Trias Company Memo 2009-12-25

(Securities Code: 2427 JASDAQ) OUTSOURCING Inc.

Summary of Interview/hearings with OUTSOURCING Inc.

Earlier in December 2009, Trias Corporation held an interview as well as hearings with OUTSOURCING Inc. (hereinafter OUTSOURCING or the Company) in order to follow up on its business results for the 3rd quarter of FY 12/09 and update its recent business activities. The following is a summary of the follow-up and update:

【Summary of Consolidated Business Results for FY12/09 3Q】

In the 3Q, net sales and gross profit rose by 18.0% and 27.6% respectively, over the 2Q, driven by the government's economic stimulus packages—including the "eco-point" bonus point system and tax cuts on eco-friendly cars—although sales and income decreased on a year-on-year basis, as shown in [Table 1]. Income was impacted by a one-time expense of some ¥120 million, which was reported as part of the Company's business results for the 2Q of FY12/09, and due to the acquisition of OUTSOURCING CENTRAL CO., LTD. (which was renamed from FULLCAST CENTRAL CO., LTD. as of June 24, 2009, or OSCN hereinafter). The expense was generated from low occupancy rates of OSCN's long-term lease dormitories at that time. It should be noted that the Company, as can be seen in the Consolidated Business Results data on page 6, did not revise its FY12/09 forecast for the full year as of August 13, when its 2Q business results were announced.

【Table 1】 FY12/09 3Q Consolidated Business Results Summary

(¥million)	FY12/08		FY12/09		
	3Q (July-Sept.)	Component Ratio	3Q (July-Sept.)	Component Ratio	Y-o-Y Change
Net Sales	6,116	100.0%	4,397	100.0%	-28.1%
Gross Profit	1,138	18.6%	877	19.9%	-22.9%
SG&A	868	14.2%	826	18.8%	-4.8%
Operating Income	270	4.4%	51	1.2%	-81.1%
Ordinary Income	269	4.4%	90	2.0%	-66.5%
Net Income	199	3.3%	43	1.0%	-78.4%

※ Prepared by Trias Corp. based on the data disclosed by OUTSOURCING Inc.

One unexpected development when evaluating the Company's 3Q business results is that its earnings structure may be subject to some changes from the 4Q and beyond. Trias has prepared the following estimates of OUTSOURCING based on the 4Q outlook in [Table 2] and [Table 3] based on our interview and hearings, in addition to the Company's 2Q business results, its forecast for the 3Q and actual 3Q figures that have since been disclosed.

【Table 2】FY12/09 Consolidated Business Results by Business Category for 3Q Actual Results and 4Q Estimates

Business Category	Item	Unit	1HF Actual	3Q Company Forecast	3Q Actual	Difference	4Q Trias Forecast	2HF Trias Forecast	Full Year Trias Forecast
Production Outsourcing	Net Sales	¥million	7,480	4,500	4,190	△ 310	5,900	10,090	17,570
	Operating Income		△ 389	0	11	11	150	161	△ 228
Admin. Serv. Outsourcing	Net Sales		43	238	54	△ 184	2,000	2,054	2,097
	Operating Income		14	46	16	△ 30	1,200	1,216	1,230
Others	Net Sales		224	102	168	66	195	363	587
	Operating Income		35	4	27	23	35	62	97
Total	Net Sales		7,733	4,840	4,397	△ 443	8,095	12,492	20,225
	Operating Income		△ 374	50	51	1	1,385	1,436	1,062

(Note: Forecast for 4Q, 2HF and Full Year by Trias Corp. based on OUTSOURCING interview/hearings; figures rounded to nearest million; Others Category includes Kessan Tanshin Nursing Care Business results)

【Table 3】FY12/09 Number of Workers for 3Q Actual Results and 4Q Estimates

Business Category	Item	Unit	1HF Actual	3Q Company Forecast	3Q Actual	Difference	4Q Trias Forecast	2HF Trias Forecast	Full Year Trias Forecast
Production Outsourcing	# Clients	Company	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	# Contract Workers	Person	5,030	4,559	5,030	471	+1,970	11,559	7,000
Admin. Serv. Outsourcing	# Clients	Company	n.a.	16	n.a.	n.a.	n.a.	51	n.a.
	# Contracted Workers	Person	n.a.	2,500	1,500	△ 1,000	+5,500	15,000	7,000

(NOTE: Forecast for 4Q, 2HF and Full Year by Trias Corp. based on OUTSOURCING interview/hearings)

Based on our hearings, we believe that the Administrative Services Outsourcing business, whose performance up until the 3Q has been marginal, will contribute significantly more to OUTSOURCING's earnings than initially forecast. In addition, based on the Company's projected number of contracted workforce at the end of the fiscal year as disclosed at the time of its 2Q business results announcement, we see a downward revision in the workforce for the Production Outsourcing and Administrative Services Outsourcing businesses through the 4Q, as shown in [Table 3]. Given this projection, we revised downward in [Table 2] the initial net sales forecast for the Production Outsourcing business for the 4Q. As for the Administrative Services Outsourcing business, two new business models have been incorporated, facilitating profit improvement.

