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OUTSOURCING Inc.

Q3 FY12/17 Financial Results and Follow-up Interview

OUTSOURCING Inc., hereafter the "Company" or the "OS Group," announced its Q3 FY12/17 financial results, and Trias Corporation conducted an interview with Executive Vice President Kazuhiko Suzuki. The following is a summary of the results and the interview.

Q3 FY12/17 Consolidated Financial Results

Cumulative Q3 FY12/17 (Jan.-Sep.; Q3 YTD) consolidated financial results again delivered sharp YoY gains in both revenue and profits, also exceeding its initial forecasts disclosed on February 14, 2017. Revenue recorded a historic high for the eight consecutive years for the Company's first nine months of its fiscal year. Its domestic dispatching businesses sustained strong growth on the back of tight labor market where Japan's overall jobs-to-applicants ratio reached 1.52 times for the first time in 43 years in every month of the July-September quarter. Overseas businesses also enjoyed addition of newly consolidated subsidiaries acquired through active M&A transactions since April 2016. While new consolidation effects is gradually fading, organic growth has become evident. The Company says the managerial environment for Q3 (Jul.-Sep.) was more favorable than it had anticipated.

As Table 1 on page 2 shows, Q3 YTD consolidated performance showed sharp growth. Revenue stood at ¥165,515 million (up 77.4% YoY), gross profit ¥31,753 million (up 68.6% YoY), operating profit ¥6,857 million (up 73.8% YoY), profit before tax ¥6,336 million (up 116.1% YoY), and profit attributable to owners of the Company (hereafter "net profit") ¥3,420 million (up 135.6% YoY). It should be noted that the Company applies the International Financial Reporting Standards (IFRS) from FY12/17, and FY12/16 numbers are retroactively restated on the IFRS basis.

Q3 YTD results surpassed the initial forecasts—revenue ¥152,000 million and operating profit ¥5,880 million—by roughly ¥13.5 billion and ¥1.0 billion, respectively.

Overseas Manufacturing and Service Operations Outsourcing Business was particularly stronger among major segments: Revenue topped the forecast by some ¥5.6 billion while operating profit before consolidation adjustments ("pre-adjusted operating profit") also by more than ¥0.8 billion. Domestic Service Operations Outsourcing Business also fared better by roughly ¥1.6 billion and ¥0.4 billion respectively, as service operations at US military facilities started to contribute in earnest from FY12/17. On the other hand, pre-adjusted operating profit from the major domestic outsourcing segments fell short by ¥1.4 billion and more in aggregate; nearly ¥1.0 billion for Manufacturing and

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slightly less than ¥0.5 billion for Engineering.

These shortages, however, were rather superficial than material, as major factors behind were allocation of headquarters function expenses, all of which were originally included in consolidated adjustment account in the initial forecasts. At the close of Q3 book, these expenses were allocated to two segments: Domestic Manufacturing Outsourcing Business and Domestic Engineering Outsourcing Business. In fact, the consolidation adjustment account amounted roughly ¥1.1 billion less than initially estimated. Therefore, the actual shortage turns out to be around ¥0.3 billion, which is explained by increased recruiting and labor expenses associated with more-than-planned hires of worksite employees during the period. In other words, these additional costs can be regarded as frontloaded investment aiming for growth in future revenue and profit.

[Table 1] Summary of Q3 FY12/17 Consolidated Financial Results

(¥ million)	FY12/16	FY12/17			FY12/16	FY12/17		
	Q3	Q3	YoY Changes		Q3 YTD	Q3 YTD	YoY Changes	
	Actual	Actual	Amount	Ratio	Actual	Actual	Amount	Ratio
Revenue	35,927	59,704	23,777	66.2%	93,307	165,515	72,208	77.4%
Cost of sales	28,431	47,727	19,296	67.9%	74,473	133,762	59,289	79.6%
Gross profit	7,496	11,977	4,481	59.8%	18,834	31,753	12,918	68.6%
Ratio of gross profit	*20.9%*	*20.1%*	-	*- 0.8pp*	*20.2%*	*19.2%*	-	*- 1.0pp*
SG&A expenses	6,006	8,864	2,858	47.6%	15,378	25,265	9,887	64.3%
Ratio of SG&A expenses	*16.7%*	*14.8%*	-	*- 1.9pp*	*16.5%*	*15.3%*	-	*- 1.2pp*
Operating profit	1,580	3,295	1,715	108.6%	3,947	6,857	2,911	73.8%
Ratio of operating profit	*4.4%*	*5.5%*	-	*+1.1pp*	*4.2%*	*4.1%*	-	*- 0.1pp*
Profit before tax	1,400	3,095	1,695	121.0%	2,931	6,336	3,404	116.1%
Ratio of profit before tax	*3.9%*	*5.2%*	-	*+1.3pp*	*3.1%*	*3.8%*	-	*+0.7pp*
Profit for the period	890	2,100	1,210	135.9%	1,612	3,979	2,367	146.8%
Profit attributable to owners of the Company	802	1,891	1,089	135.8%	1,452	3,420	1,968	135.6%
Ratio of profit attributable to owners of the Company	*2.2%*	*3.2%*	-	*+1.0pp*	*1.6%*	*2.1%*	-	*+0.5pp*

Source: Compiled by Trias Corporation from the Company IR materials
Note: The amounts shown are rounded off to the nearest million yen.

