Trias Company Memo 2009-06-29

(Securities Code: 2427 JASDAQ) OUTSOURCING Inc.
Interview Memo on Business Results
for the 1st Quarter of Fiscal Year Ending December 31, 2009

Following the business results for the 1st quarter of FY12/09 announced on May 11, 2009, Trias Corporation interviewed Chairman Haruhiko Doi of OUTSOURCING Inc., CEO Yohta Maruoka, and Managing Director Kazuhiko Suzuki, who also heads the Management Planning Section. The following is a summary of our interview:

【Business Results Summary for the 1Q of FY12/09】

Due to the dramatic cutback in production volume by the largest domestic client-manufacturers as they struggled to shed inventory, net sales fell 34.6% year-on-year, while the number of contract workers plummeted by 32.3%. This was somewhat counterbalanced by a shift from the electric machinery, transportation equipment and other industries that have been hit hard by the recession, to the relatively healthy chemical, medical and food industries, however. Made under an initiative to diversify the Company's client base as part of its overall risk management strategy, it helped offset the aforementioned losses. Gross profit fell by 55.0%, a result of decreased order inflows, one-time expenses incurred by the reduction in our contract worker force, including compensation for paid leave and penalties related to the cancelling of dormitory contracts. SG&A expenses showed a marginal decline of 8.9%, achieved in part by reining in payroll and recruitment costs. Operating, ordinary and net incomes consequently posted deficits.

【Table 1】Summary of Consolidated Business Results for FY12/09 1Q

(¥ million)	FY12/8 1Q		FY12/09 1Q		YoY Change	
	Value	To net sales	Value	To net sales	Value	Ratio
Net Sales	6,130	100.0%	4,007	100.0%	△ 2,122	-34.6%
Gross Profit	1,084	17.7%	487	12.2%	△ 597	-55.0%
SG&A	868	14.2%	791	19.7%	△ 77	-8.9%
Operating Income	216	3.5%	△ 303	n.a.	△ 519	n.a
Ordinary Income	242	4.0%	△ 274	n.a.	△ 517	n.a
Net Income	138	2.3%	△ 190	n.a.	△ 328	n.a
No. of Contract Workers (※)	7,124	n.a.	4,824	n.a.	△ 2,300	-32.3%

(※) Contract workers are those working at client-manufacturers' worksites, and includes active temporarily placed workers.

Net Sales by Segment and by Industry

(¥ million)	FY12/08 1Q		FY12/09 1Q		YoY Change		FY12/08（Reference）	
	Value	Composition Ratio	Value	Composition Ratio	Value	Ratio	Value	Composition Ratio
Production Outsourcing Business	6,047	98.7%	3,908	97.5%	△ 2,139	-35.4%	23,879	98.9%
Foods	1,519	28.8%	1,044	26.0%	△ 475	-31.3%	5,652	23.4%
Electricals and Electronics	1,766	24.8%	994	24.8%	△ 772	-43.7%	6,664	27.6%
Transport Equipment	1,395	22.8%	465	11.6%	△ 930	-66.7%	5,618	23.3%
Chemicals and Medicals	754	12.3%	849	21.2%	95	12.6%	3,360	13.9%
Metals	201	3.3%	119	3.0%	△ 82	-40.8%	749	3.1%
Other	411	6.7%	435	10.9%	24	5.8%	1,835	7.6%
Other Business	82	1.3%	98	2.5%	16	19.5%	268	1.1%
Total	6,130	100.0%	4,007	100.0%	△ 2,123	-34.6%	24,148	100.0%

As for the consolidated balance sheet, there were increases in the items of property, plant and equipment, goodwill, negative goodwill and capital resulting from mergers and acquisition of subsidiaries. Consolidated cash flows from operating, investment and financing activities fell year-on-year, while cash and cash equivalents at the end of the term rose by ¥371 million due to the mergers.

【Acquiring FULLCAST CENTRAL CO., LTD. as a Subsidiary】

On May 26, the Company announced that it would acquire FULLCAST CENTRAL CO., LTD. (hereinafter FC CENTRAL) as a subsidiary on June 12. FC CENTRAL was co-founded by CENTRAL MOTOR CO., LTD., a chassis manufacturer and wholly-owned subsidiary of TOYOTA MOTOR CORPORATION (hereinafter TOYOTA), and Fullcast Co., Ltd. (hereinafter Fullcast), which had established a business operating system that was designed to utilize an outsourced contracting model. After a series of scandals rocked the Fullcast Group, however, it could no longer sustain the operating system and net sales, which once rose to a high of ¥7 billion, plummet to just ¥1 billion. FC CENTRAL also found itself saddled with mounting debt, including a long-term lease to operate a large-scale dormitory facility, posting a ¥80 million loss on net assets at the beginning of FY9/09 and ¥440 million in losses carried forward. With the acquisition of FC CENTRAL (which was purchased for a minimal sum and without assuming any debt), the Company, having only recently entered the automotive industry, will be able to expand its business for the industry on a strategic basis.

