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# OUTSOURCING Inc.

## Q1 FY12/13 Financial Results and Follow-up Interview

OUTSOURCING Inc., hereinafter the Company or OS Group, released its Q1 FY12/13 financial results, and Trias Corporation conducted an interview with Chairman and CEO Haruhiko Doi. The following is a summary of the interview.

## Summary of Q1 FY12/13 Consolidated Financial Results

According to the Company, the early half of Q1 started off quite weak, well below budget, due to lingering effects of large-scale cancellations from the Transport Equipment sector at the end of 2012 prompted by forced inventory adjustment in China in the wake of the Senkaku Islands dispute, as well as weakness in the Electrical/Electronics sector due to a slump in handsets. However this trend reversed sharply in the latter half of Q1 driven by rapid ramp-ups in the Transport Equipment sector. Q1 net sales increased 2.3% YoY to ¥10.4bn, actually exceeding the initial company forecast of ¥10.3bn.

However, the Q1 operating loss of ¥188mn was substantially below guidance of an operating loss of ¥52mn. This was the result of additional startup cost from rapid ramp-ups in the Transport Equipment sector in March requiring unexpected additional staff from early April. The net loss was mitigated by negative goodwill and securities sales.

●【Table 1】Summary of 1Q FY12/13 Consolidated Financial Results

| ¥ mn | Q1.12 | Q1.13 | Chg | YoY |
|---|---|---|---|---|
| **Net Sales** | **10,179** | **10,415** | **236** | **2.3%** |
| CoGS | 8,247 | 8,655 | 408 | 4.9% |
| Gross Profit | 1,932 | 1,759 | (173) | -9.0% |
| SG&A Expenses | 1,880 | 1,948 | 68 | 3.6% |
| **Operating Income** | **52** | **(188)** | **(240)** | **-** |
| Non-operating Inc. | 166 | 197 | 31 | 18.7% |
| Non-operating Exp. | 148 | 200 | 52 | 35.1% |
| **Ordinary Income** | **70** | **(191)** | **(261)** | **-** |
| Extraordinary Gain | 16 | 80 | 64 | 400.0% |
| Extraordinary Loss | 47 | 0 | (47) | - |
| **Net Income** | **(9)** | **(121)** | **(112)** | **-** |

*Source: Company IR materials*

| % | Q1.12 | Q1.13 | Chg | YoY |
|---|---|---|---|---|
| **[Ratio to Net Sales]** | | | | |
| CoGS Ratio | 81.0% | 83.1% | - | - |
| GP Margin | 19.0% | 16.9% | - | - |
| SG&A Expenses Ratio | 18.5% | 18.7% | - | - |
| Operating Income Margin | 0.5% | -1.8% | - | - |
| Ordinary Income Margin | 0.7% | -1.8% | - | - |
| Net Income Margin | -0.1% | -1.2% | - | - |

*Source: Company IR materials*

During Q1, short-term borrowing increased by ¥1.3bn, reflected in cash and deposits, for increased working capital to support rising sales and to maintain liquidity for future M&A. The investments account increased by ¥1.4bn reflecting the acquisition of subsidiary shares. The Company announced on January 31 acquisition of shares of CSL, an affiliate of NEC Infrontia specializing in system and network solutions, with talented system and software engineers, as part of the Company's strategy targeting growing business opportunities from the prohibition of exclusive dispatching. The Company increased its holding in the company from 80.9% to 85.8% on February 28. For a detailed overview of changes in the regulatory framework, please refer to the Trias Corporation Q3 memo on OUTSOURCING Inc. Retained earnings decreased slightly from the ¥0.2bn net loss in Q1, causing a slight decline in the shareholders equity ratio. The Company announced a 1H special commemorative dividend of ¥5 per share in addition to the 2H dividend of ¥8 already announced, for a full-term dividend of ¥13, marking its successful move to the TSE First Section in March.

### ● [Table 2] 1Q-end FY12/13 Consolidated B/S Summary

| ¥ mn, % | Q4.12end | % Total | Q1.13end | % Total | Chg |
|---|---|---|---|---|---|
| Current Assets | 9,431 | 68.0% | 11,070 | 65.5% | 1,639 |
| Cash & Deposits | 3,363 | 24.3% | 4,645 | 27.5% | 1,282 |
| Accounts Receivable | 5,232 | 37.7% | 5,206 | 30.8% | (26) |
| Inventory | 132 | 1.0% | 125 | 0.7% | (7) |
| Fixed Assets | 4,433 | 32.0% | 5,837 | 34.5% | 1,404 |
| Property, plant and equipment | 2,008 | 14.5% | 2,016 | 11.9% | 8 |
| Intangible Fixed Assets | 1,372 | 9.9% | 1,385 | 8.2% | 13 |
| Investments & Other Assets | 1,051 | 7.6% | 2,435 | 14.4% | 1,384 |
| **TOTAL ASSETS** | **13,866** | **100.0%** | **16,909** | **100.0%** | **3,043** |