The overall consolidated ratio of gross profit narrowed from 20.2% in Q3 FY12/16 to 19.2%. Domestic outsourcing businesses for Manufacturing and Engineering largely maintained their ratio of gross profit at the year earlier levels as higher labor expenses resulted from sharply increased hires were offset by rising dispatching contract prices per head. Meanwhile, the ratio of gross profit for overall overseas businesses declined due to dilution of profit margins as new consolidations of larger scale subsidiaries resulted in changes in business mixtures.

SG&A expenses rose sharply by ¥9,887 million, or by 64.3% YoY, though its percentage to revenue ("SG&A expenses ratio") improved from 16.5% in Q3 FY12/16 to 15.3%. The better ratio is attributed to economies of scale from overall revenue growth as well as new consolidation of overseas subsidiaries with low SG&A expenses ratios.

Still, heavy expenses weighed on owing to the transition to the IFRS and also the growing number of consolidated subsidiaries. Newly consolidated subsidiaries adopted the accounting standard anew

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and all the existing group companies were restated on the IFRS basis their Q1-Q3 FY12/16 results which were previously compliant to the Japanese GAAP (J-GAAP). The Company also reinforced its support and administration backup staffs at its headquarters as the number of consolidated firms increased. In addition, recruiting expenses for worksite employees rose from ¥1,145 million in Q3 FY12/16 to ¥1,764 million after the Company proactively hired them on the back of stronger-than-expected business performance.

The Q3 consolidation adjustment account decreased noticeably from ¥913 million in Q3 FY12/16 to ¥342 million thanks mainly to the transition to the IFRS. Goodwill assets previously based on the J-GAAP is now separated into IFRS-based goodwill assets (no amortization required) and intangible assets (amortization required), and this leaves the items subject to amortization being only purchase price allocation (PPA). On the other hand, M&A related expenses (e.g. legal-related expenses and consulting fees), which must be posted as SG&A expenses time to time, decreased from ¥904 million for Q3 FY12/16 to ¥296 million as the Company plans no large-scale M&A deals in FY12/17, leading directly to the decline in the consolidation adjustment amount.

Operating profit jumped by 73.8% from ¥3,947 million in Q3 FY12/16 to ¥6,857 million while its ratio to revenue declined marginally from 4.2% to 4.1%. Negative impacts from transitory cost increases caused by new consolidation and transition to the IFRS were mostly offset by better profitability from intrinsic operations.

Ratio of operating profit before consolidation adjustments (hereafter "ratio of pre-adjusted operating profit") also narrowed from 5.1% in Q3 FY12/16 to 4.2%. By operating segment, Overseas Manufacturing and Service Operations Outsourcing Business contributed to a significant extent while major domestic operations suffered from heavier cost burden incurred by allocated overhead expenses for headquarters function (*1).

(*1) The headquarters function expenses include those incurred at the parent company for consolidation procedures and more vigorous governance for overseas subsidiaries, as well as transition to IFRS. This Q1-Q3 in particular, significant amounts of related expenses including labor expenses were incurred as restatement work from J-GAAP to IFRS for past two fiscal years (FY12/15 and FY12/16) as well as each quarter for FY12/16 concentrated, and also as the number of consolidated subsidiaries increased sharply. In the initial forecasts, these expected amounts were counted in consolidation adjustments, and when Q3 closed they were subsequently allocated to corresponding segments, namely Domestic Engineering Outsourcing Business and Domestic Manufacturing Outsourcing Business, where the impacts were substantial.

Net negative balance of the financial profits/losses account improved substantially by some ¥0.5 billion, from ¥1,016 million for Q3 FY12/16 to ¥521 million. Positive factors include loan repayments backed by an equity finance and forex conversion of overseas financial assets and loans. Based on the IFRS, non-operating and extraordinary accounting items separately disclosed in the J-GAAP profit and loss statements are included in operating profit except for the net financial account balance.

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As a result, profit before tax jumped from ¥2,931 million in Q3 FY12/16 to ¥6,336 million, or up about 2.2 times YoY, and net profit soared from ¥1,452 million to ¥3,420 million.

To characterize the Q3 alone (Jul.-Sep.), (i) pre-adjusted operating profit for both Domestic Engineering and Manufacturing Outsourcing Businesses, which had decreased YoY in 1H, turned to increase YoY; (ii) Overseas Manufacturing and Service Operations Outsourcing Business sharply increased its profit despite fading new consolidation effects; and (iii) the consolidation adjustment of operating profit contributed to the overall profit growth much more compared to 1H.

For FY12/17, YoY revenue growths are moderating quarter by quarter. As Table 2 shows YoY growth ratio decreased from 102.6% in Q1 to 66.2% in Q3. This is because contribution from newly acquired subsidiaries has been diminishing sequentially. In contrast, YoY operating profit growth once slowed from 127.9% in Q1 to 22.1% in Q2, but again sharply amplified to 108.6% in Q3. Significant contribution to the jump was largely from overseas businesses despite their new consolidation effects fading as are elaborated later for each segment.

As a result, the ratio of operating profit has improved from 2.9% in Q1 to 3.8% in Q2 and 5.5% in Q3, with a remarkable improvement seen moving from Q2 to Q3.

Operating profit also accelerated its QoQ growth from 46.2% in Q2, when AMERICAN ENGINEERING CORPORATION (hereafter "AEC"; belonging to Domestic Service Operations Outsourcing Business) was newly consolidated, to 55.8% in Q3 even without any new subsidiary additions. This acceleration was mainly driven by Overseas Manufacturing and Service Operations Business and Domestic Engineering Outsourcing Business. Some seasonal factors, which will be studied later, also contributed to the growth, while a steady organic growth apparently underlies the development.

