2427

TSE2

OUTSOURCING Inc.

Q1 FY12/12 Business Results and Follow-up Interview

OUTSOURCING Inc., hereinafter the Company or OS Group, announced its Q1 FY12/12 business results, and Trias Corporation conducted an interview with Chairman and CEO Haruhiko Doi. The following is a summary of the interview.

Summary of Q1 FY12/12 Consolidated Business Results

Q1 consolidated results are shown in Table 1, with net sales up and incomes down. In a normal year, net sales normally decline in Q1 after the end of production in Q4 (Oct-Dec) for the year-end peak sales season, however this year in Q1, net sales continued rising with ongoing production ramps following last year’s disaster and Thailand flooding. OS Group invested strategically last year in expanding worksite employees, and benefitted during Q1 of this term from the high level of production continuing, posting record high quarterly net sales. However, Q1 also had leading expenses including moving the Company head office and one-off expenses including fees for listing on the TSE 2nd Section, with one-time items totaling ¥200 million, pushing up SG&A expenses. As a result the operating income and below declined, however excluding this impact, the operating income actually rose 180% YOY.

●【Table 1】Q1 FY12/12 Consolidated Earnings Summary

(¥ million)	FY12/11				FY12/12	
	Q1	Q2	Q3	Q4	Q1	
	Actual				Actual	YoY Change
Net Sales	7,501	7,372	7,958	9,566	10,179	35.7%
Gross Profit	1,457	1,572	1,582	2,127	1,932	32.6%
Gross Margin	19.4%	21.3%	19.9%	22.2%	19.0%	—
SG&A Expenses	1,366	1,454	1,648	1,707	1,880	37.6%
SG&A Expenses Ratio	18.2%	19.7%	20.7%	17.8%	18.5%	—
Operating Income	90	117	(65)	421	52	-42.1%
Operating Margin	1.2%	1.6%	-0.8%	4.4%	0.5%	—
Ordinary Income	132	148	(22)	444	70	-46.8%
Ordinary Margin	1.8%	2.0%	-0.3%	4.6%	0.7%	—
Net Income	(24)	34	(35)	219	(9)	—
Net Margin	-0.3%	0.5%	-0.4%	2.3%	-0.1%	—

Source: OUTSOURCING Inc.; compiled by Trias Corporation

Compared with the initial Company's estimates, net sales came in ¥4 million ahead, and operating income ¥47 million ahead. The main reason for Q1 income over-shoot was the absence of the impact of seasonal sales decline. In a normal year beginning of the year production tends to finish up in late January to early February, and starts up again from March onward. Re-starting production generates hiring expense charges causing income margins to decline temporarily, however those charges were lower during Q1, and as mentioned earlier excluding one-time items gives an operating income margin of 2.4% in real terms, improving 1.2% points over the same period last term.

Q1 FY12/12 Sales Trends by Industry

Total net sales were basically in-line with the Company's estimates, however there were changes in the composition. In particular, in the field of semiconductors of the electrical and electronics in mainstay production outsourcing, the Company had initially assumed fairly severe market conditions, but actual results proved much worse.

As can be seen in Table 2, the business from electrical and electronics industry accounted for 29.8% of total net sales in the previous Q1, however this began deteriorating sharply from 4Q onward, accounting for only 17.9% of Q1 production outsourcing sales. In this field only smart-phone onsite production remained firm, and even with more firms moving toward outsourcing given the severe earnings environment, these two factors were not able to offset overall weakness in this industry. OS Group is dealing with this trend following its existing strategy to transfer personnel to favorable sectors.

On the positive side, transport equipment related (autos) and building materials related (including housing fixtures) are doing favorably. The weight of transportation equipment declined slightly from 34.6% to 32.5% (-2.1% points), but net sales for Q1 are up 27.4% YOY. Metal Products related to which Building Materials was added posted a large increase , with the weight in net sales rising from 1.2% during the previous Q1 to 10.2% this Q1. The IT related business field was added this term as a result of M&A, accounting for 4.9%.

