisition of holding-company 1998 Holdings Limited). It also acquired FUSIONi Co., Ltd. as a subsidiary in March 2017 (renamed as Trust iPowers Inc. in January 2018) as part of broadening business scope to IT and software. The Company announced the acquisition of UK-based Quattro Group as the third entity in this country in August 2018.

Pursuing three main fields - engineer dispatching, manufacturing staff dispatching, and overseas business

2. Business overview

Trust Tech has had two main business domains – the engineering field, which covers engineer dispatches and the development and design subcontracting, and manufacturing field, which handles manufacturing subcontracting and dispatching of manufacturing workers to production lines. It switched to three business segments from FY6/17 with the addition of an overseas field to cover overseas business. Trust Tech's overall income consists of these three reporting segments plus other income from special subsidiary Trust Tech With Inc. (renamed from Kyousei Sangyou Inc. in March 2017) that handles employment for disabled persons and from real estate leasing business.

The corporate group consists for Trust Tech and consolidated subsidiaries TTM Inc., TRUST NEXT SOLUTIONS and Trust iPowers in Japan. As business fields, Trust Tech, TRUST NEXT SOLUTIONS and Trust iPowers handle engineering while TTM runs the manufacturing.

Overseas initiatives started with the acquisition of a Hong Kong-based company, which provides engineering recruitment and other services, in June 2016. Since then, the Company has rapidly expanded business scope by setting up sites in Asia, with emphasis on China, and simultaneously making acquisitions in the UK. Overseas field sales have quickly risen to the ¥30bn range due to major acquisitions in the UK of MTrec in August 2016, GAP in December 2017, and Quattro Group in August 2018.

Overview of Trust Tech group companies

Business segment	Company name	Business content	Equity stake	Comment
Engineering field	Trust Tech Inc.	Provides dispatching, subcontracting, outsourcing, and recruitment services in the engineering field	-	
	TRUST NEXT SOLUTIONS Inc.	Provides control-related software development, design assistance, and testing	100%	Acquired as a subsidiary in July 2015, merged with the group and changed the company name in April 2018
	Trust iPowers Inc.	Provides dispatching and outsourcing services in the ICT field	100%	Acquired as a subsidiary in March 2017, changed the company name in January 2018
Manufacturing field	TTM Inc.	Provides subcontracting and dispatching services in the manufacturing field	100%	
Other	Trust Tech With Inc.	Provides an environment for disabled people to engage with others as members of society	100%	Formerly Kyousei Sangyou Inc.
Overseas field	MTrec Limited	Handles dispatching and recruitment business	83%	Acquired shares in August 2016
	PT.TRUST TECH ENGINEERING SERVICE INDONESIA	Personnel placement	100%	Established in September 2016
	Shan Dong Trust Bridge Human Resources Inc.	Dispatching, subcontracting and personnel placement	49%	Established in October 2016
	Trust Tech Human Business Consulting Shanghai Inc.	Personnel placement	100%	Established in July 2017
	Guangzhou Trust Dianmi Human Resources Inc.	Dispatching, subcontracting and personnel placement	49%	Established in March 2018
	Gap Personnel Holdings Limited	Dispatching and personnel placement	75%	Acquired shares in December 2017
	Quattro Group Holdings Limited	Dispatching and personnel placement	75%	Acquired shares in August 2018

Source: Prepared by FISCO from securities reports and press releases

Recruiting engineers is vital to growth in the engineering field. Responding with mid-career hires and new university graduates

3. Income structure of the engineering field segment

In the engineering field segment, Trust Tech handles the dispatch, subcontracting, and outsourcing of its engineers for R&D, design, production technology, and other technology areas at customer companies. Actual business content can be largely divided into dispatching engineers and development, design, and other subcontracting, with about 75% dispatch of engineers and 25% is subcontracting. The outsourcing business mainly involves work conducted by the Company's engineers at customer facilities, and outsourcing development at its own facilities is rare.

Average prices are higher in the engineering field compared with those in the manufacturing field because of the added value of "engineers." Price difference results in the profitability gap between the two segments. While it might appear that subcontracting should be more profitable than dispatching service, dispatching delivers almost the same profitability in many cases because process step estimates, deadlines, and other aspects of subcontracting business often differ from the initial budget in actual implementation.

Growth in this field depends on the Company's ability to secure a large number of talented engineers. It is more important to find engineers than destinations in the current tight labor environment. Trust Tech had focused on acquiring human resources by hiring people with an existing career who can be immediately used on projects, and plans to ramp up mid-career recruitment for the year ending March 31, 2019. It has also been hiring new graduates more aggressively in the past few years; in addition to hiring around 500 graduates in April 2018, the Company plans to hire around 700 new graduates in April 2019 (hiring totals include the Company's technology field and two subsidiaries).

An important point along with hiring is boosting the engineer retention rate. Trust Tech is putting efforts into increasing the average dispatching price and improving compensation for engineers. Increase in the average price is often achieved through assignments to customers paying higher prices. Key points in accomplishing this are more precise understanding of individual engineer skills and market value and matching these features with suitable assignments. Trust Tech intends to place even stronger emphasis on talent management.