● [Table 2] YoY and QoQ Changes for Q1-Q3 FY12/17 Quarterly Results

(¥ million)	FY12/17			FY12/17			FY12/17	
	Q1	Q2	Q3	YoY Changes			QoQ Changes	
	Actual	Actual	Actual	Q1	Q2	Q3	Q2/Q1	Q3/Q2
Revenue	50,238	55,573	59,704	102.6%	70.6%	66.2%	10.6%	7.4%
Operating profit	1,447	2,115	3,295	127.9%	22.1%	108.6%	46.2%	55.8%
Ratio of operating profit	2.9%	3.8%	5.5%	-	-	-	-	-

Source: Compiled by Trias Corporation from the Company IR materials

Note: The amounts shown are rounded off to the nearest million yen.

Summary of statement of financial position (equivalent to J-GAAP balance sheet) at the end of Q3 FY12/17 is shown in Table 3 on page 5. Total assets stood at ¥120,542 million at the Q3 end, increasing by ¥30,187 million, or by 33.4% from the end of FY12/16. An increase of some ¥11.0 billion mainly for goodwill and current assets resulted from German subsidiary Orizon Holding GmbH (hereafter "Orizon"; belonging to Overseas Manufacturing and Service Operations Outsourcing

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Business) which was newly consolidated on January 4, 2017, while a similar increase of some ¥10.0 billion came from AEC which was consolidated in April, 2017.

● [Table 3] Summary of Consolidated Statement of Financial Position at the End of Q3 FY12/17

(¥ million)	FY12/16-End		Q3-End FY12/17		YoY Changes	
	Amount	Composition Ratio	Amount	Composition Ratio	Amount	Major Factors
Current assets	**36,251**	**40.1%**	**56,324**	**46.7%**	**20,074**	
Cash and cash equivalents	11,746	13.0%	18,125	15.0%	6,379	
Trade and other receivables	21,006	23.2%	32,671	27.1%	11,666	Increased due to acquisition of subsidiaries' shares and expansion of business scale
Non-current assets	**54,104**	**59.9%**	**64,218**	**53.3%**	**10,113**	
Property, plant and equipment	4,994	5.5%	6,777	5.6%	1,782	
Goodwill	26,315	29.1%	40,631	33.7%	14,316	Increased due to acquisition of subsidiaries' shares
Intangible assets	8,640	9.6%	8,421	7.0%	(220)	
Other non-current financial assets	9,671	10.7%	2,585	2.1%	(7,086)	
Total assets	**90,355**	**100.0%**	**120,542**	**100.0%**	**30,187**	
Current liabilities	**45,319**	**50.2%**	**54,152**	**44.9%**	**8,833**	
Trade and other payables	13,763	15.2%	24,619	20.4%	10,856	
Bonds and borrowings	24,375	27.0%	18,259	15.1%	(6,117)	Increased due to acquisition of subsidiaries' shares and expansion of business scale
Income tax payables	948	1.0%	4,124	3.4%	3,177	
Non-current liabilities	**30,104**	**33.3%**	**38,476**	**31.9%**	**8,373**	
Bonds and borrowings	21,114	23.4%	29,573	24.5%	8,460	
Total liabilities	**75,423**	**83.5%**	**92,628**	**76.8%**	**17,206**	
Equity attributable to owners of the Company	**12,630**	**14.0%**	**26,145**	**21.7%**	**13,515**	Increased due to exercise of the subscription rights to shares
Equity	**14,932**	**16.5%**	**27,914**	**23.2%**	**12,982**	
Total liabilities and equity	**90,355**	**100.0%**	**120,542**	**100.0%**	**30,187**	

Source: Compiled by Trias Corporation from the Company IR materials
Note: The amounts shown are rounded off to the nearest million yen.

On the assets side, a major change is seen in goodwill assets increasing by ¥14,316 million from ¥26,315 million at the end of FY12/16 to ¥40,631 million. Orizon and AEC were the main factors behind the increase. Also, trade and other receivables rose by ¥11,666 million due to overall business expansion and new consolidation. "Other financial assets" under non-current assets (equivalent to non-current assets under the J-GAAP) decreased by ¥7,086 million as a bank deposit prepared for the Orizon acquisition at the end of FY12/16 was eventually paid out after the completion of the deal.

On the liabilities and equity side, trade and other payables increased by ¥10,856 million for the same reason as for trade and other receivables. Equity increased by ¥12,982 million after share warrants

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issued in January 2017 were partly converted to the Company's common shares. As a result, the ratio of equity attributable to owners of the Company to total assets (i.e., equity ratio) rose from 14.0% at the end of FY12/16 to 21.7%.

For a reference, the transition to the IFRS from the J-GAAP caused the total assets at the end of FY12/16 to inflate from ¥82,034 million to ¥90,355 million, an increase of some ¥8.3 billion. The main factor behind the increase was retroactive add-backs in compliance with the IFRS of cumulative goodwill amortization having been booked since FY12/14.

Summary for FY12/17 Consolidated Financial Forecasts

The Company left its consolidated full-year forecasts unchanged for FY12/17 from its initial projection. Sharp increases in revenue and profits are forecast to continue thanks to growth in domestic operations and contribution from newly consolidated subsidiaries both domestically and overseas. The Company plans to basically refrain from large-scale M&A transactions in FY12/17 and FY12/18, as it positions the two fiscal years for building a strong foothold in order to achieve its Medium-Term Management Plans set forth toward the year 2020. The Company decisively intends to focus on strengthening governance at subsidiaries acquired to date, building synergies among them, and preparing for another takeoff in the latter half of the Plan.