*Source: Company IR materials*

| ¥ mn, % | Q4.12end | % Total | Q1.13end | % Total | Chg |
|---|---|---|---|---|---|
| Current Liabilities | 6,875 | 49.6% | 9,113 | 53.9% | 2,238 |
| Accounts Payable | 208 | 1.5% | 281 | 1.7% | 73 |
| Short-term Loans Payable | 2,574 | 18.6% | 3,856 | 22.8% | 1,282 |
| Deferred Payments | 2,341 | 16.9% | 2,783 | 16.5% | 442 |
| Non-current Liabilities | 2,478 | 17.9% | 3,252 | 19.2% | 774 |
| Long-term Loans Payable | 1,582 | 11.4% | 1,925 | 11.4% | 343 |
| **TOTAL LIABILITIES** | **9,354** | **67.5%** | **12,366** | **73.1%** | **3,012** |
| Shareholders Equity | 4,008 | 28.9% | 3,774 | 22.3% | (234) |
| Capital Stock | 485 | 3.5% | 486 | 2.9% | 1 |
| Capital Surplus | 881 | 6.4% | 882 | 5.2% | 1 |
| Retained Earnings | 3,032 | 21.9% | 2,796 | 16.5% | (236) |
| Treasury Stock | (391) | -2.8% | (391) | -2.3% | 0 |
| Other Comprehensive Income | 78 | 0.6% | 121 | 0.7% | 43 |
| Subscription Rights to Shares | 103 | 0.7% | 119 | 0.7% | 16 |
| Minority Interests | 321 | 2.3% | 526 | 3.1% | 205 |
| **TOTAL NET ASSETS** | **4,511** | **32.5%** | **4,542** | **26.9%** | **31** |
| **TOTAL LIABILITIES & NET ASSETS** | **13,866** | **100.0%** | **16,909** | **100.0%** | **3,043** |

*Source: Company IR materials*

## ● [Table 3] Flurry of Additional Hiring in March

| workers, ¥ mn | Q1.13 Plan | Q1.13 Actual | Chg | Startup Costs | Q2 - Q4 ddl Sales |
|---|---|---|---|---|---|
| Temporary & Contract Hires | 982 | 1,292 | 310 | 60 | 900 |
| Enrolled Workers | 3,358 | 3,558 | 200 | - | 500 |
| Total Additional Sales | - | - | - | - | 1,400 |

*Source: Compiled by Trias Corporation from the Company IR materials*

As mentioned earlier, while Q1 net sales cleared budget in the end, operating income came in substantially below budget, a shortfall to initial Company estimates of ¥136mn. The main factor for this was an unexpected surge in March of demand for workers primarily from Transport Equipment makers requiring additional staff from early April. As can be seen in Table 3 above, the Company hired 310 additional workers in Q1, incurring startup costs of ¥60mn, without booking the related revenue.

Also, the rapid recovery in production caused a change in plans for temporary worker contracts that were scheduled to be terminated ahead of the 3-year legal limit. The Company is focusing on switching these to outsourced contracts. These factors caused GPM to temporarily drop to 17.1% (Q1 CE 20.5%), but the outlook for GPM going forward is Q2 21.1%, Q3 23.9%, and Q4 23.0%. The Company expects additional sales from the above of ¥1.4bn from Q2 to Q4. A rough calculation of an average 22.7% GPM times ¥1.4bn yields additional gross profit of ¥318mn.

The Company announced changes to reporting operating segments on Q1 results, reflecting the expanding scope of business, and aiming to provide more accurate disclosure close to the business reality. Table 4 below gives an overview of changes to reporting operating segments. In a nutshell, the Company is splitting the old segment Domestic Production Outsourcing into Manufacturing Outsourcing and Engineering Outsourcing. Names of three of the remaining four segments changed, but the content is the same as the old segments.

In addition, the Company changed reporting classifications for the sales breakdown by industry. Table 6 shows the FY12/12 Sales Breakdown by Industry restated using the new sectors. In addition to dividing key sectors by Manufacturing Outsourcing and Engineering Outsourcing, two new sectors for Construction & Plant-related and After-services Maintenance have been added. Also, Overseas Business is split out from the old sector Others. Operating segments increased from five to six, and industry sectors increased from seven to fifteen.

### [Table 4] Overview of New Reporting Operating Segments

| | Before the change | After the change |
|---|---|---|
| Production Outsourcing Business | Domestic Outsourcing Business | Manufacturing Outsourcing Business<br>Engineering Outsourcing Business |
| | Overseas Outsourcing Business | Overseas Business |
| Administrative Outsourcing Business | Administrative Operations Outsourcing Business | Administrative Outsourcing Business |
| | Recruitment Agency Service Outsourcing Business | Staff Agency Business |
| Other Business | | Other Business |

*Source: Company IR materials*

### [Table 5] FY12/12 Operating Segment Results Restated using New Reporting Segments

| ¥ mn, Old Segments | 1H12 | 2H12 | FY12/12 |
|---|---|---|---|
| **Net Sales** | **20,408** | **21,682** | **42,090** |
| Domestic Outsourcing | 18,055 | 18,850 | 36,905 |
| Overseas Outsourcing | 1,997 | 2,542 | 4,539 |
| Administrative Operations Outsourcing | 303 | 330 | 633 |
| Recruitment Agency Service Outsourcing | 257 | 179 | 436 |
| Other Business | 79 | 73 | 152 |
| Intra-company transfers | (286) | (295) | (582) |
| **Operating Income** | **249** | **750** | **1,000** |
| Domestic Outsourcing | 246 | 533 | 779 |
| Overseas Outsourcing | (76) | 38 | (38) |
| Administrative Operations Outsourcing | 90 | 158 | 248 |
| Recruitment Agency Service Outsourcing | 78 | 70 | 148 |
| Other Business | 4 | 3 | 8 |
| Eliminations | (93) | (56) | (149) |