Profitability from efficient matching of personnel and dispatching sites is vital in manufacturing field; utilizing a local-supply model

4. Income structure of the manufacturing field segment

The manufacturing field segment operates services that supply personnel for production lines at customer companies using its production line staff. It uses operation subcontracting (on-site subcontracting) and manufacturing staff dispatches as the two services formats. While sales ratios of subcontracting and dispatching fluctuate, the split appears to be roughly equal. In a comparison of subcontracting and staff dispatches for manufacturing, profitability should be higher for subcontracting because of leeway to raise margin by enhancing productivity with autonomous efforts. The reality, however, is profitability does not differ much because of stringent terms from the customer side.

Manufacturing services have a lower average fee than engineering, and fees vary more due to impact of changes in demand for manufactured products. Contract periods tend to be shorter as well. These attributes contribute to lower profitability in manufacturing services versus engineering.

Trust Tech is focusing on regional hiring and sales activities in order to enhance profitability in the manufacturing field. Dispatches of manufacturing personnel to remote locations involve moving and transfer expenses. This approach aims to curtail and reduce such costs. Japan has many corporate communities in automotive, electric equipment, and other fields in its regional cities. Effective matching via recruitment of workers and subcontracting and dispatching customers in such regional cities enhances the cost reduction efficiency. Trust Tech has been improving its profitability in the manufacturing segment due to success in steadfast efforts with this type of regional focus; EBITDA margin reached 5.4% in June 2018, arriving at a top position in the industry.

Employee numbers in the manufacturing field segment has been in a range of 2,000 to 2,500 people up to now due to responses to changes in subcontracting and dispatching demand. Furthermore, manufacturing subcontracting and dispatching demand is rooted in efforts to lower labor costs at customer firms. Considering this background, Trust Tech enlists a mix of indefinite-term employees and limited-term employees in the manufacturing field to flexibly meet demand. Trust Tech sees shortages in manufacturing personnel in Japan as a structural issue and expects continued rise in demand in the medium to long term for manufacturing staff. It thus plans to boost manufacturing employee numbers from a range of 2,000 to 2,500 people to a range of 2,500 to 3,000 people.

Conducts manufacturing staff dispatches at three UK-based subsidiaries, offers Japan-style manufacturing staff dispatches through the Chinese joint venture in Asia

5. Overseas field details and income structure

The "overseas field" is a categorization based on the geographical aspect of the business, rather than a distinction related to the nature of business in Japan. In the overseas field, the Company adjusts its market engagement and growth strategy by mature markets (mainly developed countries) and immature markets in Asia and other areas because extent of development in human resource service business differs depending on the level of social maturity.

In mature markets, the Company follows a basic policy of entering through acquisition of local companies due to the large number of existing human resource companies. It has acquired three subsidiaries in the UK (MTrec, GAP, and Quattro Group) with business content that corresponds to the manufacturing field in Japan. Income structure hence is nearly the same as its domestic manufacturing field.

In Asia, meanwhile, the Company is positioning itself gradually based on market advancement levels because these are immature markets. It limits local subsidiaries to personnel recruitment business. These sites mainly handle market surveys and information gathering at this point due to lack of dispatching markets. From an earnings perspective, the subsidiaries appear to be profitable because of their low-cost structures. Joint-venture companies in China, however, engage in Japan-style dispatching business, partly made possible because of the ability to alleviate business risk with the presence of a joint-venture partner. The initial joint venture in Shandong is already profitable, and the one in Guangzhou is proceeding along the same path and has moved within range of achieving profitability in the near future.

Business performance

Steep sales increase from adding UK-based GAP as a subsidiary, profit rose just over 30% YoY on improved margins in domestic engineering and manufacturing fields

● Overview of FY6/18 results

The Company posted steep sales and profit gains in FY6/18 with net sales at ¥65,363mn (+51.9% YoY), operating income at ¥4,297mn (+33.4%), ordinary income at ¥4,228mn (+32.7%), and net income attributable to parent shareholders at ¥2,569mn (+33.5%). Net sales and operating income reached all-time highs. EBITDA (operating income + goodwill write-off costs + depreciation costs + acquisition one-time costs), which the Company monitors as a key performance indicator (KPI), climbed ¥1,321mn (33.0%) to ¥5,332mn.

The Company announced the acquisition of UK-based dispatching firm GAP in November 2017 and raised its outlook for the addition. Final results were roughly on track with revised guidance at +1.3% in net sales and -1.2% in operating income.

Overview of FY6/18 results

(¥mn)

	FY6/17			FY6/18							
					2H			Full year			
	1H	2H	Full year	1H	Forecast	Results	YoY	Forecast	Results	YoY	Change from forecast
Net sales	20,471	22,564	43,035	29,676	34,823	35,687	58.2%	64,500	65,363	51.9%	1.3%
Operating profit	1,306	1,913	3,220	2,210	2,139	2,086	9.1%	4,350	4,297	33.4%	-1.2%
Ordinary profit	1,283	1,901	3,186	2,201	2,148	2,027	6.6%	4,350	4,228	32.7%	-2.8%
Profit attributable to owners of parent	726	1,197	1,924	1,312	1,377	1,256	4.9%	2,690	2,569	33.5%	-4.5%

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

Net sales on a companywide basis increased ¥22,328mn YoY, with segment breakdown of ¥14,574mn in the overseas field, ¥6,856mn in the engineering field, and ¥945mn in the manufacturing field.