Table 4 shows Company's full-year forecasts for FY12/17 financial performance. It expects revenue to increase by 58.6% YoY to ¥213,000 million. Profits are forecast to grow by at least 70% YoY at all the levels, with operating profit at ¥9,500 million (up 70.8% YoY), profit before tax at ¥8,900 million (up 82.4% YoY) and net profit at ¥5,100 million (up 71.3% YoY).

● [Table 4] FY12/16 Actual Results and FY12/17 Forecasts (IFRS)

(¥ million)	FY12/16 Full-Year Actual	FY12/17 Full-Year Forecasts	YoY Changes	
			Amount	Ratio
Revenue	**134,283**	**213,000**	**78,717**	**58.6%**
Cost of sales	106,519	-	-	-
Gross profit	27,764	-	-	-
Ratio of gross profit	*20.7%*	-	-	-
SG&A expenses	21,649	-	-	-
Ratio of SG&A expenses	*16.1%*	-	-	-
Operating Profit	**5,563**	**9,500**	**3,937**	**70.8%**
Ratio of operating profit	*4.1%*	*4.5%*	-	*+0.4pp*
Profit before tax	**4,879**	**8,900**	**4,021**	**82.4%**
Ratio of profit before tax	*3.6%*	*4.2%*	-	*+0.6pp*
Profit for the year	**3,388**	**5,800**	**2,412**	**71.2%**
Profit attributable to owners of the Company	**2,977**	**5,100**	**2,122**	**71.3%**
Ratio of profit attributable to owners of the Company	*2.2%*	*2.4%*	-	*+0.2pp*

Source: Compiled by Trias Corporation from the Company IR materials
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To note quickly, however, Q3 cumulative results have already surpassed revenue by roughly ¥13.5 billion and operating profit by almost ¥1.0 billion compared to the initial forecasts. If Q4 (Oct.-Dec.) performance is in line with the Company's quarterly forecasts, full-year revenue should be roughly ¥226.5 billion and operating profit roughly ¥10.5 billion, after each quarter up to Q3 having topped its respective forecasts. Nonetheless, the Company kept the initial forecasts intact by maintaining its vigilant stance, "referring to yet rising political and economic uncertainties ahead on a global scale."

The revenue increase is broken down to the existing and the newly consolidated businesses as are seen in Table 5. On top of organic growth in existing businesses, newly consolidated subsidiaries in Domestic Manufacturing Outsourcing Business and two overseas segments should be fully contributing for 12 months. Newly consolidated subsidiaries in 2017 were: Orizon from January and AEC from April.

The segment most significantly contributing to the revenue increase is Overseas Manufacturing and Service Operations Outsourcing Business with roughly ¥47.5 billion YoY growth which accounts for as much as 60% of the overall consolidated growth. The next are three domestic operations—engineering, manufacturing and service operations outsourcing businesses—each expected to increase revenue by some ¥9.0 billion YoY. (For details on trends by key operating segment, please refer to page 8.)

● [Table 5] Breakdown of FY12/17 Revenue Increase by Existing and Newly Consolidated Businesses (IFRS)

(¥ billion)	FY12/16 Actual	FY12/17 Forecasts	YoY Changes
Domestic Engineering Outsourcing Business	40.2	48.7	8.5
Domestic Manufacturing/Administrative Outsourcing Business (total)	35.5	45.6	10.1
Overseas Business (total)	53.2	70.2	17.0
Dispatching business such as for welfare facilities in the US military base	5.4	6.6	1.2
Existing Business Total	134.4	171.1	36.7
Orizon Holding GmbH (Orizon)	-	34.3	34.3
AMERICAN ENGINEERING CORPORATION (AEC)	-	7.6	7.6
New Cosolidation Total	-	41.9	41.9
Existing Business + New Consolidation	134.4	213.0	78.6

Source: Compiled by Trias Corporation from the Company IR materials

Consolidated operating profit is forecast to jump by 70.8% YoY from ¥5,563 million for FY12/16 to ¥9,500 million for this fiscal year, leading the ratio of operating profit to widen from 4.1% to 4.5%. Looking at significance from each segment to the growth in overall pre-adjusted operating profit (up 64.5% YoY), Overseas Manufacturing and Service Operations Outsourcing Business consists of 35.9%, the largest among segments boosted by newly consolidated operations, while the domestic two mainstay segments account for more than 20% each thanks to favorable demand.

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Consolidation adjustments, a subtraction factor from the overall consolidated operating profit, is estimated to increase from ¥1,471 million in FY12/16 to ¥2,071 million in FY12/17. However, headquarters-function expenses and PPA amortization, which account for the most part of the adjustments, will be ultimately assigned to individual segments as was seen up to Q3. At the same time, M&A related expenses, also included in the adjustments, should be insignificant due to the Company's aforementioned stance to withhold large-scale acquisitions this term.

Profit before tax and subsequent profit items are all forecast to jump by more than 70% YoY, similar to the operating profit. Under the J-GAAP adopted up to FY12/16, nominal net profits were excessively small, or distorted, as official tax calculations did not allow M&A related expenses to be deducted as a loss, but this impact will be much alleviated due to the Company's stance of withholding large-scale M&A deals.