●【Table 2]】Q1 FY12/12 Sales Breakdown by Industry

(¥ million)	FY12/11 Q1 Actual	FY12/11 Q2 Actual	FY12/11 Q3 Actual	FY12/11 Q4 Actual	FY12/12 Q1 Actual
Production Outsourcing Business	**7,251**	**7,133**	**7,590**	**9,172**	**9,832**
Electrical and Electronics	2,159	2,257	2,194	2,058	1,757
Foods	440	490	515	561	441
Trasport Epuipment	2,511	2,105	2,714	3,274	3,199
Chemical and Medicals	1,016	1,145	947	1,066	1,041
Metals	84	102	183	467	1,004
IT-related	—	—	—	—	481
Other	1,040	1,032	1,034	1,749	1,905

Sales Composition	FY12/11 Q1 Actual	FY12/11 Q2 Actual	FY12/11 Q3 Actual	FY12/11 Q4 Actual	FY12/12 Q1 Actual
Production Outsourcing Business	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Electrical and Electronics	29.8%	31.6%	28.9%	22.4%	17.9%
Foods	6.1%	6.9%	6.8%	6.1%	4.5%
Trasport Epuipment	34.6%	29.5%	35.8%	35.7%	32.5%
Chemical and Medicals	14.0%	16.1%	12.5%	11.6%	10.6%
Metals	1.2%	1.4%	2.4%	5.1%	10.2%
IT-related	—	—	—	—	4.9%
Other	14.3%	14.5%	13.6%	19.1%	19.4%

Source: OUTSOURCING Inc.; compiled by Trias Corporation

Business Trends of Transport Equipment Related (Autos)

Large production increases are planned for 2H of this year in the transport equipment business field. Macro uncertainties since the Lehman collapse have pushed out the replacement buying cycle of autos, and there is pent-up latent demand. Auto makers are planning to release many new model products and model changes, backed by front-loaded demand for Eco-car subsidies and making some assumptions for replacement demand. OS Group believes replacement demand will grow in the medium-term, but expects a temporary drop from the summer onward after front-loaded Eco-car subsidies demand drops out, and expects production increases for products to ASEAN countries to pick up from the beginning of next year.

Business Trends of Metal Products Related (incl. home fixtures)

Business for building materials which is seeing a rising trend of orders begins with subsidiary ORJ which concluded an outsourced administrative service contract on January 23, 2012 with LIXIL*, the largest domestic maker of building materials. Following Thailand flooding, as an emergency measure the Thai government issued temporary working visas to local workers willing to work in Japan for alternative production. LIXIL decided to bring over approximately 1,000 local employees affected by flooding to work in a Japan factory for 6 months, and ORJ won the contract for administrative operations outsourcing service. This was the first contract of this nature in Japan for helping to deal with accepting overseas workers. The Thai government gave ORJ high marks for the success of this administrative operations outsourcing service, and this has led to expanding orders in the production outsourcing of building materials.

In the field of building materials, there is of course demand for reconstruction in Tohoku, and there is also rising construction demand in emerging economies. OS Group is currently strategically strengthening its ability in a global framework to help overseas subsidiaries grow orders to meet rising demand.

※ Note: Formed through the merger of 5 building materials and home fixtures firms in April 2011: Tostem, Inax, ShinNikkei, Sun Wave (excluding the manufacturing division), and Toyo Exterior.

Q1 FY12/12 Results by Operating Segment

Given the various trends by business mentioned above, earnings results by operating segment are shown in Table 3. According to the Company, ¥200 million in one-time expenses including the expenses of moving the head office as well as listing on the TSE 2nd Section were allocated across divisions, with the major portion allocated to production outsourcing.

For the domestic companies group of mainstay production outsourcing, net sales fell slightly short of target, however incomes absorbed one-time items, and earnings improved more than expected largely due to declining sales of electrical and electronics equipment which has many temporary placement contracts for the mass production process, while transport equipment sales which has many production outsourcing contracts for higher value-added processes including R&D increased.

