Trias Corporation

Trias Company Memo
9-Mar-2010

(Securities Code: 2427 / JASDAQ) OUTSOURCING INC.
Summary of Business Results Meeting for Fiscal Year ended December 31, 2010
and Follow-up Interview

On February 17, 2010, OUTSOURCING Inc. (hereinafter OSI or the Company) held its Business Results Meeting for FY12/09, which was attended by CEO Yohta Maruoka, Managing Director Kasuhiko Suzuki and Shigeo Namikawa of the Management Planning Office. The following is a summary of that meeting, along with our follow-up Interview of the aforementioned corporate officials:

【FY12/09 Consolidated Business Results Summary and FY12/10 Earnings Forecast Preconditions】

On February 5, 2010, OSI announced a major downward revision in its earnings forecast for FY12/09 (with consolidated sales revised from ¥24,300 million to ¥17,964 million; operating income from ¥1,150 million to a loss of ¥151 million; ordinary income from ¥1,200 million to ¥20 million; and net income from ¥670 million to a loss of ¥229 million). Among the primary causes of this revision was the turmoil in the production outsourcing market in the wake of the Lehman Bros. collapse, particularly as manufacturers transitioned rapidly to hiring workers directly from the second half of 2009. (For further information on this, please see "Changes in Production Outsourcing Industry's Operating Environment" in the Trias Company Memo issued on December 25, 2009.

【Table 1】FY12/09 Consolidated Business Results Summary

(¥ million)	FY12/08		FY12/09			FY12/10		
							Y-o-Y change	
	Actual	Component Ratio	Actual	Component Ratio	Y-o-Y Change	Forecast	Amount	Ratio
Net Sales	24,148	100.0%	17,964	100.0%	-25.6%	26,000	8,036	44.7%
Gross Profit	4,495	18.6%	3,386	18.8%	-24.7%	-	-	-
SG&A	3,382	14.0%	3,536	19.7%	4.6%	-	-	-
Operating Income	1,113	4.6%	△ 150	-0.8%	n.a.	1,600	1,750	-
Ordinary Income	1,134	4.7%	22	0.1%	-98.0%	1,700	1,678	-
Net Income	641	2.7%	△ 215	-1.2%	n.a.	1,000	1,015	-

* Note: Respective tables prepared by Trias Corporation based on the disclosed data by OSI

At the outset of FY2009, OSI expected orders for manufacturing temporary placement workers to rise as production of eco-cars and eco-friendly home appliances ramped up to meet the year-end shopping season. The plan was to convert these temporarily placed worker orders sequentially to outsourced production contracting over time. However, because manufacturers began moving rapidly to the direct hire of seasonal workers instead, OSI responded by shifting its focus on providing outsourced administrative services to clients to manage the hiring and post-recruitment management of these seasonal workers, from Q3 to Q4. The Company intensified its efforts in Q4, particularly through its consolidated subsidiary ORJ INC. (hereinafter ORJ), offering one-stop service contracts that combined proprietary software ("C-Cube") with the administration of labor affairs, worker dormitories and other operations to manage seasonal workers. As a result, while the sales decline from its production outsourcing business (hereinafter production OS) was too large to offset entirely, the Company believed that it could post a profit for the year due to earnings generated from its administrative operations outsourcing business (hereinafter administration OS). Concurrent to this, however, was the fact that OSI had adopted a more conservative accounting methodology which is more in line with international accounting practices. Under the new methodology, sales from the Company's software system (which, in previous years, had been included with its full-range, integrated administrative operations service contracts) and post-recruitment administrative services are to be divided proportionally depending on the length of the contract. Thus, the majority of sales and profit that had been generated from OSI's administration OS will be posted from next fiscal year—resulting in the significant downward revision of the Company's earnings forecast.

On the other hand, Q4 sales have recovered to that recorded in Q4 of the previous term. Sales and gross margins for the first three quarters developed in this way: Q1 ¥4,007 million (gross margin of 12.2%); Q2 ¥3,725 million (18.5%); Q3 ¥4,397 million (20.0%). In Q4, gross margins rose to 22.8%, or a 3.6% gain year-on-year. As for sales by industrial sector, the recovery of the transport equipment industry, which had previously been delayed, is finally moving forward. According to OSI, the earnings forecast for FY10/12 that was announced on February 10, 2010 is based on the Q4 trend. The key factor contributing to the Q4 SG&A increase was due to the increase in the number of subsidiaries following the acquisition of Try Angle Co., Ltd., RPM Co., Ltd., SEISHOW CO., LTD., and ELZEX CO., LTD. OSI is now adopting initiatives to streamline its Group management structure and expects to achieve a cost reduction of ¥200 million from the consolidation of the Group's administrative departments.