Trends by Key Operating Segment: Q3 FY12/17

Domestic businesses saw higher profits and overseas businesses sustained strong growth in Q3

Q3 performances of each segment are summarized in Table 6 on page 10. Revenue in domestic businesses continued to grow steadily thanks to a tighter labor market which led to an increase in dispatching contract unit price. Overseas businesses also saw sharp growth; while revenue growth in 1H was driven largely by positive M&A effects, revenues continued to grow notably in Q3 even after the M&A effects ran its course.

Overseas Manufacturing and Service Operations Outsourcing Business was the largest contributor in terms of revenue in Q1-Q3 due to active M&A deals conducted in FY12/16. In domestic businesses, pre-adjusted operating profit declined YoY in 1H due to temporary factors, but increased YoY in Q3.

Business trends in the major segments are as follows:

Domestic Engineering Outsourcing Business: Demand continues to be strong, with Q3 YTD revenue up 25.2% YoY and pre-adjusted operating profit also rising slightly by 1.2% YoY. Q3 profits increased 17.3% YoY, offsetting the 14.5% YoY decrease in 1H which was due to temporary factors.

Q1-Q3 profit margin dropped from 5.9% a year earlier to 4.8%. This is due to the aforementioned sharp increase in allocation of headquarter function expenses, and also to increases in upfront recruiting and personnel expenses to hire new employees, corresponding to the segment revenue expansion. However, on a quarterly basis, pre-adjusted operating profit surged from ¥411 million in Q2 to ¥991 million in Q3 as the new graduates hired in April started working at client sites. Profit margin

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also improved sharply from 3.4% in Q2 to 7.5% in Q3 significantly contributing to the increase in consolidated profits and profitability.

Q3 YTD pre-adjusted operating profit fell short of the initial plan by nearly ¥0.5 billion. This can be attributed to the allocation of expenses for headquarter functions and PPAs, which were initially allocated to the consolidated adjustment account, as well as over-budget personnel expenses due to hiring more worksite employees than planned. However, the Company regards the latter as a positive, and has raised the recruitment budget as such upfront investment should contribute to stronger growth.

By client industry, IT-related revenue (30.8% of the segment revenue) increased 11.9% YoY, Transport Equipment (24.1%) increased 20.3% YoY, and Electrical & Electronics (20.4%) increased sharply by 50.1% YoY driven mainly by clients who manufacture electrical and electronics automobile components. As for Construction & Plant-related (13.0%)—a key focus for the Company alongside IT-related—revenue grew steadily, up 27.9% YoY, bolstered by strong demand.

Domestic Manufacturing Outsourcing Business: Revenue increased sharply by 35.8% YoY, while pre-adjusted operating profit decreased from ¥1,138 million a year earlier to ¥640 million, and profit margin decreased from 4.7% to 1.9%. As mentioned, while the profit margin at the gross profit level was maintained, an increase in upfront investment for recruiting new graduates in addition to the sharp increase in allocation of headquarter function expenses weighed in. Looking at Q3 alone, however, profits rose sharply from ¥124 million in FY12/16 to ¥303 million.

Q3 YTD pre-adjusted operating profit fell short of the initial forecast of ¥1,591 million by over ¥0.9 billion. Similar to Domestic Engineering Outsourcing Business, most of this shortfall was due to increased allocation of headquarter function expenses. Also, additional costs incurred from recruiting more workers than initially planned. However, according to the Company, if one excludes headquarter function expenses, operating profit would have exceeded ¥2.4 billion, increasing roughly 20% YoY. This is because, in addition to higher dispatching contract unit prices, the PEO scheme (*2)—a new scheme and focus of the Group to effectively utilize personnel—is seeing steady progress.

(*2) The Company has been refraining from marketing activities for the traditional manufacturing dispatching business. This is because: demand is very volatile, e.g., for client production ramp-ups for new models; unit contract prices are lower than engineering by 20% or more; and using external media leads to higher recruiting expenses. Instead, the Company is devoting its efforts to the PEO scheme, which hires fixed-term contract employees of client makers whose contracts will soon expire, as regular employees of subsidiary PEO Co., Ltd., and dispatches them to other makers participating in the scheme. The Labor Contract Act requires employers to grant indefinite employee contracts for fixed-term contract employees whose contracts were signed after April 2013 and renewed repeatedly for more than 5 years and who wish to continue their work. Many of OS Group's maker clients are eager to join the scheme in order to avoid heavier fixed costs.

By client industry, Electrical & Electronics (39.6% of the segment revenue) became the largest contributor, with revenue soaring 72.9% YoY owing to the consolidation of OS Partners CO.,LTD.

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(hereafter "OS Partners"). OS Partners serves many car battery makers, and has been operating at full capacity in response to the increase in hybrid and electric car production. Transport Equipment (31.1%) revenue also increased 11.4% YoY.

●[Table 6] Summary for Q3 FY12/17 Financial Results by Operating Segment (IFRS)