*Source: Compiled by Trias Corporation from Company IR materials*

| ¥ mn, New Segments | 1H12 | 2H12 | FY12/12 |
|---|---|---|---|
| **Net Sales** | **20,408** | **21,682** | **42,090** |
| Manufacturing Outsourcing | 12,579 | 12,020 | 24,600 |
| Engineering Outsourcing | 5,476 | 6,831 | 12,308 |
| Overseas Business | 1,997 | 2,542 | 4,539 |
| Administrative Outsourcing | 303 | 330 | 633 |
| Staff Agency | 257 | 179 | 436 |
| Other Business | 79 | 73 | 152 |
| Intra-company transfers | (286) | (295) | (582) |
| **Operating Income** | **249** | **750** | **1,000** |
| Manufacturing Outsourcing | 19 | 94 | 113 |
| Engineering Outsourcing | 227 | 440 | 667 |
| Overseas Business | (76) | 38 | (38) |
| Administrative Outsourcing | 90 | 158 | 248 |
| Staff Agency | 78 | 70 | 148 |
| Other Business | 4 | 3 | 8 |
| Eliminations | (93) | (56) | (149) |

## [Table 6] FY12/12 Sales Breakdown by Industry Restated using New Reporting Sectors

| ¥ mn, Old Sectors | 1H12 | 2H12 | FY12/12 |
|---|---|---|---|
| **Production Outsourcing** | **19,768** | **21,127** | **40,895** |
| Transport Equipment | 6,245 | 5,708 | 11,954 |
| Electrical/Electronics | 3,703 | 4,079 | 7,782 |
| Pharma/Chemicals | 2,093 | 2,302 | 4,396 |
| Building Materials | 1,919 | 1,820 | 3,740 |
| IT | 1,005 | 1,950 | 2,956 |
| Foods | 868 | 986 | 1,854 |
| Others | 3,932 | 4,278 | 8,211 |

*Source: Compiled by Trias Corporation from Company IR materials*

| ¥ mn, New Sectors | 1H12 | 2H12 | FY12/12 |
|---|---|---|---|
| **Mfg. Outsourcing** | **12,303** | **11,875** | **24,178** |
| Transport Equipment | 4,254 | 3,368 | 7,623 |
| Electric & Electronics | 2,516 | 2,803 | 5,320 |
| Chemicals & Medicals | 1,732 | 1,929 | 3,662 |
| Metals & Construction Materials | 1,903 | 1,802 | 3,706 |
| Foods | 866 | 872 | 1,739 |
| Others | 1,029 | 1,098 | 2,127 |
| **Engineering Outsourcing** | **5,470** | **6,789** | **12,260** |
| Transport Equipment | 1,974 | 2,134 | 4,108 |
| Electric & Electronics | 1,159 | 1,142 | 2,301 |
| Chemicals & Medicals | 358 | 370 | 728 |
| Metals & Construction Materials | 13 | 9 | 23 |
| IT-related | 905 | 1,863 | 2,769 |
| Construction & Plant-related | - | - | - |
| After-services Maintenance | - | - | - |
| Others | 1,059 | 1,269 | 2,328 |
| **Overseas Business** | **1,994** | **2,462** | **4,457** |

Next we examine the new reporting classifications for further insight into Q1 results. Table 7 shows the sales breakdown by industry. In Manufacturing Outsourcing, Transport Equipment continued to experience lingering effects from large-scale production adjustments related to China, and Electric & Electronics suffered from production adjustments related to handsets. However, Engineering Outsourcing was a completely different story. Management focus initiatives place high priority on diversifying into sectors not influenced by high volatility of the busy/slack manufacturing cycle, and in Q1 IT surpassed Transport Equipment to become the largest sector within Engineering Outsourcing driven by demand for big data-related systems etc.

Overseas Business continues to post brisk expansion, rising 17.5% QoQ and 48.5% YoY. According to the Company, it added 1,400 workers in Thailand in Q1. While leading investment and startup costs hold down profits initially, overseas business is expected to continue to make a growing contribution to profits. It is worth noting that while the weight of Manufacturing Outsourcing declined 14.9% YoY to 47.6%, Engineering Outsourcing rose over 10.6% to 37.9%, and Overseas Business rose 4.4% to 14.6%.