【Table 2】FY12/09 4Q Consolidated Business Results Summary

(¥ million)	FY12/08		FY12/09		
	4Q(Oct-Dec)	Component Ratio	4Q(Oct-Dec)	Component Ratio	Y-o-Y Change
Net Sales	5,836	100.0%	5,832	100.0%	-0.1%
Gross Profit	1,123	19.2%	1,332	22.8%	18.6%
SG&A	808	13.8%	1,159	19.9%	43.4%
Operating Income	315	5.4%	172	2.9%	-45.4%
Ordinary Income	312	5.3%	238	4.1%	-23.7%
Net Income	130	2.2%	143	2.5%	10.0%

【Table 3】Net Sales by Segment and by Industry

(¥million)	FY12/08 Actual	FY12/09 Actual	YoY change Amount	YoY change Ratio
Production Outsourcing Business	23,879	17,200	△ 6,679	-28.0%
Electricals and Electronics	6,664	4,742	△ 1,922	-28.8%
Foods	5,652	3,437	△ 2,215	-39.2%
Transport Equipment	5,618	2,810	△ 2,808	-50.0%
Chemicals and Medicals	3,360	3,669	309	9.2%
Metals	749	332	△ 417	-55.7%
Other	1,835	2,208	373	20.3%
Administrative Operations Outsourcing Business	-	184	-	n.a.
Nursing-care Business	-	347	-	n.a.
Other Business	268	232	△ 36	-13.4%
Total	24,148	17,964	△ 6,184	-25.6%

Note: Administrative Operations Outsourcing Business and Nursing Care Business which had previously included in Other Business entry, were categorized as separate entries from Q2 FY12/09

【Clarifying Steps Leading to FY09/12 Downward Revision】

Given the various factors involved, the reason for OSI's downward revision may be unclear. In to better clarify the process through which the revision was made, including two earnings revisions announced in the first half, OSI points out the following developments: First, as can be seen in Table 4, the Company initially revised downward its earnings forecast in both net sales and earnings for 1H on May 26, 2009. The reason for this was because manufacturers, having bit hit hard by the global economic crisis, engaged in a sweeping restructuring of their workforce, regardless of whether workers were permanent or temporary. Then, in a press release issued on August 5, 2009, the Company revised its earnings forecast for the second time, this time announcing a modest upward revision in net sales and profit. OSI believed that reduced SG&A costs and revenue generated from its administration OS were factors favoring an upward revision. At this point, the Company expected that manufacturers would have to secure a sizeable increase in temporary workers to cope with higher production levels from autumn. Indeed, based on this assumption, OSI had factored in expanded orders from the automobile industry for FULLCAST CENTRAL CO., LTD., which became a subsidiary in May 2009 (now renamed OUTSOURCING CENTRAL CO., LTD., or hereinafter OSC), and its affiliate, TECHNOSMILE, INC. As a result, the Company did not revise its earnings forecast for the full year.

After the Q3 business results announcement, Trias interviewed OSI on several occasions and released a memo dated December 25, 2009, which reported that the Company would not only be unable to attain its projected sales and earnings target for 1H as a result of its production OS results, but that it would also see a cumulative shortfall of ¥1,057 million in net sales and ¥373 million in operating income in Q3. As shown in Table 5, Trias projected a shortfall of ¥3,700 million in sales and ¥748 million in operating income for our Q4 earnings forecast, which was based on developments in that quarter, particularly the fact that, despite OSI's predictions to the contrary, the Company's production OS business would suffer a major hit because manufacturers were accelerating their hiring of seasonal workers. On the other hand, Trias assumed that orders for OSI's "full-range, integrated administrative operations service contracts," which includes the high-margined C-Cube software system, would increase toward the end of the fiscal year, with profit to slightly exceed the cumulative shortfall in operating income of ¥1,121 million from term's beginning. Thus, Trias judged that a profit shortfall would not occur despite the fact that it could not offset the full-year shortfall in consolidated sales of ¥4,757 million.