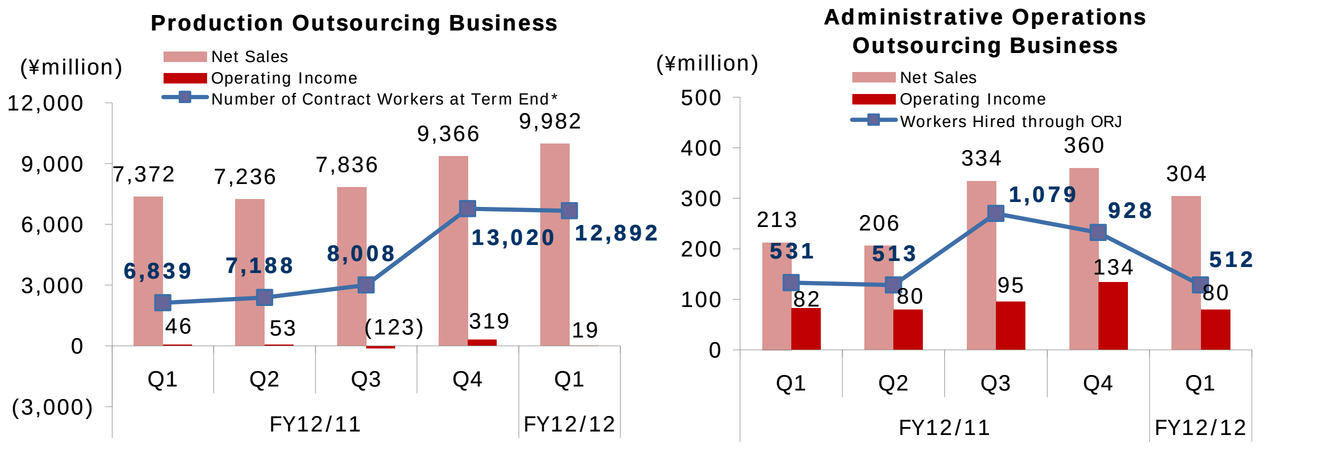
The overseas companies segment of production outsourcing began making a contribution from this Q1. There are presently 5,000 contract workers, mostly white collar, and the Company plans to step up investing in strengthening its number of workers with an aim toward doubling annual sales to ¥4 billion in the next two years. According to the Company, realistic potential for full-term operating income this year is ¥130 million, and the Company has factored in ¥30 million in leading investment.

●【Table 3】 Q1 FY12/12 Results by Operating Segment Summary

(¥ million)		FY12/11 Q1	FY12/11 Q2	FY12/11 Q3	FY12/11 Q4	FY12/12 Q1 Actual	FY12/12 Q1 Initial Fcst
		Actual					
Production Outsourcing Business	Net Sales	7,372	7,236	7,836	9,366	9,982	10,070
	Domestic Business Group	—	—	—	—	8,984	9,045
	Overseas Business Group	—	—	—	—	998	1,025
	Operating Income	46	53	(123)	319	19	(7)
	Domestic Business Group	—	—	—	—	55	8
	Overseas Business Group	—	—	—	—	(36)	(15)
	Number of Contract Workers at Term End*	6,839	7,188	8,008	13,020	12,892	13,802
	Domestic Business Group	—	—	—	8,361	7,963	8,796
	Overseas Business Group	—	—	—	4,659	4,929	5,006
Administrative Operations Outsourcing Business	Net Sales	213	206	334	360	304	265
	Operating Income	82	80	95	134	80	65
	Workers Hired through ORJ	531	513	1,079	928	512	745
Other Busienss	Net Sales	36	33	33	35	43	45
	Operating Income	0	(2)	0	2	2	2
Intercompany elimination	Net Sales	(121)	(104)	(246)	(196)	(150)	(205)
Elimination/ All company	Operating Income	(39)	(13)	(38)	(50)	(50)	(55)
Total	**Net Sales**	**7,501**	**7,372**	**7,958**	**9,566**	**10,179**	**10,175**
	Operating Income	**90**	**117**	**(65)**	**421**	**52**	**5**

Source: OUTSOURCING Inc.; compiled by Trias Corporation
*Include workforce, actual and forecast, of Indonesia-based PT. SELNAJAYA, an equity method affiliate

●【Graph 1】 Quarterly Trend of Mainstay Business Earnings and Number of Contract Workers



*Includes the workforce, actual and forecast, of Indonesia-based PT. SELNAJAYA, an equity method affiliate

The 2012 Issue and Changing Business Environment with Industry Consolidation

Industry curtailment has begun in production outsourcing

Until now industry curtailment has not proceeded in the production outsourcing market, however OS Group sees major changes unfolding in response to dealing with the 2012 Issue. In order to meet demand for rapid production recovery in mid-2009 post-Lehman, a large number of manufacturers used temporary placement contracts. According to estimates by the Company, 200,000 temporary placement contracts will run into the three-year legal limit mid-year in 2012, which will force companies to either adopt direct employment seasonal worker contracts, or, steadily switch over to contracts for outsourced contracting service. In the production outsourcing market, switch over to contracts for outsourced contracting service has already begun with providers who can comply with laws and regulations. The current environment clearly favors large, listed firms, and industry curtailment has begun to surface.