### [Table 7] Quarterly Trend of Sales Breakdown by Industry

| ¥ mn, % | Q1.12 | Q2.12 | Q3.12 | Q4.12 | Q1.13 | YoY |
|---|---|---|---|---|---|---|
| **Manufacturing Outsourcing** | **6,147** | **6,155** | **6,031** | **5,843** | **4,834** | **-21.4%** |
| Transport Equipment | 2,119 | 2,135 | 1,849 | 1,518 | 1,355 | -36.1% |
| Electric & Electronics | 1,230 | 1,285 | 1,405 | 1,398 | 1,049 | -14.7% |
| Chemicals & Medicals | 869 | 863 | 909 | 1,019 | 897 | 3.2% |
| Metals & Construction Materials | 995 | 907 | 942 | 860 | 675 | -32.2% |
| Foods | 439 | 427 | 425 | 447 | 378 | -13.9% |
| Others | 493 | 535 | 500 | 598 | 478 | -3.0% |
| **Engineering Outsourcing** | **2,686** | **2,784** | **3,222** | **3,566** | **3,850** | **43.3%** |
| Transport Equipment | 1,073 | 900 | 981 | 1,152 | 1,126 | 4.9% |
| Electric & Electronics | 515 | 643 | 559 | 582 | 532 | 3.3% |
| Chemicals & Medicals | 170 | 187 | 182 | 188 | 213 | 25.3% |
| Metals & Construction Materials | 7 | 6 | 4 | 4 | 1 | -85.7% |
| IT-related | 426 | 479 | 852 | 1,010 | 1,344 | 215.5% |
| Construction & Plant-related | - | - | - | - | 72 | - |
| After-services Maintenance | - | - | - | - | 34 | - |
| Others | 491 | 567 | 640 | 628 | 525 | 6.9% |
| **Overseas Business** | **998** | **996** | **1,201** | **1,261** | **1,482** | **48.5%** |
| **[% Total]** | | | | | | |
| Manufacturing Outsourcing | 62.5% | 62.0% | 57.7% | 54.8% | 47.6% | - |
| Engineering Outsourcing | 27.3% | 28.0% | 30.8% | 33.4% | 37.9% | - |
| Overseas Business | 10.2% | 10.0% | 11.5% | 11.8% | 14.6% | - |
| **[Key Domestic Sectors]** | | | | | | |
| Transport Equipment | 32.5% | 30.5% | 27.1% | 25.0% | 24.4% | - |
| Electric & Electronics | 17.7% | 19.4% | 18.8% | 18.6% | 15.6% | - |
| Chemicals & Medicals | 10.6% | 10.6% | 10.4% | 11.3% | 10.9% | - |
| Metals & Construction Materials | 10.2% | 9.2% | 9.0% | 8.1% | 6.6% | - |
| IT-related | 4.3% | 4.8% | 8.1% | 9.5% | 13.2% | - |

*Source: Compiled by Trias Corporation from Company IR materials*
*Note: Does not include Administrative Outsourcing, Staff Agency or Other Business.*

One of the most important revelations from the new reporting classifications is the size of contribution to profits of Engineering Outsourcing. In FY12/12, Engineering Outsourcing accounted for two-thirds of operating income, followed by Administrative Outsourcing at 25% (before eliminations). According to the Company, one of the consequences of major production adjustments last year was many manufacturers approaching the 3-year limit on the use of temporary dispatching were able to take advantage of the cooling off period, and reset consecutive work periods. However, demand for conversion to direct hiring by makers remains brisk, and Administrative Outsourcing continues to make a strong profit contribution.

### [Table 8] Quarterly Trend of Consolidated Financial Results

| ¥ mn | Q1.12 | Q2.12 | Q3.12 | Q4.12 | Q1.13 | YoY |
|---|---|---|---|---|---|---|
| Net Sales | 10,179 | 10,228 | 10,719 | 10,963 | 10,415 | 2.3% |
| Gross Profit | 1,932 | 2,104 | 2,131 | 2,304 | 1,759 | -9.0% |
| SG&A Expenses | 1,880 | 1,906 | 1,844 | 1,840 | 1,948 | 3.6% |
| Operating Income | 52 | 197 | 286 | 463 | (188) | - |
| Ordinary Income | 70 | 238 | 321 | 523 | (191) | - |
| Net Income | (9) | (14) | 228 | 436 | (121) | - |
| **(Ratio to Net Sales)** | | | | | | |
| GP Margin | 19.0% | 20.6% | 19.9% | 21.0% | 16.9% | - |
| SG&A Exp. Ratio | 18.5% | 18.6% | 17.2% | 16.8% | 18.7% | - |
| OI Margin | 0.5% | 1.9% | 2.7% | 4.2% | -1.8% | - |
| ORI Margin | 0.7% | 2.3% | 3.0% | 4.8% | -1.8% | - |
| NI Margin | -0.1% | -0.1% | 2.1% | 4.0% | -1.2% | - |

*Source: Company IR materials*

## FY12/13 Consolidated Financial Forecasts

As mentioned earlier, Q1 sales exceeded plan, however operating income fell short of guidance by ¥136mn as a result of leading investment and startup costs from the flurry of additional unexpected hires in March. Since the Company did not revise estimates after Q1 results, Table 9 shows that Q2 implied operating income is ¥453mn. It remains to be seen whether the Company can make up the entire Q1 shortfall in Q2, however Chairman Doi noted that demand from the Transport Equipment sector is extremely brisk, and despite the high base last year for comps given strong domestic demand driven by eco-car tax subsidies, domestic auto sales this year are quite strong driven by the high level of new model launches for both passenger and mini vehicles. Toyota raised its 1H domestic production forecast by 150,000 units to 1.65mn units.