Acquisition of GAP as a subsidiary was a major source of the steep rise in overseas field sales. GAP reported about GBP133mn (roughly ¥18.6bn using a ¥140/GBP rate) in sales in FY3/17, the period before the acquisition, and incorporated nine months of income from GAP covering 2-4Q (July 2017 to March 2018) in FY6/18 results.

Engineering field sales grew at a healthy pace of 25.7% YoY. Organic growth provided the entire gain in FY6/18 because this segment did not have any acquisition impacts. We think the breakdown by factors was about 5% from higher engineer dispatch pricing and roughly 21% from a rise in the number of dispatched people.

Manufacturing field sales were up 10.6% YoY, reaching the Company's goal of a 10% increase. This segment also realized the gain through organic growth. Estimated breakdown was about 8% from a rise in the number of dispatched people and roughly 2% from higher dispatch pricing.

EBITDA expanded ¥1,321mn YoY as mentioned earlier. While profit rose YoY in all segments, improved profitability (EBITDA margin) in engineering and manufacturing fields contributed substantially to higher EBITDA. EBITDA margin rose from 12.4% to 13.1% in the engineering field and from 4.8% to 5.4% in the manufacturing field. Higher sales were the main driver of margin advances in both areas.

Overseas field EBITDA expanded 56.6% YoY to ¥476mn thanks to the acquisition of GAP as a subsidiary. However, EBITDA margin dropped from 4.1% to 2.2% because of one-time costs at MTrec and the addition of GAP, which has relatively low margin, as a subsidiary.

Breakdown by business segments

(¥mn)

		FY6/17			FY6/18				
		1H	2H	Full year	1H	2H	Full-year forecast	Full-year results	YoY
Net sales	Engineering field	12,418	14,299	26,717	16,069	17,504	33,863	33,573	25.7%
	Manufacturing filed	4,308	4,649	8,957	4,918	4,984	9,900	9,902	10.6%
	Overseas field	3,756	3,643	7,399	8,711	13,263	7,795	21,974	197.0%
	Others	30	27	57	30	39	47	69	21.2%
	Net sales prior to adjustment (total)	20,513	22,618	43,131	29,729	35,790	51,605	65,519	51.9%
	Adjustment	-42	-54	-95	-53	-103	-105	-156	-
	Net sales (total)	20,471	22,564	43,035	29,676	35,687	51,500	65,363	51.9%
EBITDA	Engineering field	1,465	1,854	3,319	2,281	2,115	4,080	4,396	32.4%
	Manufacturing filed	175	257	432	254	282	482	536	24.1%
	Overseas field	135	169	304	311	165	391	476	56.6%
	Others	-35	-49	-84	-57	-74	-137	-131	-
	EBITDA prior to adjustment (total)	1,742	2,229	3,971	2,790	2,487	4,817	5,277	32.9%
	Adjustment	19	20	39	13	41	58	54	36.6%
	EBITDA (total)	1,761	2,249	4,010	2,803	2,529	4,875	5,332	33.0%

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

Medium- to long-term growth strategy

Announced a new mid-term business plan, aiming for prompt attainment of ¥10bn in operating income

1. Overview of new mid-term business plan

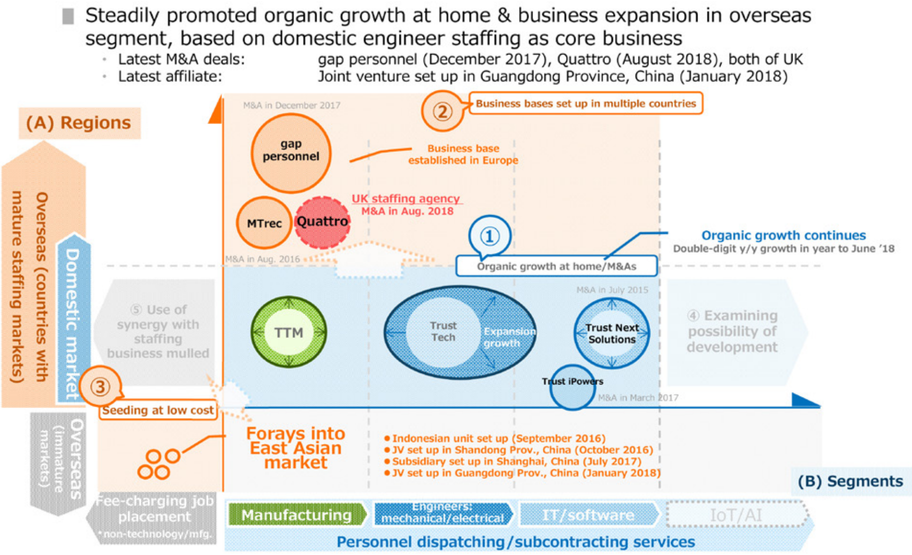
The Company presented a new three-year mid-term business plan (rolling mid-term plan) that covers FY6/19-21 at the disclosure of FY6/18 results.

A key difference in this mid-term business plan is inclusion of a specific goal of ¥10bn in operating income. Previous plans restricted sales and operating income goals to growth speed (sales and profit growth rates).

Growth strategy is essentially the same as in the previous plan. Namely, the Company aims to continue strong growth by expanding regionally and in business fields and establishing unique positions. While the new mid-term business plan does not appear to offer much that is new at first glance, we think it has evolved from the previous plan because the Company offers more specific and detailed goals and fleshed out initiatives to achieve the goals and is taking concrete steps in various areas.