Estimates from the Company, experts and think tanks generally perceive the market for production outsourcing is worth some ¥3 trillion to ¥3.5 trillion and employing some 1.5 million workers. One-third of the work force—or 400,000 or so people—works in the auto industry, comprising a market of ¥1 trillion. Until recently, the market's largest players—such as NISSO CORPORATION and NIKKEN SOGYO CO., LTD., which were founded from as early as the 1970s and are unlisted—have remained dominant due to their history in the industry and the difficulty for newcomers to challenge them. The financial and economic crisis, however, has radically altered the situation. The auto industry's work force has been drastically reduced, adversely impacting the finances of the largest outsourcing providers. The result: The industry is undergoing a major reorganization.

Given these circumstances, the Company plans to rename FC CENTRAL to OUTSOURCING

CENTRAL (hereinafter OS CENTRAL) and is now working to strengthen ties with the TOYOTA Group in order to gain ground on competing companies in the auto industry. The Company plans to aggressively leverage its infrastructure to turn OS CENTRAL's low dorm occupancy rate around and to facilitate conversion to outsourced contracting services among the latter's clients. While TOYOTA is coping with the first phase of increased production that has commenced from April by relying on its own workers within the Group, it is believed that they will have to bring in workers from external sources, including seasonal hires, for the second phase that is slated to start from June. And from September, when production for the new hybrid models scales upward, TOYOTA is expected to meet its work force needs through outsourced workers on a more comprehensive basis.

It should be noted that this experience, in which the Company enters into a joint venture co-funded by a manufacturer, has drawn considerable interest not only from within the automotive industry, but also from other industries, including the major electronics manufacturers. The objective, then, is to demonstrate the viability of this business model so that it may be applied to other industries as well.

【Developing an Industry-Specific Business Model】

The transportation equipment industry has been strategically targeted because it is ideally suited to demonstrate the efficacy of the Company's foundational industry-specific business model. The Company will provide superior quality production outsourcing services to the industry through its subsidiaries and affiliates. OS CENTRAL, for example, engages in outsourced contracting business primarily for automotive production lines and temporary contracting business for engineers and skilled workers. TECHNOSMILE, INC. (hereinafter TECHNOSMILE), meanwhile, is an affiliate of TOYOTA KYUSHU, INC. that produces through a highly skilled work force high-quality automotive components at its own factory and provides consulting services for human resources development. Another engineering subsidiary, ENABLE Inc., specializes in the production outsourcing business for the auto industry and develops, manufactures and distributes high performance auto parts used mainly in racing vehicles. ORJ INC., moreover, focuses on a wide range of administrative outsourcing activities, including labor management operations for seasonal workers.

The Company also intends to strengthen its position in the medical industry through this industry-specific business model, an industry originally developed by the pre-merger predecessor. Although the medical industry business has thus far focused on the medical equipment field, it will likely be expanded to include the pharmaceutical industry through contracted product development and other services.

【Cooperative Ventures with the Pre-Merger Free Work Co., Ltd..】

Free Work Co., Ltd. (hereinafter FW) was absorbed by the Company in March. Originally established to develop the production outsourcing business in western Japan, particularly in the Kansai area, in the fields of electronics and precision machinery, FW was especially well positioned the major Kansai-based manufacturers of automotive products, batteries (including photovoltaic batteries), and home electronics products known as “white goods.” Because the pre-merger Company had only a weak presence in the Kansai-based consumer electronics manufacturers, the OUTSOURCING Group’s M&A of FW proved beneficial for both parties as their strengths were complementary and were not redundant. In the future, the pre-merger OUTSOURCING, the pre-merger FW and TECHNOSMILE, with its strength in human resource development and consulting services, intend to apply the industry-specific business model based on co-funded joint ventures with manufacturers for the electronics industry as well.