Given this background, OS Group sees the expiry of a large number of temporary placement contracts from mid-2009, i.e. “the 2012 Issue,” as a major business opportunity. This includes focusing the entire Group’s resources on making proposals for shifting to contracts for outsourced contracting service, as well as going through subsidiary ORJ to offer recruitment agency service for makers opting to adopt direct employment seasonal worker contracts, as well as aggressive proposals for comprehensive outsourced administrative services, and the Company is targeting 10% share of the total demand (20,000 workers) for switching over contracts. For building materials where the Company is currently expanding orders, there are a large number of firms which also used temporary placement contracts, and OS Group is stepping up marketing efforts for developing new clients.

Domestic on-site production is seeing the workforce become more fluid

Along with progress in industry curtailment in production outsourcing marked by the 2012 Issue, domestic on-site production is seeing the workforce become more fluid. Table 4 shows examples of major domestic firm layoffs announced since the beginning of 2012 as well as domestic plant consolidation. OS Group estimates this transition to a more fluid workforce will accelerate going forward. In accordance with this outlook, the Company has not let up on hiring contract workers, and actually sees the average cost softening this term, and is therefore planning to invest aggressively.

●【Table 4】 Examples of major domestic firms' layoff plans (announced since 2012)

Company	Details of Mainly On-Site Production Layoff Plans
OLYMPUS	・By fiscal 2013-end planning to reduce group workers by 7% (roughly 2,700)
Renesas Electronics	・Planning to cut just under 30% of total workforce (12,000 out of 42,000) ・Also planning domestic plant closures and unifications
Panasonic	・Within fiscal 2012, planning to eliminate 2,000 domestic production R&D positions as well as 1,000 production engineers
RICHO	・Cut roughly 5,000 workers in fiscal 2011 ・Planning to cut 4,000 in fiscal 2012 including 3,000 US workers
SONY	・Reducing roughly 10,000 workers in the total group, including separation of medium/small size LCD panels
NEC	・Including outsourcing, planning to cut 7,000 workers domestically, and 3,000 overseas
TDK	・In order to maximize efficiency, planning to cut the group workforce by 11,000 over the next 2 years. ・Closing 2 plants in Akita Prefecture.

Source: Compiled by Trias Corp. from media sources of layoff announcements since 2012

Domestic hiring results and beginning of term plans are shown in Table 5. During Q1 domestic hires were slightly below the initial plan but domestic hiring expense was above plan. The Company sees the average price softening going forward as the domestic workforce becomes more fluid.

Based on strategic hiring last term, OS Group has built a framework that can facilitate up to 1,500 hires per month domestically, and there is little risk related to hiring ability, but during Q1 the Company met its target for applicants, and came in slightly lower on actual hires. This was due to the greater than expected decline in semiconductor related hires, and not being able to meet demand for hiring increases in the transport equipment sector. However, higher value-added transport equipment contracts which require specialized skills and physical strength, rather than labor intensive semiconductor-related contracts, resulted in improved margins.

●【Table 5】 FY12/12 Domestic Hiring Results and Initial Plan

	(Unit)	FY12/12 Q1 Actual	FY12/12 Q1 Initial Plan
No. of applicants	persons	12,236	12,081
No. of workers recruited	persons	2,543	3,055
No. of contract & temporary workers recruited	persons	2,031	2,310
No. of workers placed for payment	persons	512	745
Ratio of no. of workers recriuted among no. of applicants	%	20.8%	25.3%
Recruitment expenses	¥ thousand	219,080	204,315
Recruitment expenses per head	¥	86,150	66,879

	(Unit)	2012 Initial Plan Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
No. of applicants	persons	4,338	4,176	4,626	4,345	4,020	4,567	5,378	4,367	3,511
No. of workers recruited	persons	1,194	1,152	1,300	1,316	1,212	1,390	1,663	1,405	1,163
No. of contract & temporary workers recruited	persons	872	856	1,013	1,007	913	1,025	1,293	1,040	833
No. of workers placed for payment	persons	322	296	287	309	299	365	370	365	330
Ratio of no. of workers recriuted among no. of applicants	%	27.5%	27.6%	28.1%	30.3%	30.1%	30.4%	30.9%	32.2%	33.1%
Recruitment expenses	¥ thousand	77,879	72,440	76,628	74,581	68,596	79,173	83,142	73,176	62,492
Recruitment expenses per head	¥	65,225	62,882	58,944	56,672	56,597	56,959	49,995	52,083	53,733

Source: OUTSOURCING Inc.; compiled by Trias Corporation

Group Strategy to Win Amidst Industry Curtailment

Handling more sophisticated demands from makers

Until now production outsourcing firms were mainly required to have the ability to deal with production volatility and short-term fluctuations. In particular, mass production assembly processes tend to be simple temporary placement contracts, with the main function in delivering a large number of workers in a short period of time. When the macro environment was more stable, the busy season was longer, and makers were able to grow profits even after paying out leading expenses from personnel placement during production start-up periods.