We review details in the business segment explanations. In Japan, a major effort is expansion of business fields for engineer dispatching, particularly broader activities in IT and software areas. In mature overseas markets, the main focus is the “next” move following establishment of a manufacturing staff dispatching foundation in the UK. However, it is difficult to make specific predictions because of likely utilization of M&A. In Asia, which has immature markets, the Company restricts its local subsidiaries to recruitment business. By entering the dispatching business through joint ventures in China, it “laid seeds” while curtailing risk. The Company is ready now to proceed to the stage of recouping benefits from these efforts.

Image of medium-term growth strategy

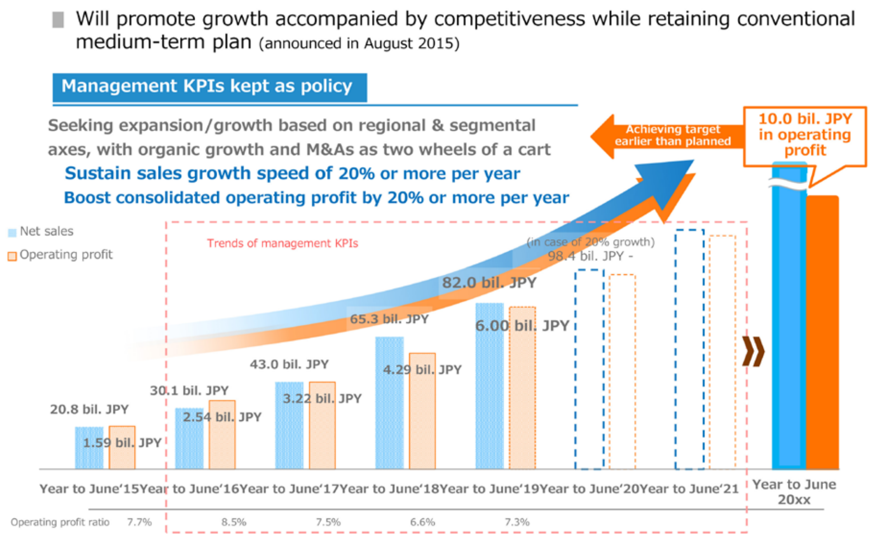


Source: The Company's results briefing materials

The earnings goal presented this time is ¥10bn in operating income. There is also an indication of the targeted growth pace, just as previously, calling for "annual increase of at least 20% in operating income." Starting with the ¥6bn operating income target in FY6/19, this value should surpass ¥10bn in FY6/22 based on the proposed growth rate (¥6bn x (1.2) to the third power = ¥10.3bn). The Company hopes to realize this level sooner.

While the plan does not offer a sales goal, estimated sales at the time of attaining ¥10bn in operating income work out to about ¥137bn applying the 7.3% operating margin targeted in FY6/19. Another approach puts sales at roughly ¥141.7bn assuming three straight years of 20% annual growth set as a goal from the ¥82bn FY6/19 target. Based on these values, we think the sales goal is around ¥140bn. Necessary sales for ¥10bn in operating income might also drop to about ¥120bn if we also factor in profitability gains in engineering and overseas fields.

Mid-term business plan's goals



Source: The Company's results briefing materials

Increase in engineers is the biggest growth driver, aiming for 10,000 engineers and 15% operating margin with support from higher prices and IT business expansion

2. Mid-term growth strategy in the engineering field

As growth strategy in the engineering field, the Company wants to sustain high growth and improve profitability through concentrated investment of business resources with positioning as the main source of group growth.

In this context, the Company presents three specific tactical investment areas – 1) increased hiring in all areas (new university graduates, mid-career, and overseas), 2) utilization of AI and RPA to enhance engineer value and tasks, and 3) new acquisitions. Numerical goals are 10,000 active engineers and 15% operating margin.

Strategy and goals for the engineering field in the mid-term plan

Engineering field	
Strategy	Goals
Sustain high growth and improve profitability via concentrated investment of business resources with positioning as the main source of group growth	☆ Investment content: Hiring (new university graduate, mid-career, and overseas) Utilization of AI and RPA to enhance engineer value and tasks, new acquisitions, and others ☆ Target operating margin: 15% ☆ Target number of active engineers: 10,000 people

Source: Prepared by FISCO from Company materials

(1) Number of engineers

We think clear correlation exists on a quarterly basis between the number of engineers at period-end and sales when comparing growth rates with the previous quarter. In other words, the number of engineers is the primary driver of income growth in the engineering field. The Company's initiative to expand hiring as a specific growth strategy measure in the engineering field hence is very convincing.

The goal for increase in employees noted below suggests that the Company is targeting an average annual personnel growth rate of about 20%. We estimate from this that it envisions 20-25% average sales growth as well.

While the mid-term goal for engineers is 10,000 people, near-term focus is the target of 6,600 people at end-June 2019, an addition of about 1,400 people versus 5,209 people at end-June 2018. The Company intends to reach the target through expanded hiring of both new university graduates and mid-career engineers. In mid-career hiring, it started efforts to expand hiring from 1H FY6/19 and is engaged in hiring activities at 20-30% more than the previous pace. It already increased hiring staff and other related personnel to carry this out. In new university graduates, the Company plans to hire 700 people on a combined basis at Trust Tech and the two engineering group companies (Trust Next Solutions and Trust iPowers). Nevertheless, new university graduates enter the firm in April 2019 and hence contribute to income from period-end timing. This means actual contributions are likely to start from FY6/20.