【Table 4】Difference between forecasts and actual achievement for FY12/09 1H

Consolidated (¥million)	FY2009 1H OSI Initial Forecast 09/2/16	FY2009 1H OSI Revised Forecast (1) 09/5/26	FY2009 1H OSI Revised Forecast (2) 09/8/5	FY2009 1H Actual 09/8/13
Net Sales	9,100	7,600	7,733	7,733
Operating Income	0	△ 500	△ 375	△ 374
【Difference between forecasts and ctial achievement】				
Net Sales	△ 1,367	133	0	
Operating Income	△ 374	126	1	

【Table 5】Difference between forecasts and actual achievement for FY12/09 2H and full year

Consolidated (¥million)	FY12/09 Q3 OSI Revised Forecast (2) 09/8/5	Q3 Actual 09/11/5	Q4 OSI Revised Forecast (2) 09/8/5	Q4 Trias Forecast 09/12/25	Q4 Actual 10/2/10	Full Year OSI Initial Forecast 09/2/16	Full Year Trias Forecast 09/12/25	Full Year Actual 10/2/10
Net Sales	**4,840**	**4,397**	**11,733**	**8,095**	**5,832**	**24,306**	**20,225**	**18,047**
Production OS	4,500	4,190	9,600	5,900	5,569	21,580	17,570	17,283
Administrative Operations O	238	54	1,930	2,000	85	2,211	2,097	185
Other	102	168	203	195	177	529	587	579
Operating Income	**50**	**51**	**1,477**	**1,385**	**172**	**1,153**	**1,062**	**△ 89**
Production OS	0	11	898	150	160	509	△ 228	△ 217
Administrative Operations O	46	16	565	1,200	3	625	1,230	36
Other	4	27	14	35	27	53	97	91
【Difference between forecasts and actual achievement】								
Net Sales	**△ 443**		**△ 5,901**	**△ 2,263**		**△ 6,259**	**△ 2,178**	
Production OS	△ 310		△ 4,031	△ 331		△ 4,297	△ 287	
Administrative Operations O	△ 184		△ 1,845	△ 1,915		△ 2,026	△ 1,912	
Other	66		△ 26	△ 18		50	△ 8	
Operating Income	**1**		**△ 1,305**	**△ 1,213**		**△ 1,242**	**△ 1,151**	
Production OS	11		△ 738	10		△ 726	11	
Administrative Operations O	△ 30		△ 562	△ 1,197		△ 589	△ 1,194	
Other	23		13	△ 8		38	△ 6	

As for the full-year business results from its production OS business announced by OSI on February 10, 2010, while the Trias forecast for sales was higher than what was actually achieved, operating income was nearly in line with the figure we predicted. As for the Company's administration OS business, net sales was ¥1,912 million and operating income ¥1,194 million below our forecast. In the press release on its earnings forecast revision issued by OSI on February 5, 2010, the posting of net sales of ¥1,100 million will be delayed until to fiscal 2010; moreover, the shortfall of ¥800 million in sales and ¥100 million in operating income was due to the loss of previously expected orders for reemployment support.

【FY12/10 Earnings Forecast and Future Business Area of Focus】

According to the Company's FY12/10 earnings forecast by business segment, the production OS business is expected to post net sales of ¥24,300 million and operating income of ¥870 million, while its administration OS business targets ¥630 million in net sales and operating income of ¥80 million. Incidentally, the delayed carried over from FY12/09 will be ¥300 million in sales from the C-Cube software system and ¥400 million in sales from post-recruitment administration OS. In addition, ¥300 million in software system sales and ¥100 million from administration OS sales are projected in FY12/11.

A key strategy OSI is pursuing to differentiate itself from competitors in solutions to facilitate conversion to outsourced contracting is its ability to provide integrated outsourcing services to R&D divisions as well. The recent succession of M&As the Company has carried off is the first step in expanding this capability not just to the transport equipment industry, but also to the pharmaceutical, chemical, semiconductor, IT and telecommunication industries. OSI's production OS business consists of two sub-segments: the manufacturing production OS and engineering OS units. Out of the 6,109 worksite employees the Company has placed at the end of FY12/09, more than 1,000 belong to the engineering OS unit.

Apart from the parent company, two subsidiaries—OSC and MOLTI, Ltd.—are engaged in the manufacturing OS business. Sales generated from the two subsidiaries are incorporated in the ¥14,600 million in OSI sales. Given OSC's business scale at the point when it joined the OSI Group, it is believed that the subsidiary could add as much as ¥2,000-2,500 million if it continues to grow without incident. The difference between the sales forecast of ¥2,430 million from the production OS business and sales of the manufacturing OS unit should come from the engineering OS unit. Of the 6,700 worksite employees that the OSI Group expects to hire by the end of FY12/10, more than half will be those hired by the engineering OS unit.

As mentioned in the Trias Company Memo issued on December 25, 2009, the OSI is pushing forward investment to accelerate its M&A strategy and to launch a new business model. At the same time, however, the Company has shown lapses in judging the environment in which it operates and the accuracy of its earnings forecast leaves room for improvement. In our opinion, OSI must clear out and consolidate its business infrastructure, which has expanded too rapidly, especially since in the first half of fiscal 2009, by business model—and only then can it take steps to reinforce their respective functions. Trias also believes that the Company needs to further examine its outsourced contracting services that extend to the R&D realm in order to come up with specific steps and initiatives relevant to this effort.