However, production busy seasons are shortening from heightened global competition, and it is becoming difficult to recover production start-up costs. Needs in the marketplace have become more sophisticated, requiring production outsourcing firms to be able to simultaneously handle two conflicting elements of adaptability to raise efficiency at production start-up, as well as securing liquidity.

For OS Group which is dealing with major changes in maker needs and aiming at becoming industry No.1, the Company is strengthening its ability to deal with production volatility and handle specialization requirements. The Company is re-organizing the group to make further progress in its strategy to diversify amongst sectors. The Company has started with re-organizing the transportation equipment group, merging redundant production subsidiaries under this Group’s umbrella into OUTSOURCING Inc., and is concentrating engineering process divisions like R&D into subsidiary

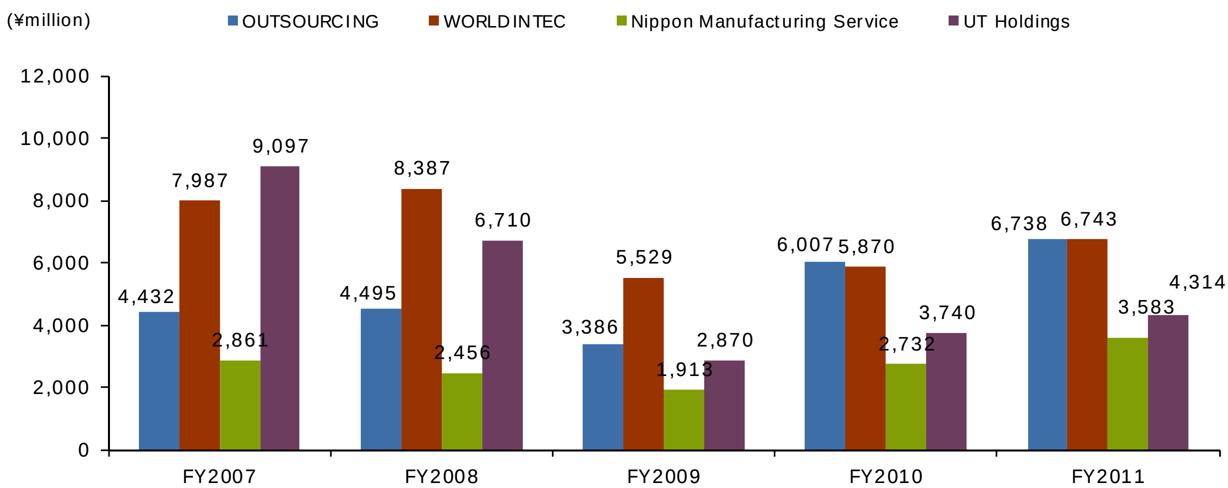
Outsourcing Technology. Additionally engine testing specialty business is being concentrated with subsidiary Enable. Going forward the Company will establish a human resource training division as well as a system for career advancement.

In order to establish a business base for achieving the ability to handle both production volatility and requirements for specialization, the Company is forming industry specialized groups including the Electrical and Electronics Group, the IT/Telecom Group, the Pharmaceutical and Chemicals Group, etc. For production outsourcing, the Company has built a structure to handle and manage needs from any sector.

Achieving Industry No. 1 Scale (= Gross Profit)

OS Group has identified and is targeting strategic growth in gross profits in order to sustain aggressive investment mentioned earlier. For operating income and below, the existence or lack of aggressive hiring investments tends to suggest differences in income amounts, however, as can be seen in Graph 2, OS Group's level of gross profit has reached the top levels in recent years in a comparison of major listed production outsourcing firms. Going forward the Company plans to increase business scale, strengthen management controls and group re-organization, lowering the SG&A ratio, targeting higher operating income margin. In the current mid-term management plan, FY12/14 consolidated net sales of ¥117 billion and operating income of ¥8.3 billion are targeted, with gross profit margin of 22%, SG&A expenses ratio of 15%, and operating income margin of 7%.