(2) Price perspective

The Company hopes to reach 15% operating margin in profitability*. Increase in dispatching prices is an important factor. There are two main aspects to pricing. One is rising prices driven by supply-demand conditions. This is currently happening. Customers are roughly divided into cost-push and demand-pull categories, though they share extremely strong demand for engineers. We cannot say conclusively whether these conditions will last. However, it is possible to make adjustments to prolong this situation by broadening business areas as explained below.

* This is the average value for parent operating margin at the three engineering companies, including Trust Tech, and does not necessarily match operating margin for the field.

The other is an initiative of best matching with customer needs and pricing that the Company already performs through understanding and assessment of individual engineer skills and the value of these skills in the market. Despite tightness in the engineer dispatching market, opportunities to raise prices are limited, such as when the dispatch destination changes. Matching is an effort to maximize the price increase effect at that time. Substantial improvement room still exists because this takes some time.

Meanwhile, the Company intends to reflect higher pricing in better payment terms for employees too. Expansion of the number of engineers is vital to the growth strategy, as explained earlier. The Company is putting effort into creation of a win-win relationship between itself and employees in order to steadily implement this strategy. An important theme of the latest mid-term business plan is provision of a more favorable environment, including pay, to employees.

(3) Business areas

In areas, we expect IT and software expansion to continue serving as a major driver. The IT and software area was also a theme in the previous mid-term plan, and these efforts are enabling the Company to increase related sales to the ¥10bn range targeted in FY6/19 (combined sales from Trust Next Solutions and Trust iPowers that handle IT and software business). While Trust Tech itself caters to companies in the manufacturing industry (mainly the automotive industry), IT and software work is the fastest growing area in the automotive industry as seen in automated driving and connected cars. The Company wants to promptly double IT and software sales at the two subsidiaries and parent company.

The Company completed operations to support this initiative during FY6/18. FUSIONi, which it acquired as a subsidiary in March 2017, had strengths in SI service, software development, and system maintenance and operation. In January 2018, the Company merged group SI-related business with FUSIONi and renamed the combined entity as Trust iPowers. Additionally, Freedom Co., Ltd., which was acquired as a subsidiary in July 2015, covers development and design assistance for control software (embedded software), and the Company merged it with related subsidiaries and renamed the combined entity as Trust Next Solutions in April 2018. The three companies in the engineering field, including Trust Tech, are targeting fulfillment of the group's growth goal by expanding their own scope through utilization of unique capabilities and strengths and also collaborating appropriately as a group.

Targeting 10% sales growth via increase in manufacturing staff volume and additions to dispatching customers and 5% operating margin by bolstering "region-centric" initiatives

3. Mid-term growth strategy in the manufacturing field

The Company's growth strategy in the manufacturing field seeks steady expansion of business scope while sustaining industry top-class profitability with operating margin* in the 5% range.

* EBITDA margin and operating margin are similar for this segment.

As numerical goals, it calls for annual sales growth at about 10% in growth potential and keeping operating margin in the 5% range in profitability*.

* Operating margin at manufacturing business firm TTM.

Strategy and goals for the manufacturing field in the mid-term business plan

Manufacturing field	
Strategy	Goals
Maintain a steady expansion pace while sustaining robust profitability from the past three years	☆ Robust profitability: Keeping operating margin in the 5% range ☆ Targeted growth rate: Roughly 10% annually

Source: Prepared by FISCO from Company materials

The Company hopes to achieve the growth goal of 10% annually through increase in the number of manufacturing staff and expansion of destinations. It previously had 2,000 to 2,500 people, but wants to raise the range to 2,500 to 3,000 people.

The Company has a two-pronged strategy of new university graduate and mid-career hiring, similar to the engineering field. It has accelerated the pace of mid-career hiring in 1H FY6/19, as noted earlier, and intends to hire 200 new university graduates to join in April 2019. These efforts aim to raise the number of manufacturing employees to 2,900 people at end-FY6/19, an increase of more than 400 people from 2,466 people a year ago.

While pricing is moving upward in the manufacturing field, it is difficult to factor in higher pricing as part of the growth strategy. This is why the plan adopts measures to boost the staff volume range as already explained. Yet it is also necessary to arrange dispatching destinations to absorb the increase. We think adding to the number of dispatch destination companies is more realistic than raising the number of dispatched employees per location. The Company is already strengthening its initiatives in this area. Demand is strong in engineering and manufacturing fields, but management senses differences in relative strength and weakness among individual companies. More attention will be given to increases in dispatch destination companies than previously, including as a risk hedge.

We expect the Company to "reinforce region-centric hiring and sales," just as it has done up to now, to achieve the profitability goal of sustaining operating margin in the 5% range. Improvement in expenses efficiency is likely to account for a large portion of securing profitability due to difficulty of anticipating continuous, stable price increase, as mentioned above.