### [Table 9] FY12/13 1H and Full-Term Company Estimates

| ¥ mn, % | Q1.13 Init CE | Q1.13 Actual | Q2.13 Init CE | Q2.13 Implied | 1H13 Init CE | 2H13 Init CE | FY12/13 Init CE |
|---|---|---|---|---|---|---|---|
| Net Sales | 10,354 | 10,415 | 11,976 | 11,915 | 22,330 | 27,670 | 50,000 |
| Operating Income | (52) | (188) | 317 | 453 | 265 | 1,255 | 1,520 |
| Ordinary Income | | (191) | | 491 | 300 | 1,290 | 1,590 |
| Net Income | | (121) | | 276 | 155 | 845 | 1,000 |
| **[Ratio to Net Sales]** | | | | | | | |
| OI Margin | -0.5% | -1.8% | 2.6% | 3.8% | 1.2% | 4.5% | 3.0% |
| ORI Margin | | -1.8% | | 4.1% | 1.3% | 4.7% | 3.2% |
| NI Margin | | -1.2% | | 2.3% | 0.7% | 3.1% | 2.0% |
| **[YoY Change]** | | | | | | | |
| Net Sales | 1.7% | 2.3% | 17.1% | 16.5% | 9.4% | 27.6% | 18.8% |
| Operating Income | nm | nm | 60.9% | 129.9% | 6.4% | 67.1% | 52.0% |
| Ordinary Income | | nm | | 106.3% | -2.9% | 52.8% | 37.9% |
| Net Income | | nm | | nm | nm | 27.3% | 56.0% |

*Source: Compiled by Trias Corporation from Company IR materials; CE=Company Estimates*

Table 10 shows the Company estimates by operating segments. It is clear from this that the Q1 operating income shortfall relative to budget can be attributed to 1) additional startup costs for Manufacturing Outsourcing (unexpected March hires), 2) additional startup costs for Overseas Business (Thailand, Vietnam, etc), and 3) corporate eliminations higher than forecast. Given that sales growth remains on track and the Q1 shortfall was only due to startup costs related to future earnings, the shortfall itself does not merit much concern. **Perhaps the more relevant question is, are 2H initial Company estimates too bullish?**

Chairman Doi responded to our question that the ¥3.8bn estimated sales increase in Engineering Outsourcing is broken down as: IT ¥1.7bn, On-Site Building Work Supervisory Engineers Temporary Placement ¥0.7bn, and Electrical Appliance After-sales Maintenance Service Business ¥0.8bn. The other significant increase is Overseas Business of ¥1.4bn (please see Table 12). **Regarding traditional demand sectors, the Company 2H estimates only budget for a slight increase YoY versus the depressed level in the 2H of last term.**

● [Table 10] 1H and Full-Year FY12/13 Company Estimates by Operating Segment

| ¥ mn, % | Q1.13 Init CE | Q1.13 Actual | Q2.13 Init CE | Q2.13 Implied | 1H13 Init CE | 2H13 Init CE | FY12/13 Init CE |
|---|---|---|---|---|---|---|---|
| **Net Sales** | **10,354** | **10,415** | **11,976** | **11,915** | **22,330** | **27,670** | **50,000** |
| Manufacturing Outsourcing | 5,009 | 4,891 | 5,570 | 5,688 | 10,579 | 12,393 | 22,972 |
| Engineering Outsourcing | 3,660 | 3,882 | 4,317 | 4,095 | 7,977 | 10,646 | 18,623 |
| Administrative Outsourcing | 183 | 164 | 263 | 282 | 446 | 715 | 1,161 |
| Staff Agency | 49 | 38 | 64 | 75 | 113 | 135 | 248 |
| Overseas Business | 1,504 | 1,513 | 1,835 | 1,826 | 3,339 | 3,911 | 7,250 |
| Other Business | 47 | 48 | 47 | 46 | 94 | 96 | 190 |
| Intra-company transfers | (98) | (123) | (122) | (97) | (220) | (229) | (449) |
| **Operating Income** | **(52)** | **(188)** | **317** | **453** | **265** | **1,255** | **1,520** |
| Manufacturing Outsourcing | (87) | (255) | 185 | 353 | 98 | 298 | 396 |
| Engineering Outsourcing | 0 | 112 | 11 | (101) | 11 | 610 | 621 |
| Administrative Outsourcing | 24 | 45 | 64 | 43 | 88 | 217 | 305 |
| Staff Agency | 15 | 15 | 20 | 20 | 35 | 42 | 77 |
| Overseas Business | 33 | (18) | 75 | 126 | 108 | 162 | 270 |
| Other Business | 4 | 5 | 3 | 2 | 7 | 7 | 14 |
| Eliminations | (43) | (93) | (43) | 7 | (86) | (86) | (172) |

*Source: Compiled by Trias Corporation from Company IR materials*

***Note: CE=Company Estimates; New operating segment reporting classifications were announc initial estimates for the Manufacturing Outsourcing segment were Q1 net sales ¥8,669mn, operating income -¥87mn, Q2 net sales ¥9,889mn, operating income ¥196mn.***

## [Table 11] 2H FY12/13 Initial Company Estimates by Operating Segment

| ¥ mn, % | 2H12 | 2H13 | Chg | YoY |
|---|---|---|---|---|
| **Net Sales** | **21,682** | **27,670** | **5,988** | **27.6%** |
| Manufacturing Outsourcing | 12,020 | 12,393 | 373 | 3.1% |
| Engineering Outsourcing | 6,831 | 10,646 | 3,815 | 55.8% |
| Overseas Business | 2,542 | 3,911 | 1,369 | 53.9% |
| Administrative Outsourcing | 330 | 715 | 385 | 116.7% |
| Staff Agency | 179 | 135 | (44) | -24.6% |
| Other Business | 73 | 96 | 23 | 31.5% |
| Intra-company transfers | (295) | (229) | 66 | - |
| **Operating Income** | **750** | **1,255** | **505** | **67.3%** |
| Manufacturing Outsourcing | 94 | 298 | 204 | 217.0% |
| Engineering Outsourcing | 440 | 610 | 170 | 38.6% |
| Overseas Business | 38 | 162 | 124 | 326.3% |
| Administrative Outsourcing | 158 | 217 | 59 | 37.3% |
| Staff Agency | 70 | 42 | (28) | -40.0% |
| Other Business | 3 | 7 | 4 | 133.3% |
| Eliminations | (56) | (86) | (30) | - |