●【Graph 2】 Comparison of Gross Profit amongst Major Listed production outsourcing firms



Reference

●Consolidated Key Stock Indicators / Financial Data and Business Results

No. of Shares Issued	Dec-11	15,569,800
No. of Treasury Stock	Dec-11	1,139,500
Market Value (¥million)	28-Jun-12	4,718
BPS (¥)	Dec-11	238.4
ROE (%)	Dec-11	5.8
ROA (%)	Dec-11	1.6
PER (times)	FY12/12 fcst	5.0
PCFR (times)	Dec-11	10.1
PBR (times)	Dec-11	1.3
Share Price (¥)	28-Jun-12	303
Unit Share (shares)	Dec-11	100
Average Daily Volume (shares)	28-Jun-12	12,401

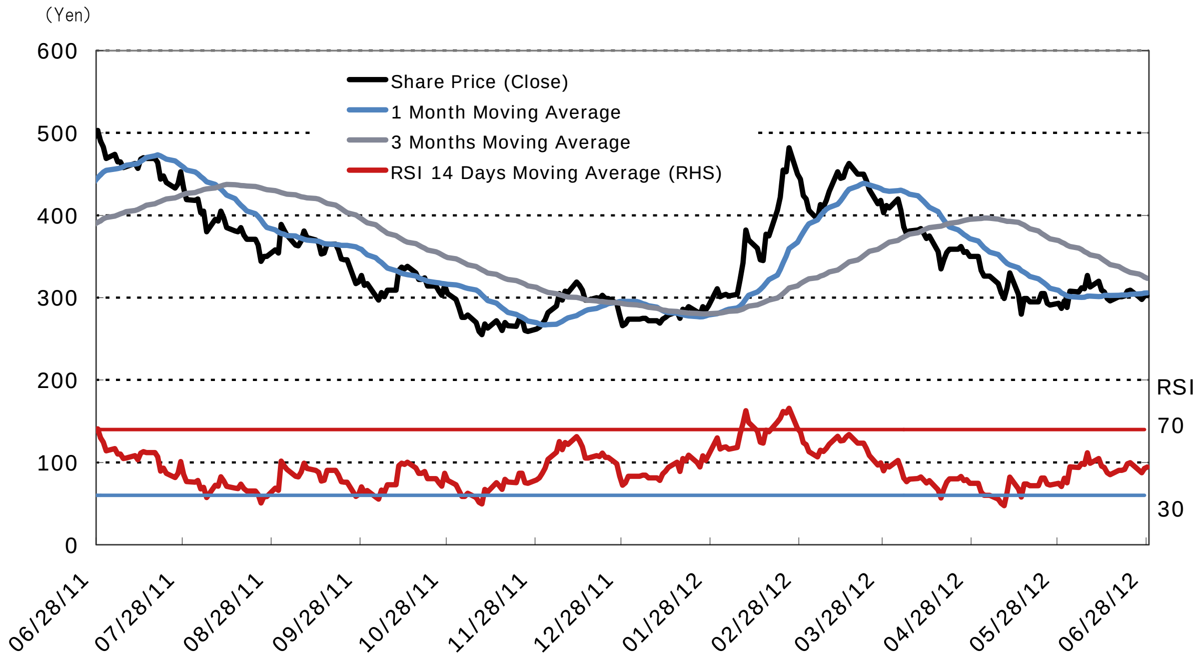
Total Assets (¥million)	Dec-11	11,921
Shareholders' Equity (¥million)	Dec-11	3,440
Interest-Bearing Debt (¥million)	Dec-11	3,342
Equity Ratio (%)	Dec-11	28.9
Ratio of Interest-Bearing Debt (%)	Dec-11	97.2
Free Cash Flows (¥million)	Dec-11	138

ROE=Current Net Income÷Shareholders' Equity
ROA=Current Net Income÷Total Assets
PCFR=Maket Value÷(Current Net Income+Depreciation)
Ave. Daily Vol.=Ave. Daily Vol. for the last 12 months
Interest-Bearing Debts Ratio=I.B.D.÷Shareholders' Equity
Free Cash Flows=Operating CF+Investment CF

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	DPS (¥)
FY12/08	24,148	1,113	1,134	641	5,412.28	644.00
FY12/09	17,964	(150)	22	(215)	(1,511.00)	644.00
FY12/10	28,386	1,173	1,401	760	52.46	7.21
FY12/11	32,397	563	702	194	13.48	8.00
1H FY12/12 fcst	21,180	235	280	65	4.50	0.00
FY12/12 fcst	46,470	1,660	1,750	875	60.63	8.00

Note: FY12/12 forecast announced on Feburuary 10, 2012

●Stock Price Charts and RSI



Source: Prepared by Trias Corp. with Bloomberg 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