We expect the Company to increase sales and hiring locations as a specific measure in "reinforcing region-centric hiring and sales." For hiring, it has been bolstering Internet recruitment and operates five real-world Job Park sites. It also focused on dispatch destinations, including an aim of risk distribution, as noted earlier. The Company strengthened these activities in the previous mid-term plan period. We thus think its operational skill has risen considerably. "Reinforcing region-centric hiring and sales," meanwhile, still has substantial growth potential (improvement leeway). From this perspective, we believe the Company is capable of expanding sales and sustaining profit margin.

Seeks further expansion with emphasis on earnings underpinned by the UK business that has grown to ¥30bn.

4. Mid-term growth strategy in the overseas field

In the overseas field, acquisitions are the core growth strategy in developed countries with mature markets. The Company aims to pursue opportunities in other countries and regions underpinned by the UK business that has grown to ¥30bn. A key point, however, is "emphasis on earnings" as a prerequisite.

In Asia, which has immature markets, meanwhile, the Company ramped up businesses on its own (establishing subsidiaries and joint ventures). It puts strong focus on earnings, similar to developed countries, in the mid-term plan based on "stage transition from laying seeds to sprouting."

Strategy and goals in the mid-term plan for the overseas field

Overseas field	
Strategy	Goals
☆ Pursuing growth with emphasis on earnings underpinned by UK business that expanded to ¥30bn in sales over the past three years ☆ Businesses in the Asian market are transitioning from "laying seeds" to "sprouting"	

Source: Prepared by FISCO from Company materials

The Company acquired UK-based Quattro Group as a subsidiary in August 2018, following its purchase of GAP as a subsidiary in December 2017. Use of GAP as the direct buyer in the Quattro Group acquisition takes into account synergies. GAP and Quattro both mainly cater to the food products industry, though with regional separation in western and eastern parts of the country.

List of subsidiaries in the UK

Name	MTrec Limited	1998 Holdings Limited	Quattro Group Holdings Limited
Main business subsidiaries	-	GAP Personnel Holdings Ltd.	Quattro Recruitment Ltd.
Founded	March 2006	June 1998	January 2010 (company establishment date)
Location	Newcastle upon Tyne, United Kingdom	Wrexham, United Kingdom	Norwich, United Kingdom
Fiscal year	March	March	May
Business performance*	Net sales: £44.9mn Profit before tax: £2.3mn	Net sales: £133.0mn Profit before tax: £2.6mn	Net sales: £43.6mn Profit before tax: £1.4mn
Number of employees	Approx. 50	Approx. 230	(-)
Number of dispatched staff	Approx. 3,000	Approx. 7,000	(-)
Share purchase date	August 30, 2016	December 1, 2017	August 31,02018
Share purchase ratio	85%	75%	75%
Acquisition costs (one-time)	¥160mn (FY6/17)	¥230mn (FY6/18)	¥70mn (FY6/19)
Goodwill	Approx. ¥1,400mn	Approx. ¥2,500mn	(-)
Depreciation period	10 years	10 years	(-)

Note: Results are FY3/16 for MTrec, FY3/17 for GAP, and FY5/18 for Quattro; values taken from disclosed materials
Source: Prepared by FISCO from Company materials

This acquisition applies the same scheme and post-acquisition management model as the two preceding cases. Its framework aims to ensure purpose alignment with an earn-out arrangement for the acquisition price (the amount changes depending on earnings) and retention of existing executives as shareholders and management by not purchasing 100% of the equity.

It remains unclear at this point how the stance of “emphasis on earnings” will affect acquisitions and potential differences with past cases. Since the three UK companies are all profitable, this might mean that the Company intends to target opportunities with larger profits or higher profit margins. There is also a possibility of targeting companies with engineering businesses, as in Japan. We will wait to see the next steps.

In Asia, almost all companies have attained profitability at the single-month level and multiple companies are profitable in period income as well. The one remaining one is the joint venture in Guangzhou that began business in January 2018. However, we expect this company to achieve profitability in the near future by following the same path as the Shandong-based joint venture since it uses the same model. While we think the Company is likely to focus on expansion of business scope and income at existing Asian entities, rather than increasing the number of companies, for the time being, it might still establish a new joint venture depending on the counterpart.

Focus on employing people with disabilities, actively assists disabled people

5. ESG initiatives

The Company explained what (where) it is targeting at the start of the mid-term plan announcement. Essentially we think it wants to be a “good company.” ESG and stewardship are commonly heard terms recently. We believe these concepts similarly target cultivation of “good companies.” The Company is pursuing efforts that are correct and achieve growth.

Points reviewed earlier in the report dealt with initiatives aimed at growth. Provision of jobs and assistance to people with disabilities is an initiative as a “good company.” The Company’s subsidiary Trust Tech With Inc. employs disabled people. Trust Tech With makes flower arrangements with a staff of about 60 disabled people. Group companies use these flowers as interior decorations, at various events, and as presents for visitors.

Business outlook

Forecast to have significant gains in sales and profit due to M&A effects in overseas field and sales gains in technological field

● Overview of the FY6/19 outlook

Trust Tech projects significantly increased sales and profits, with net sales at ¥82,000mn (up 25.5% YoY), operating profit at ¥6,000mn (up 39.6%), ordinary profit at ¥5,900mn (up 39.5%), profit attributable to owners of parent at ¥3,700mn (up 44.0%) , and EBITDA at ¥7,048 mn (up 32.3%) in FY6/19.