Before the merger, FW had three subsidiaries: SUCCESS STAFF CO., LTD. based in Fukuchiyama City, Kyoto, specialized in the white-collar temporary staff business, but will be absorbed by OUTSOURCING on August 1, 2009. Also to be absorbed in August and based in Kyoto, MISTRAL SERVICE CO., LTD. (hereinafter MISTRAL) provides nursing care services. The third subsidiary, Tokyo-based DAISEI ENGINEERING Co., Ltd. (hereinafter DAISEI ENG.), provides design services on a temp staff basis for plant engineering needs, as well as maintenance staff for water and sewage systems, primarily in the Tokyo metropolitan area, and for recycling infrastructure and related systems. MISTRAL works closely with the local community by providing assisted-living services for people at home, and trains nursing care workers under contract from Kyoto prefecture. The strategy has proven successful and, as a result, it has managed to sustain a solid profit base over the years. DAISEI ENG. is contracted with many major engineering companies in the environmental and petroleum industry, including TSUKISHIMA KIKAI CO., LTD., JGC Corporation, MEIDENSHA CORPORATION and JOMO. In 2008, it began working on projects overseas for the first time. While its sales remains modest—in the range of several hundred million yen—the subsidiary is believed to have great potential for growth in the future.

【Earnings Forecasts for FY12/09 and Revised Year-End Dividend】

On May 26, the Company revised downward its interim business forecast on a consolidated and non-consolidated basis. Several factors came into play for the revision, led by poor 1Q results combined with a delay in the startup of several large projects in the 2Q. However, these projects did begin from the 3Q, while demand for outsourced staffing also began picking up momentum. And because earnings from the new subsidiary, OS CENTRAL, were also not factored in, the Company did not revise its full-year forecast as a result. With regards to ORJ, it will be reaching the target of 15,000 workers for placement as part of its outsourced administrative contracting services by the end of FY12/09 as planned. Each worker is expected to generate a monthly service fee of ¥30,500, which consists of a basic charge of ¥20,000/month, in addition to fees from incidental services for recruitment and placement, for ORJ. The Company is projecting that order inflows will rebound from the 3Q and that client-manufacturers with outsourced administrative contracts will begin to seek large-sized outsourced production contracting proposals in the 4Q.

On the same day, the Company announced that it would revise upward the year-end dividend, from ¥433/share to ¥644/share, taking into account that earnings would recover from the 2H. In addition, the Company stated that, should its EPS exceed ¥6,440, the target payout ratio on dividends would be changed to 10%.

(Concludes the interview memo)

(2427) OUTSOURCING Inc.

Key Financial Data and Business Results (Consolidated)

Key Stock Indicators (Consolidated)		
No. of Shares Issued	Dec. 08	128,220
No. of Treasury Stock	Dec. 08	15,740
Market Value (¥million)	Jun.26, 2009	5,539
BPS (¥)	Dec. 08	22,524.6
ROE (%) ※1	Dec. 08	27.6
ROA (%) ※2	Dec. 08	10.9
PER (times)	FY12/09 est.	10.0
PCFR(times) ※3	Dec. 08	6.9
PBR (times)	Dec. 08	1.9
Share Price (¥)	Jun.26, 2009	43,200

Key Financial Data (Consolidated)		
Total Assets (¥million)	Dec. 08	6,051
Shareholders' Equity (¥million)	Dec. 08	2,533
Interest-Bearing Debt (¥million)	Dec. 08	1,015
Equity Ratio (%)	Dec. 08	41.9
Ratio of Interest-Bearing Debt (%) ※4	Dec. 08	40.1
Free Cash Flows (¥million) ※5	Dec. 08	-380

※1 ROE=Current Net Income÷Averaged Shareholders' Equity of beginning of term and term end
※2 ROA=Cureent Net Income÷Averaged Total Assets of beginning of term and term end
※3 PCFR=Maket Value÷(Current Net Income+Depreciation)
※4 Ratio=Interest-Bearing Debts÷Shareholders' Equity
※5 Free Cash Flows=Operating CF+Investment CF

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend per Share (¥)
FY12/05	17,881	95	103	34	273.5	300.00
FY12/06	21,197	119	118	97	783.3	300.00
FY12/07	24,321	1,013	1,004	583	4,917.3	492.00
FY12/08	24,148	1,113	1,134	641	5,412.3	644.00
FY12/09 1HF f.	7,600	-500	-450	-431	-2,788.5	0.00
FY12/09 f.	24,300	1,150	1,200	670	4,326.2	644.00

Note: FY12/09 f. is the Company's forecast announced on May 26, 2009.