(¥ million)	FY12/16 Q3 YTD Actual	FY12/17 Q3 YTD Actual	YoY Changes Amount	YoY Changes Ratio/pp	Earnings Contribution Ratio
Revenue before adjustments	**95,827**	**169,444**	**24,159**	**65.6%**	**-**
Adjustments	(2,520)	(3,929)	(1,409)	-	-
Reveue	**93,307**	**165,515**	**72,208**	**77.4%**	**100.0%**
Domestic Engineering Outsourcing (OS)	29,139	36,489	7,350	25.2%	10.2%
Domestic Manufacturing OS	24,364	33,083	8,719	35.8%	12.1%
Domestic Service Operations OS	2,454	8,437	5,983	243.8%	8.3%
Domestic Administrative OS	619	728	109	17.6%	0.2%
Domestic Recruiting and Placing	1,011	1,273	262	25.9%	0.4%
Overseas Engineering OS	14,512	21,271	6,759	46.6%	9.4%
Overseas Manufacturing and Service Operations OS	20,713	63,887	43,174	208.4%	59.8%
Other	495	347	(148)	-29.9%	-0.2%
Domestic businesses total	**58,082**	**80,357**	**22,275**	**38.4%**	**30.8%**
Overseas businesses total	**35,225**	**85,158**	**49,933**	**141.8%**	**69.2%**
Operating profit before adjustments	**4,860**	**7,199**	**2,339**	**48.1%**	**100.0%**
Domestic Engineering Outsourcing (OS)	1,714	1,734	20	1.2%	0.9%
Domestic Manufacturing OS	1,138	640	(498)	-43.8%	-21.3%
Domestic Service Operations OS	180	563	383	212.8%	16.4%
Domestic Administrative OS	181	103	(78)	-43.1%	-3.3%
Domestic Recruiting and Placing	507	392	(115)	-22.7%	-4.9%
Overseas Engineering OS	527	843	316	60.0%	13.5%
Overseas Manufacturing and Service Operations OS	608	2,908	2,300	378.3%	98.3%
Other	5	16	11	220.0%	0.5%
Domestic businesses total	**3,725**	**3,448**	**(277)**	**-7.4%**	**-11.8%**
Overseas businesses total	**1,135**	**3,751**	**2,616**	**230.5%**	**111.8%**
Ratio of operating profit before adjustments	**5.1%**	**4.2%**	**-**	**-0.8pp**	**-**
Domestic Engineering Outsourcing (OS)	5.9%	4.8%	-	-1.1pp	-
Domestic Manufacturing OS	4.7%	1.9%	-	-2.8pp	-
Domestic Service Operations OS	7.3%	6.7%	-	-0.6pp	-
Domestic Administrative OS	29.2%	14.1%	-	-15.1pp	-
Domestic Recruiting and Placing	50.1%	30.8%	-	-19.3pp	-
Overseas Engineering OS	3.6%	4.0%	-	0.4pp	-
Overseas Manufacturing and Service Operations OS	2.9%	4.6%	-	+1.7pp	-
Other	1.0%	4.6%	-	+3.6pp	-
Domestic businesses total	**6.4%**	**4.3%**	**-**	**-2.1pp**	**-**
Overseas businesses total	**3.2%**	**4.4%**	**-**	**+1.2pp**	**-**
Adjustments	(913)	(342)	384	**-**	**-**
Consolidated operating profit	**3,947**	**6,857**	**2,910**	**73.7%**	-
Ratio of consolidated operating profit	**4.2%**	**4.1%**	**-**	**-0.1pp**	-
No. of worksite employees at term-end	**No. of Employees**	**No. of Employees**	**Changed No.**	**Ratio/pp**	
Domestic Engineering OS	5,844	7,956	2,112	36.1%	-
[Utilization rate for Domestic Engineering OS]	98.3%	97.8%	-	-0.5pp	-
Domestic Manufacturing OS	9,033	10,684	1,651	18.3%	-
Domestic Service Operations OS	1,557	2,803	1,246	80.0%	-
Overseas Engineering OS	1,787	2,132	345	19.3%	-
Overseas Manufacturing and Service Operations OS	22,097	33,024	10,927	49.5%	-

Source: Compiled by Trias Corporation from the Company IR materials

Note: Overseas businesses total suggests the total of 2 overseas businesses and domestic businesses total suggests the total of the rest of the businesses.
The amounts shown are rounded off to the nearest million yen.

At this point, let us quantitatively analyze the shortfalls in pre-adjusted operating profits in Domestic Engineering Outsourcing Business and Domestic Manufacturing Outsourcing Business. As mentioned,

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the main reason for the shortfalls is that headquarter function expenses—initially allocated to the consolidated adjustment account—were allocated to these two segments in Q3. Thus, adding the pre-adjusted operating profits of the two segments to consolidated adjustments, and then comparing the initial plan with actual results should give a clearer picture of the actual shortfall.

As shown in Table 7, for Q3 YTD FY12/17, the initial forecast of adjusted operating profits for both segments totaled ¥2,350 million while the actual result was ¥2,032 million. Thus, the actual shortfall was ¥318 million. As most of this shortfall derives from an increase in personnel expenses due to hiring more workers than planned, and an increase in recruiting/offering expenses for future revenue growth, both of which are upfront investments, one can argue that once these expenses are overlooked, actual results were mostly in line with initial forecasts.

In 1H, aggregate adjusted operating profit decreased by ¥616 million from FY12/16 due to a temporary increase in headquarter function expenses, personnel expenses, and recruiting and offering expenses. However, significant rebound was achieved in Q3, increasing, albeit slightly, from ¥1,939 million in Q3 YTD FY12/16 to ¥2,032 million in Q3 YTD FY12/17.

● [Table 7] Two Domestic Outsourcing Segments: Q1-Q3 FY12/17 Initial Forecasts vs. Results

(¥ million)	FY12/16 Q3 YTD	FY12/17 Q3 YTD		
	Actual	Initial Forecasts	Actual	Difference
Operating profit before adjustments				
Domestic Engineering Outsourcing Business	1,714	2,222	1,734	(488)
Domestic Manufacturing Outsourcing Business	1,138	1,590	640	(950)
Aggregated operating profit before adjustments of above two businesses	2,852	3,812	2,374	(1,438)
Adjustments	(913)	(1462)	(342)	1,120
Aggregated adjusted operating profit of above two businesses	1,939	2,350	2,032	(318)

Source: Compiled by Trias Corporation from the Company IR materials
Note: The amounts shown are rounded off to the nearest million yen.