Overview of the FY6/19 outlook

(¥mn)

	FY6/18			FY6/19					
				1H		2H		Full year	
	1H result	2H result	Full-year result	Forecast	YoY	Forecast	YoY	Forecast	YoY
Net sales	29,676	35,687	65,363	39,188	32.1%	42,812	20.0%	82,000	25.5%
Operating profit	2,210	2,086	4,297	2,550	15.4%	3,450	65.3%	6,000	39.6%
Ordinary profit	2,201	2,027	4,228	2,500	13.6%	3,400	67.7%	5,900	39.5%
Profit attributable to owners of parent	1,312	1,256	2,569	1,600	21.9%	2,100	67.1%	3,700	44.0%
EBITDA	2,803	2,529	5,332	2,941	4.9%	4,107	62.4%	7,048	32.2%

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

Relative weight of 1H and 2H earnings is a key point in the FY6/19 outlook. The Company's earnings normally have a 50:50 balance, but skew toward 2H with a 40:60 split in FY6/19. This difference stems from robust investment in 1H for site and personnel reinforcement measures in domestic engineering and manufacturing fields and advertising for mid-career hiring. While profit growth is likely to slow in 1H because of this spending, the Company expects stronger profit thanks to the sales increase effect from more dispatched people in 2H and a roughly 40% YoY gain in FY6/19 profit.

Below we review trends by business segments.

In the engineering field, the plan targets ¥41,230mn in net sales (+22.8% YoY) and ¥5,873mn EBITDA (+33.6%). While the sales increase effect from more mid-career hiring during the period (particularly in 1H) is likely to be the primary source of profit gains, as explained above, we expect improved pricing to provide a boost of about 5% again, similar to the previous year. We will be closely watching the extent of expansion particularly in IT and software areas, in addition to existing strength in automotive industry business, during FY6/19.

In the manufacturing field, the plan targets ¥11,000mn in net sales (+11.1% YoY) and ¥562mn EBITDA (+4.9%). While EBITDA margin drops to 5.1%, it remains in the 5% range, the Company's goal. This year focuses on personnel expansion, just as in the engineering field, with a target of 2,900 people at the end of June 2019, including new university graduates. Key points are securing dispatching customers to absorb additional personnel and progress with hiring.

In the overseas field, the plan targets ¥29,830mn in net sales (+35.7% YoY) and ¥731mn EBITDA (+53.6%). GAP, which was acquired in December 2017 and contributed nine months to FY6/18, will make a full-year contribution in FY6/19 and thereby provide an extra three months to sales. Furthermore, Quattro Group, which was acquired in August 2018, will boost sales with nine months of its results. There might also be a sales increase effect from shift to new transactions during FY6/19 at MTrec, following completion of contracts with some major customers. In light of these factors, we think sales could surpass ¥30,000mn.

In EBITDA, acquisition costs should offer a net ¥160mn lift to earnings based on decline in GAP-related costs (about ¥230mn) and new Quattro costs (¥70mn). Other profit additions include Quattro earnings and goodwill depreciation costs, GAP's full-year contributions, improved MTrec profit, and increased profits at Asian companies. We think the Company is likely to attain its EBITDA target.

Breakdown by business segments

(¥mn)

		FY6/18				FY6/19	
		1H	2H	Full year	YoY	Full year forecast	YoY
Net sales	Engineering field	16,069	17,504	33,573	25.7%	41,230	22.8%
	Manufacturing field	4,918	4,984	9,902	10.6%	11,000	11.1%
	Overseas field	8,711	13,263	21,974	197.0%	29,830	35.7%
	Others	30	39	69	21.2%	78	12.7%
	Net sales prior to adjustment (total)	29,729	35,790	65,519	51.9%	82,138	25.4%
	Adjustment	-53	-103	-156	-	-138	-
	Net sales (total)	29,676	35,687	65,363	51.9%	82,000	25.5%
EBITDA	Engineering field	2,281	2,115	4,396	32.4%	5,873	33.6%
	Manufacturing field	254	282	536	24.1%	562	4.9%
	Overseas field	311	165	476	56.6%	731	53.6%
	Others	-57	-74	-131	-	-244	-
	EBITDA prior to adjustment (total)	2,790	2,487	5,277	32.9%	6,922	31.2%
	Adjustment	13	41	54	36.6%	125	131.5%
	EBITDA (total)	2,803	2,529	5,332	33.0%	7,048	32.2%

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

Simplified income statement and key indicators

(¥mn)

	FY6/15	FY6/16	FY6/17	FY6/18	FY6/19	
					1H forecast	Full-year forecast
Net sales	20,819	30,143	43,035	65,363	39,188	82,000
YoY	18.0%	44.8%	42.8%	51.9%	32.1%	25.5%
Gross profit	4,868	7,192	9,344	13,302	-	-
Sales ratio	23.4%	23.9%	21.7%	20.4%	-	-
SG&A expenses	3,271	4,643	6,124	9,005	-	-
Sales ratio	15.7%	15.4%	14.2%	13.8%	-	-
Operating profit	1,597	2,549	3,220	4,297	2,550	6,000
YoY	23.7%	59.6%	26.3%	33.4%	15.4%	39.6%
Operating margin	7.7%	8.5%	7.5%	6.6%	6.5%	7.3%
Ordinary profit	1,623	2,528	3,185	4,228	2,500	5,900
YoY	23.1%	55.8%	26.0%	32.7%	13.6%	39.5%
Profit attributable to owners of parent	1,024	1,523	1,923	2,569	1,600	3,700
YoY	28.5%	48.7%	26.3%	33.5%	21.9%	44.0%
EPS after the stock split (¥)	53.39	78.91	99.17	128.63	75.55	174.70
Dividend after the stock split (¥)	30.00	40.00	45.00	55.00	30.00	70.00
BPS after the stock split (¥)	228.22	274.80	339.37	641.30	-	-