【Changes in Production Outsourcing Industry's Operating Environment】

According to OUTSOURCING, the evolution of its business models has been triggered by changes in the industry's operating environment from October 2009. At the time, the Company expected that manufacturers would hire an additional 100,000 workers—of which half were directly employed; 30% made up of outsourced manufacturing workers; and the remaining 20% coming from temporary placement workers—in preparation of a major production volume increase from the fall. That figure actually grew to 150,000, with 65% of those workers hired directly by the maker, while 30% were outsourced manufacturing workers and a mere 5% from temporarily placed workers. The jump in the first category of workers was offset by an equal contraction in the third category of workforce. The Company believes the workforce composition was not the result of any strategic initiative adopted by manufacturers, but rather a preemptive move made out of widespread expectations of some kind of regulatory ban on temporary placed workers that the newly voted coalition government led by the Democratic Party of Japan would enact in the near future. Nevertheless, the need among manufacturers for outsourced manufacturing workers remains both incontrovertible and inexorable, and an increasing number of companies are expected to convert to this outsourced workforce following a one- to two-year period of direct employment, explained OUTSOURCING.

In way of addressing the trend for makers to hire workers directly, the Company is tackling the issue on two levels. On one level is the issue of direct employment itself. If OUTSOURCING's projections are accurate, then manufacturers over the short term will have to hire nearly 100,000 workers directly on a nationwide basis. Most of these companies, however, are not prepared to employ such a large number of workers in a short period of time, lacking the infrastructural capacity, including the company dormitories to house them once they are hired. They must therefore ask companies like OUTSOURCING to act as agents to recruit and hire these workers. The Company's Recruitment Agency business model generates sales of ¥250,000 per head and considerable operating margins as well. And because providers of production outsourcing workers can utilize their expertise, the Company reports that competition in this field is intensifying.

The second level is the issue of post-direct employment. Once workers are hired, a broad range of administrative needs—from labor management and dormitory administration to daily transportation for commuting a large workforce—will be created. Manufacturers lack the infrastructure to cope with such demands. Furthermore, in the Outsourced Administrative Services business, the standard fee structure is ¥20,000 per head and generates a profit margin higher than that associated with the Production Outsourcing business but less than that achieved in the Recruitment Agency business. The higher margins have begun to attract the Company's competitors to the comprehensive administrative services field, which includes recruitment agency and outsourced administrative services. Still, because the field requires such expertise as dormitory administration that ordinary production outsourcing manpower providers do not possess, these providers have begun to experience considerable difficulties at the sites they have been contracted to manage from October.

【OUTSOURCING Responses to Changes in Operating Environment】

Under the aforementioned circumstances, the Company has incorporated additional business models to its Administrative Services Outsourcing business. With regards to its Recruitment Agency business and post-recruitment Outsourced Administrative Services business, OUTSOURCING has differentiated itself from the competition through ORJ INC. (hereinafter ORJ), which has an extensive knowledge base in dormitory administration. The Company co-established ORJ with Relocation Japan Ltd.—a subsidiary of Relo Holdings, Inc. (Securities Code 8876/JASDAQ), a provider of comprehensive employee benefit administrative services for corporations—in October 2008. Given the difficulties other outsourcing providers are experiencing with regards to dorm administration and related relocation services at manufacturing sites of clients, OUTSOURCING believes that the situation plays into its hands as a one-stop provider of recruitment agency and administrative services. Another business model that the Company has launched is the 3C (or Three-Cube) ORJ TOTAL Management System, that was previously featured in the **2009-09-30 Trias Company Memo**. Developed since the 1Q, the 3C system integrates ORJ's dormitory administration expertise with the Company's proprietary labor management system built up over the past ten years at a cost of some ¥500 million. As a result, OUTSOURCING is confident in the business model's ability to deliver extraordinary profit margins.