*Source: Compiled by Trias Corporation from Company IR materials*

## [Table 12] Quarterly Trend of Temporary and Contract Workers

| No. of workers | Fiscal Year | Q1 | Q2 | Q3 | Q4 | FY |
|---|---|---|---|---|---|---|
| **[No. of contract workers]** | | | | | | |
| Manufacturing Outsourcing | 12/12 Act | 6,279 | 6,229 | 5,871 | 5,550 | 5,550 |
| | 12/13 CE | * | 6,077 | 6,695 | 6,888 | 6,888 |
| | 12/13 Act | 5,313 | | | | |
| Engineering Outsourcing | 12/12 Act | 1,600 | 1,597 | 1,818 | 1,902 | 1,902 |
| | 12/13 CE | * | 2,453 | 2,777 | 2,937 | 2,937 |
| | 12/13 Act | 2,097 | | | | |
| **[No. of contract workers]** | | | | | | |
| Administrative Outsourcing | 12/12 Act | 8,500 | 5,070 | 5,879 | 6,467 | 6,467 |
| | 12/13 CE | 6,300 | 8,700 | 11,400 | 13,200 | 13,200 |
| | 12/13 Act | 6,149 | | | | |
| **[Hired through ORJ]** | | | | | | |
| Staff Agency | 12/12 Act | 512 | 694 | 498 | 511 | 2,215 |
| | 12/13 CE | 350 | 462 | 547 | 389 | 1,748 |
| | 12/13 Act | 261 | | | | |

*Source: Compiled by Trias Corporation from Company IR materials*

***Note: New operating segment reporting classifications were announced on 1Q results; the initial estimate for Manufacturing Outsourcing was Q1 contract workers 7,502. The total of Manufacturing and Engineering Outsourcing was 7,410.***

## [Table 13] Hiring Plan for FY12/13

| | FY12/12 Actual | Q1.13 CE | Q2.13 CE | Q3.13 CE | Q4.13 CE | FY12/13 CE |
|---|---|---|---|---|---|---|
| **[Temp & contract workers]** | | | | | | |
| Number recruited (persons) | 6,789 | 948 | 1,672 | 1,818 | 1,070 | 5,508 |
| Hiring cost (¥/person) | 49,443 | 48,000 | 45,000 | 44,000 | 42,500 | 44,701 |
| % remaining 2 months | 65.9% | 69.0% | 70.5% | 71.0% | 72.5% | 70.8% |
| Hiring cost for remaining | 75,027 | 69,565 | 63,830 | 61,972 | 58,621 | 63,141 |
| **[Paid introductions]** | | | | | | |
| Number recruited (persons) | 2,139 | 350 | 462 | 547 | 389 | 1,748 |
| Hiring cost (¥/person) | 109,807 | 120,000 | 113,000 | 106,000 | 100,000 | 109,318 |
| **[Engineers and others]** | | | | | | |
| Number recruited (persons) | 578 | 258 | 373 | 306 | 292 | 1,229 |
| Hiring cost (¥/person) | 226,998 | 316,547 | 211,823 | 221,761 | 210,993 | 236,085 |

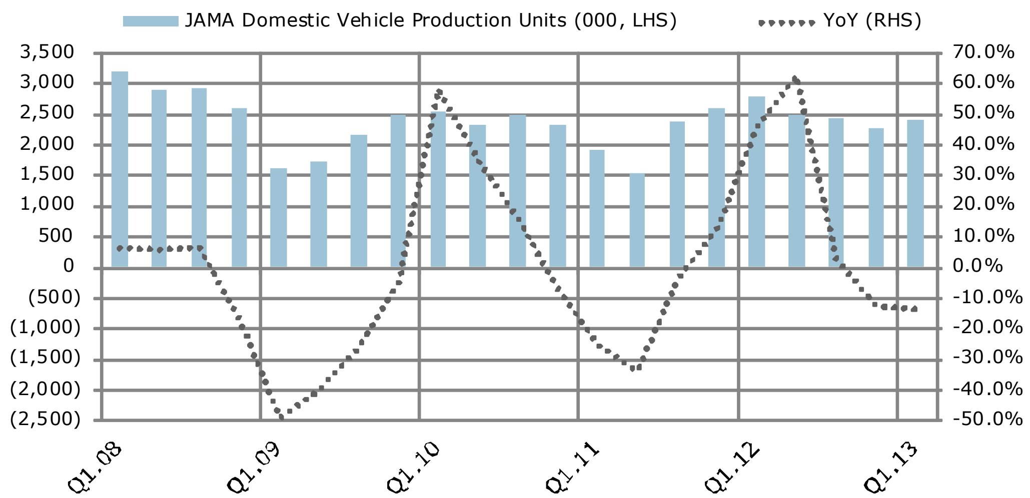
*Source: Company IR materials; Note: CE=Company Estimates*