(This concludes the summary of the Business Results Meeting and Follow-Up Interview.)

【Reference】OUTSOURCING INC. (Securities Code: 2427)

Key Financial Data and Business Results (Consolidated)

Key Stock Indicators (Consolidated)		
No. of Shares Issued	Dec. 09	155,398
No. of Treasury Stock	Dec. 09	6,500
Market Value (￥million)	Mar 9, 2010	5,128
BPS (￥)	Dec. 09	19,180.1
ROE (%) ※1	Dec. 09	-8.0
ROA (%) ※2	Dec. 09	-278.9%
PER (times)	FY12/10 f.	4.9
PCFR(times) ※3	Dec. 09	-1,282.0
PBR (times)	Dec. 09	1.7
Share Price (￥)	Mar 9, 2010	33,000
Unit Share (shares)	Mar 9, 2010	1
Average Daily Volume (shares) ※4	Mar 9, 2010	707

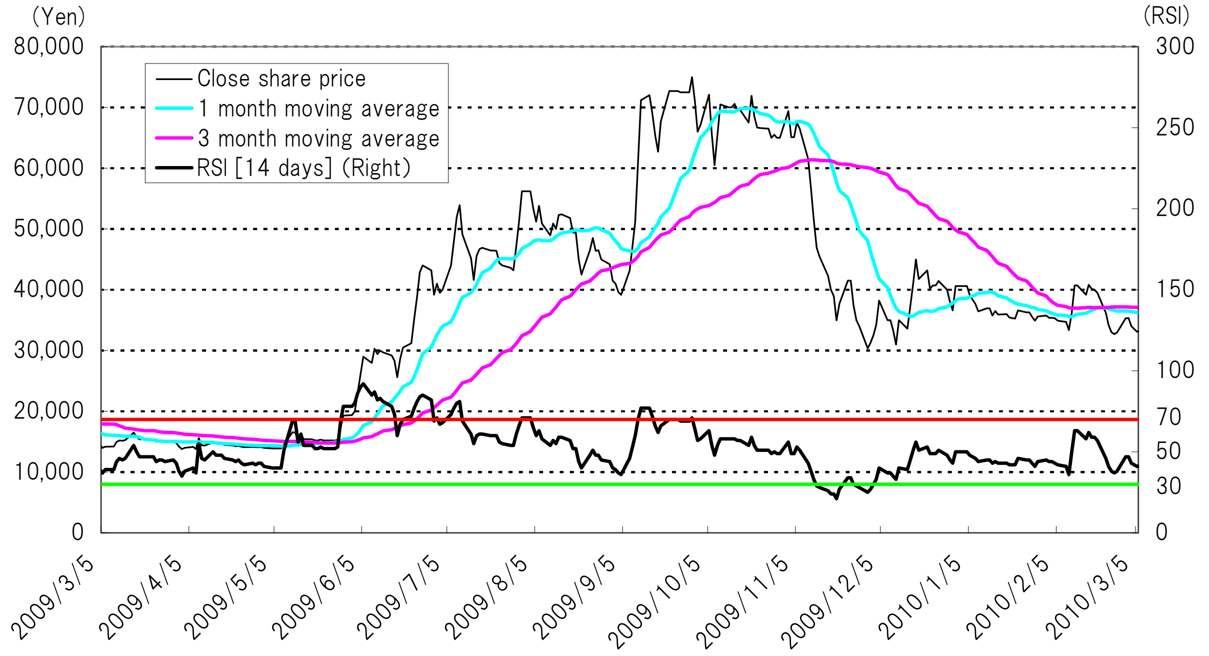
Key Financial Data (Consolidated)		
Total Assets (￥million)	Dec. 09	9,365
Shareholders' Equity (￥million)	Dec. 09	2,855
Interest-Bearing Debt (￥million)	Dec. 09	3,309
Equity Ratio (%)	Dec. 09	30.5
Ratio of Interest-Bearing Debt (%) ※5	Dec. 09	116
Free Cash Flows (￥million) ※6	Dec. 09	473

※1 ROE=Current Net Income÷Averaged Shareholders' Equity of beginning of term and term end
※2 ROA=Current 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 12 months
※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	17,964	△ 150	22	△ 215	△ 1,511.0	644.00
FY12/10 fcst.	26,000	1,600	1,700	1,000	6,716	672.00

Note: FY12/10 forecasts announced on Feb. 10, 2010

Share Price Charts and RSI



Source: Prepared by Trias Corp. with Bloomberg L.P. data.
Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices. In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.
RSI=averaged share price appreciation for N days÷(averaged share price appreciation for N days +averaged share price decline for N days) x100