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

Simplified balance sheet

(¥mn)

	As of June 30, 2014	As of June 30, 2015	As of June 30, 2016	As of June 30, 2017	As of June 30, 2018
Current assets	5,283	6,551	8,984	11,999	20,944
Cash and deposits	2,429	3,038	3,930	4,581	9,410
Notes and accounts receivable - trade	2,388	2,954	4,060	6,245	10,045
Non-current assets	1,172	1,174	2,929	4,805	7,184
Property, plant and equipment	193	221	256	427	595
Intangible assets	145	130	2,202	3,845	5,960
Investment and other assets	832	821	471	532	628
Total assets	6,455	7,725	11,914	16,805	28,128
Current liabilities	2,584	3,287	6,531	7,641	12,405
Accrued expenses	1,447	1,754	2,394	3,031	4,208
Short-term loans payable	-	-	1,900	1,571	2,641
Non-current liabilities	38	31	60	2,466	2,007
Long-term loans payable	-	-	-	2,306	1,810
Shareholders' equity	3,837	4,409	5,323	6,520	13,385
Capital stock	1,492	1,529	1,538	1,562	4,199
Capital surplus	650	687	696	720	3,356
Retained earnings	1,694	2,193	3,089	4,238	5,830
Accumulated other comprehensive income	-5	-3	-5	74	196
Net assets	3,832	4,406	5,322	6,697	13,715
Total liabilities and net assets	6,455	7,725	11,914	16,805	28,128

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

Cash flow statement

(¥mn)

	FY6/14	FY6/15	FY6/16	FY6/17	FY6/18
Cash flows from operating activities	861	1,209	1,418	2,274	5,144
Cash flows from investing activities	-154	-147	-1,807	-2,395	-2,720
Cash flows from financing activities	-451	-459	1,287	764	2,415
Effect of exchange rate change on cash and cash equivalents	-2	6	-6	8	-10
Net increase (decrease) in cash and cash equivalents	254	609	892	651	4,829
Cash and cash equivalents at beginning of period	2,175	2,429	3,038	3,930	4,581
Cash and cash equivalents at end of period	2,429	3,038	3,930	4,581	9,410

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

Shareholder returns

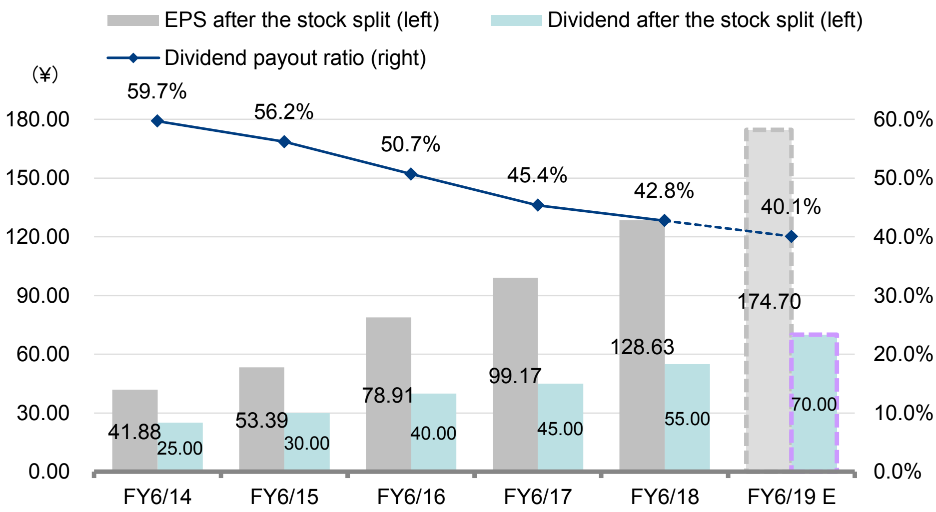
In FY6/19, plans to increase the dividend by ¥15 YoY to ¥70. Dividend increase for the seventh consecutive year

Trust Tech sees shareholder returns as an important management issue and is mainly focusing on dividends. It places emphasis on stability in setting the dividend value, but also intends to have the dividend reflect earnings while securing internal retention in order to fund expansion of business scope and improvements in the income structure.

The Company paid a ¥55 dividend in FY6/18 (¥20 interim, ¥35 period-end), a ¥10 YoY hike, as expected. This put the dividend payout at 42.8%. In FY6/19, the dividend outlook calls for a ¥15 increase to ¥70 (¥30 interim, ¥40 period-end), paying a 40.1% ratio based on the EPS estimate.

While the dividend payout ratio has been declining annually compared to the past level, we believe the Company's dividend results demonstrate strong awareness of shareholder compensation in light of dividend hikes in seven straight years (after adjusting for share splits), upcoming growth investments with overseas acquisitions and additions to domestic personnel, and three share splits in the past eight years.

Earnings per share, dividend, and dividend payout ratio



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

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