Overseas Manufacturing and Service Operations Outsourcing Business: The business became the largest earning segment, accounting for 38.6% of consolidated revenue and 40.4% of pre-adjusted operating profit. Compared to Q3 FY12/16, revenue increased 208.4% YoY (approximately 3.1 times) from ¥20,713 million to ¥63,887 million, and pre-adjusted operating profit soared by roughly 4.8 times from ¥608 million to ¥2,908 million. As mentioned, revenue exceeded the initial forecast by about ¥5.6 billion and pre-adjusted operating profit by more than ¥0.8 billion.

The outperformance was driven by strong local currency-based performance, as well as a weaker-than-expected yen. Q3 revenue rose 6.8% QoQ, and pre-adjusted operating profit increased markedly from ¥681 million in Q2 to ¥1,273 million, although no new subsidiaries were consolidated.

Q2 tends to experience downward pressure on both revenue and profits as paid leaves increase for major events such as May Day and Ramadan. With the absence of such impacts, Q3 profits increased

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sharply. That said, even compared to Q1, Q3 revenue increased by 8.4% and profits by 33.4%, suggesting solid organic growth as the scope of consolidated companies was the same over this period.

Four service outsourcing groups contributed to Q1-Q3 results: BEDDISON Group (Australia, *3) and OS HRS Group (Malaysia, *3), consolidated at the end April 2016, and VERACITY (U.K., *3) and LIBERATA (U.K., *3), consolidated in August 2016. Also, manufacturing outsourcing company Orizon (Germany, *3) joined in January 2017, the acquisition of which was announced in December 2016.

Pre-adjusted operating profit margin rose sharply from 2.9% in Q1-Q3 FY12/16 to 4.6%. We assume VERACITY and Orizon in particular, contributed to profits.

(*3) The outline of each company is as follows:

Abbreviation	Registered Name	Headquarters	Major Businesses	Consolidation Date
BEDDISON	BEDDISON Group	Australia	Public service oriented dispatching	Apr. 2016
OS HRS	OS HRS Group	Malaysia	Payroll accounting service	May 2016
VERACITY	VERACITY OSI UK LIMITED	the U.K.	Outsourcing services to various public bodies	Aug. 2016
LIBERATA	LIBERATA UK LIMITED	the U.K.	BPO service to governments	Aug. 2016
Orizon	Orizon Holding GmbH	Germany	Manufacturing related dispatching	Jan. 2017

Note: VERACITY OSI UK LIMITED was formerly named ALLEN LANE CONSULTANCY LIMITED (ALC) at the time of acquisition and changed its name in June 2017.

Overseas Engineering Outsourcing Business: The business expanded rapidly bolstered by consolidation of new subsidiaries as well as organic growth. Revenue jumped by 46.6% YoY from ¥14,512 million to ¥21,271 million thanks partly to contributions by BEDDISON's engineering business (*4), and J.B.W/CDL (*4). Pre-adjusted operating profit increased 60.0% YoY from ¥527 million to ¥843 million.

For Q3 alone, revenue grew by 28.7% YoY and pre-adjusted operating profit increased from ¥240 million in FY12/16 to ¥388 million. This can be regarded as solid organic growth as the scope of consolidated subsidiaries was the same. The Company says that all regions including India delivered revenue and profit growth as orders won before and after acquisitions were monetized.

As a result, pre-adjusted operating profit margin for the segment rose from 3.6% a year before to 4.0% for the Q1-Q3 total and from 4.0% to 5.0% for Q3 alone.

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(*4) The outline of each company is as follows:

Abbreviation	Registered Name	Headquarters	Major Businesses	Consolidation Date
BEDDISON	BEDDISON Group	Australia	Public IT service oriented dispatching	Apr. 2016
J.B.W./CDL	J.B.W./CDL Group	the U.K.	IT intensive collection and legal enforcement services for unpaid debts for governments	Apr. 2016

Domestic Service Operations Outsourcing Business: The business is still small in terms of size, but expected to grow rapidly with the addition of AEC, a service supplier to US military facilities, in April 2017. Revenue increased 3.4 times YoY from ¥2,454 million to ¥8,437 million, and pre-adjusted operating profit rose sharply from ¥180 million to ¥563 million. On a quarterly basis, profit increased from ¥275 million in Q2 to ¥310 million in Q3, with AEC's contribution including in both quarters.

With the acquisition of AEC, US military facilities outsourcing business is now the largest component within the segment. AEC mainly serves US military facilities in Japan with air-conditioner and electrical works, repair and maintenance of military facilities, and associated services, contributing to a substantial expansion of the Company's service offerings for US military facilities. The Company also plans to extend this business to US military facilities in other regions such as Guam and Hawaii.

Q3 YTD pre-adjusted operating profit was ¥563 million, already exceeding the initial full-year forecast of ¥492 million. Initially, AEC was expected to incur more expenses from reviewing accounting and administration methods as well as reinforcing governance in line with OS Group's policies. Instead, profits were boosted by shifting from an accounting method of recognizing revenue and profits based on completed contracts to the percentage of completion. Revenue and profits are also growing in businesses other than for US military facilities.