## TOPIC

### Diversification Driving Sustainable Growth: Focus Initiatives for FY12/13

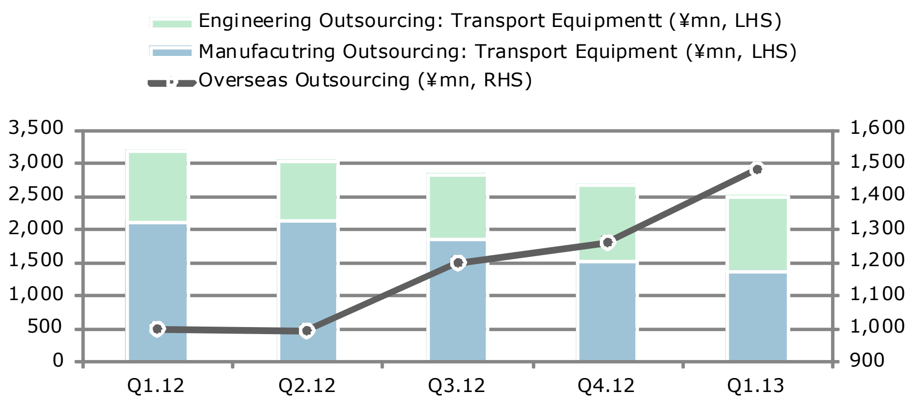
In recent discussions with several overseas investors, it has come to our attention that there are some common misconceptions regarding autos sector outsourcing demand. Specifically, that the level of domestic auto production is a proxy for auto sector outsourcing demand. To be sure, there is some correlation, but in actual experience, demand for outsourcing arises from 1) long-term structural changes of domestic manufacturers needing to diversify the work force, and 2) short-term production overflows.

## [Graph1] Misconception regarding autos sector outsourcing demand



Graph 1 shows that other than the ramp-up post-Lehman, the trend of Transport Equipment Outsourcing is not strongly correlated with the trend or level of domestic auto production. The case in point is in Q1 (Jan-Mar) domestic auto production declined 14% YoY, however total Transport Equipment outsourcing declined a much worse 22% YoY. In the current quarter (Apr-Jun) domestic auto production is running at roughly -6%, and the Company is reporting brisk demand.

- **[Graph 2] Engineering Outsourcing has risen from 33% to 45% of Transport Equipment**




*Source: Compiled by Trias Corporation from Company IR materials and JAMA monthly data*

Graph 2 provides some valuable insights into what is actually happening with Transport Equipment. While Manufacturing Outsourcing declined 36% YoY in Q1, Engineering Outsourcing actually rose 5% YoY. More importantly, Overseas Business continues to grow at nearly 50% YoY, which includes Transport Equipment major customers.

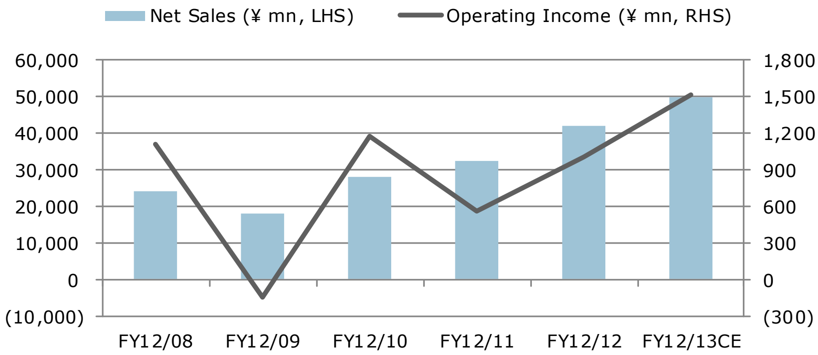
**Key focus initiatives for FY12/13 include: 1) diversification into sectors not influenced by high volatility from the busy/slack manufacturing cycle, 2) continue to strengthen overseas expansion, 3) leverage group synergies and provide total client solutions that respond to changes in the legal and regulatory framework (CSL acquisition etc), and 4) increase hiring efficiency (stay after 2 months).**

## [Table 14] High Growth Driven by Diversification Sectors and Overseas Expansion

| ¥ mn | Q1.13 Act | Q2.13 CE | Q3.13 CE | Q4.13 CE | FY12/13 CE | YoY |
|---|---|---|---|---|---|---|
| IT engineers | 1,344 | 1,390 | 1,766 | 1,800 | 6,300 | 127.5% |
| Construction & Plant-related | 72 | 125 | 300 | 403 | 900 | new |
| After-services Maintenance | 34 | 163 | 491 | 312 | 1,000 | new |
| **Non-busy/slack cycle total** | **1,450** | **1,678** | **2,557** | **2,515** | **8,200** | **196.1%** |
| **Overseas Business** | **1,513** | **1,835** | **1,910** | **2,001** | **7,250** | **62.8%** |

*Source: Compiled by Trias Corporation from Company IR materials; CE=Company Estimates*

## [Graph 3] Despite the Financial Crisis, 5YR CAGR: Net Sales +15.7%, Operating Income +6.4%




*Source: Compiled by Trias Corporation from Company IR materials*

As financial analysts it is often easy to get bogged down in analyzing details, and “miss the forest for the trees”. Taking a step back and looking at the big picture, despite the financial crisis, which resulted in a massive drop in production due to the negative impacts of the credit squeeze, OUTSOURCING Inc net sales only declined 25% in FY12/09, rising by 58% a year later, and exceeding the pre-Lehman sales level by over 17%. While FY12/11 incomes were negatively impacted by increased hiring costs as a result of massive disruptions following the disaster in March, the Company has continued to grow both its sales and profits over the last 5 years.