NOTE: 3C stands for Cost (to efficiently manage such administrative expenses as recruitment, retention, dormitory management and employee benefit packages); Control (to manage information pertaining to seasonal workers under a single integrated system); and Communication (to disseminate information throughout the client company on a real-time basis). It is a visualization tool to manage such areas as recruitment, the administration of employees and dormitories, and cost control, as well as bringing these diverse components under unified management.

【Table 4】Business Models under Administrative Services Outsourcing Business

Recruitment Agency	Unit	Per-Capita Price	Oct.	Nov.	Dec.	4Q Total
Original Forecast	Persons	¥250,000	2,000	2,000	2,000	6,000
Latest Estimate			500	1,500	2,000	4,000
Outsourced Admin. Serv.	**Unit**	**Per-Capita Price**	**Oct. end**	**Nov. end**	**Dec.end**	
Original Forecast	Persons	¥20,000 per month	10,000	12,000	15,000	
Latest Estimate			2,000	4,000	7,000	
System Sales	**Unit**	**Unit Price**	**Oct.**	**Nov.**	**Dec.**	**4Q Total**
Original Forecast	System	some ¥million?				
Latest Estimate						100+α

(NOTE: Latest Estimates developed by Trias Corp. based on OUTSOURCING interview/hearings)

Because OUTSOURCING did not expect manufacturers to rely so extensively on direct employment, it originally slotted its Outsourced Administrative Services business as a short-term revenue source that would be available this fiscal year and for the first half of the next. Now, however, because the lead time for makers to convert to production outsourcing from direct employment has grown longer, the Company believes this business can serve as a revenue source beyond the first half of next fiscal year at the very minimum.

【Production Outsourcing Business Evolving】

On November 6, 2009, OUTSOURCING acquired SEISHOW CO., LTD. (hereinafter SEISHOW)—a provider of outsourced R&D and engineering placement services—as a subsidiary. While SEISHOW has 630 employees (estimate for the end of December 2009), when combined with the engineering staff of the OUTSOURCING Group, that figure rises to over 1,000, technicians and engineers who can be placed R&D departments upstream in the manufacturing process. The Company targets placement staff in lower profile R&D realms such as innovations to improve fuel consumption of hybrid eco-cars, not the design and development projects related to key components, which represent an automaker's core field of expertise. OUTSOURCING is thus distancing itself from its competitors by offering comprehensive outsourcing services covering the entire gamut of a client-maker's manufacturing process, from upstream R&D to downstream production, the latter being a realm that it had concentrated on in the past. The Company plans to expand its outsourced R&D business through M&A, with the target to achieve sales of ¥50 billion from the business in FY12/11. In the face of major upheaval in the industry's operating environment, including the Lehman collapse and change of government led by the Democratic Party of Japan, production outsourcing providers have begun to differentiate themselves in their management strategies. OUTSOURCING has adeptly responded to the manifold challenges it faces by developing new business models, as well as adopting an M&A strategy to strengthen its weaknesses and to reach a larger client base. The Company has also aggressively recruited professionals when launching new businesses. Despite its dynamic and decisive business moves, however, the Company has yet to achieve a higher degree of precision with regards to earnings forecasts for its new businesses. Trias thus believes that the Company will need to be monitored closely, tracking the evolution of its Production Outsourcing business at least every three months in the next fiscal year, the period during which its Administrative Services Outsourcing business is likely to support earnings momentum.

(This concludes the summary of the interview/hearings.)

OUTSOURCING INC. (Securities Code: 2427)

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)	Dec.25, 2009	4,693
BPS (¥)	Dec. 08	22,524.6
ROE (%) ※1	Dec. 08	27.6
ROA (%) ※2	Dec. 08	11.0%
PER (times)	FY12/09 f.	8.5
PCFR(times) ※3	Dec. 08	5.8
PBR (times)	Dec. 08	1.6
Share Price (¥)	Dec.25, 2009	36600
Unit Share (shares)	Dec.25, 2009	1
Average Daily Volume (shares)	Dec.25, 2009	636

Key Financial Data (Consolidated)		
Total Assets (¥million)	Dec. 08	6,051
Shareholders' Equity (¥million)	Dec. 08	2,533
Interest-Bearing Debt (¥million)	Dec. 08	1,141
Equity Ratio (%)	Dec. 08	41.9
Ratio of Interest-Bearing Debt (%) ※4	Dec. 08	45.1%
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 Average Daily Volume=Average Daily Volume for the last 1 year
※5 Ratio=Interest-Bearing Debts÷Shareholders' Equity
※6 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	7,733	△ 374	△ 306	△ 401	△ 2,940.5	-
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 Nov. 5, 2009.