We believe this achievement was the result of top management’s decision to invest heavily in times of crisis, viewing them as substantial business opportunities, and ongoing commitment to rapid overseas expansion, diversification into new fields not influenced by high volatility of the busy/slack production cycle, and M&A targeting total solutions to meet client needs in the changing legal and regulatory environment. Going forward, heavy investment needs should slow, which will lead to higher margins as the company reaps a return on these leading investments. As Chairman Doi often reminds us, the Company’s mission is to meet the sophisticated needs of its clients while contributing to employment in society, and he has not hesitated to invest in future growth opportunities.

## Reference

### Key Financial Data and Business Results (Consolidated)

| | | |
|---|---|---|
| No. of Shares Issued | Dec-12 | 15,569,800 |
| No. of Treasury Stock | Dec-12 | 1,139,500 |
| Market Value (¥mn) | 19-Aug-13 | 12,253 |
| BPS (¥) | Sep-12 | 283.2 |
| ROE (%) | Sep-12 | 15.7 |
| ROA (%) | Sep-12 | 4.7 |
| PER (times) | FY12/13 fcst. | 11.4 |
| PCFR (times) | Dec-12 | 12.7 |
| PBR (times) | Dec-12 | 2.8 |
| Share Price (¥) | 19-Aug-13 | 787 |
| Unit Share (shares) | 19-Aug-13 | 100 |
| Average Daily Volume (shs) | 19-Aug-13 | 127,432 |

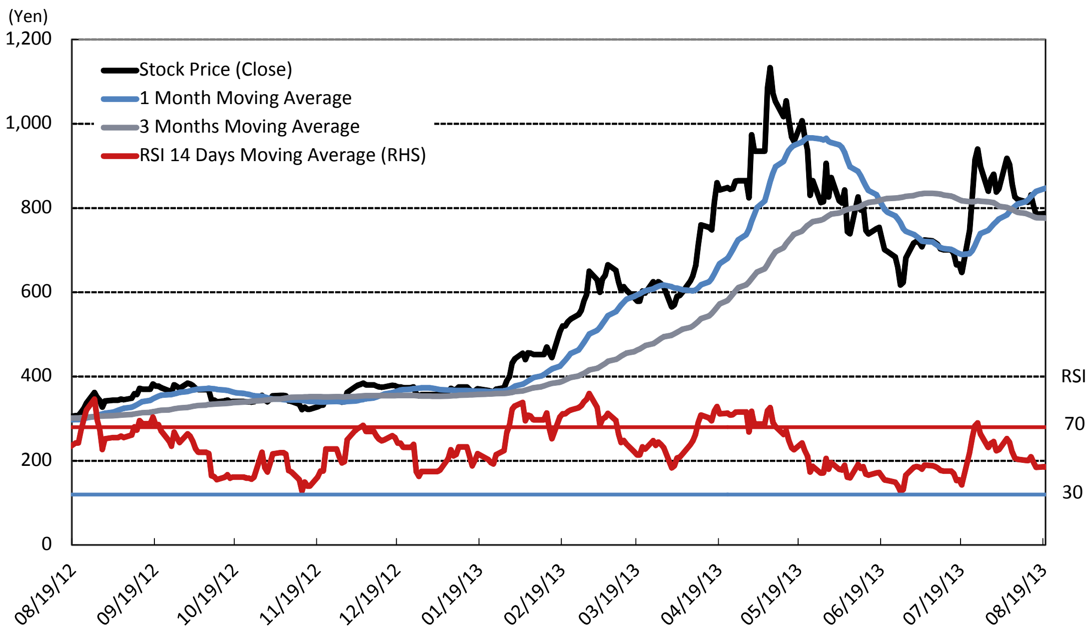
| | | |
|---|---|---|
| Total Assets (¥mn) | Dec-12 | 13,866 |
| Shareholders' Equity (¥mn) | Dec-12 | 4,087 |
| Interest-Bearing Debt (¥mn) | Dec-12 | 4,502 |
| Equity Ratio (%) | Dec-12 | 29.5 |
| Ratio of Interest-Bearing Debt (%) | Dec-12 | 110.2 |
| Free Cash Flows (¥mn) | Dec-12 | 306 |

ROE = Net Income ÷ Shareholders' Equity
ROA = Net Income ÷ Total Assets
PCFR = Maket Value ÷ (Net Income+Depreciation)
Ave. Daily Vol. = Ave. Daily Vol. for the last 12 months
Interest-Bearing Debts* Ratio = I.B.D. ÷ Shareholders' Equi
*Incl. current portion of accounts payable-installment purch
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 |
| FY12/12 | 42,090 | 1,000 | 1,153 | 641 | 44.46 | 8.00 |
| FY12/13 1H fcst. | 22,330 | 265 | 300 | 155 | 10.74 | 5.00 |
| FY12/13 Full Year fcst. | 50,000 | 1,520 | 1,590 | 1,000 | 69.29 | 13.00 |

Note: FY12/13 forecasts announced on April 26, 2013

### 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