Aside from the segments above, **Domestic Administrative Outsourcing** and **Domestic Recruiting and Placing Businesses** saw profits decline YoY. Both were results of special factors: the former due to frontloaded costs incurred from shifting the target from Japanese to foreign technical intern trainees, and the latter due to certain clients transitioning from recruiting and placing to the PEO scheme.

Overall, as shown in Table 6 on page 10, in domestic businesses, total revenue increased 38.4% YoY while total pre-adjusted operating profit decreased 7.4% YoY. Meanwhile, the two overseas segments grew sharply despite diminishing M&A effects, with total revenue increasing 141.8% (approximately 2.4 times) YoY and pre-adjusted operating profit increasing 230.5% (approximately 3.3 times) YoY. Operating profit margin for domestic businesses declined from 6.4% in Q1-Q3 FY12/16 to 4.3% while that for overseas businesses rose from 3.2% to 4.4%.

Based on each segment's contribution to consolidated pre-adjusted operating profit (i.e., the change in each segment's profit divided by the change in consolidated profits), the largest contributors were Overseas Manufacturing and Service Operations Outsourcing Business (98.3%), followed by

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Domestic Service Operations Outsourcing Business (16.4%) and Overseas Engineering Outsourcing Business (13.5%).

Consolidated adjustment, a negative factor to profits, declined from ¥913 million in Q3 FY12/16 to ¥342 million. Under IFRS, goodwill assets are not amortized on a straight-line basis, but instead, the market value of acquired subsidiaries is assessed on a timely basis (i.e. goodwill impairment test). Accordingly, consolidated adjustment decreases significantly compared to J-GAAP accounting where amortization aside from PPA increases in parallel with goodwill.

Trends by Key Operating Segment: FY12/17 Forecasts

Significant growth in revenues and profits are expected for the full-year driven by organic growth and consolidation of new subsidiaries

Table 8 on page 16 summarizes FY12/17 forecasts for each segment. While profits from domestic businesses were weak in 1H, significant growth is projected for the full-year. Revenues from overseas businesses should continue to grow rapidly owing to positive effects from new subsidiaries and organic growth of existing businesses.

As mentioned, revenues for Q1-Q3 have already exceeded expectations, so initial forecasts should be achieved with ease unless an unexpected event occurs. As effects from consolidating new subsidiaries in overseas businesses diminish toward the year-end, the Company expects domestic businesses to contribute more to consolidated profits. However, performances may vary between segments due to the aforementioned increase in upfront recruitment expenses.

Domestic Engineering Outsourcing Business: Revenue is expected to increase 21.1% YoY, and pre-adjusted operating profit 32.1% YoY. Demand should remain strong particularly in Electrical & Electronics, IT-related and Transport Equipment. Pre-adjusted segment operating profit margin is projected to rise from 7.3% in FY12/16 to 8.0%, but may fall short due to the heavier allocation of headquarter function expenses.

The Company plans to further increase the number of worksite employees to 8,456 by FY12/17-end from 6,066 at FY12/16-end. Aside from recruiting some 550 new graduates, the Company will continue to proactively utilize the KEN School scheme.

Domestic Manufacturing Outsourcing Business: Revenue is expected to increase 28.6% YoY and pre-adjusted operating profit 75.3% YoY, but again, profit could fall short due to heavier allocations of headquarter function expenses. OS Partners, fully consolidated in FY12/17, will contribute significantly to revenue and profit growth. By client industry, Electrical & Electronics and Transport Equipment is

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expected to grow rapidly on the back of strong demand for auto-related products such as batteries. For the time being, pre-adjusted operating profit margin is projected to rise from 3.8% in FY12/16 to 5.2%.

The Company plans to increase worksite employee from 9,033 at FY12/16-end to 13,097 by FY12/17-end. As described in (*2) on page 9, the grace period of the Labor Contract Act expires at the end of March 2018. Thus, transfer of enrollment from client companies may gradually advance.

Domestic Service Operations Outsourcing Business: Revenue should soar from ¥3,470 million in FY12/16 to ¥12,101 million. AEC, consolidated on April 3, 2017, will add ¥7.6 billion to revenue. The number of worksite employees is expected to increase sharply to 3,836 by FY12/17-end from 1,609 at FY12/16-end.

Operating profit/loss is expected to turn around significantly from a loss of ¥258 million in FY12/16 to a profit of ¥492 million, mainly owing to contribution by AEC. Accordingly, pre-adjusted operating profit margin should improve 11.5% points YoY to 4.1%. Full-year results are set to exceed forecasts, since Q3 YTD profit was ¥564 million, already surpassing forecasts.

Overseas Engineering Outsourcing Business: Revenue is projected to increase 18.2% YoY and pre-adjusted operating profit 68.2% YoY. While BEDDISON's engineering business and J.B.W./CDL, both consolidated in April 2016, should contribute to this growth, both businesses are not so large in scale, so most of the growth should be attributed to organic growth. Pre-adjusted operating profit margin should rise from 3.3% in FY12/16 to 4.7%.

Overseas Manufacturing and Service Operations Outsourcing Business: Revenue is anticipated to increase by roughly 2.5 times YoY and operating profit by roughly 2.2 times YoY, driving consolidated revenue and profit growth. The aforementioned four groups including BEDDISON have contributed to results during Q1-Q3, and Orizon, consolidated in January 2017, should also add ¥34.3 billion to revenue. Full-year results are likely to surprise largely to the upside since Q3 YTD operating profit was ¥2,908 million and is already nearing the full-term forecast of ¥3,007 million.

Pre-adjusted operating profit margin is estimated to narrow from 4.3% in FY12/16 to 3.8% in FY12/17. While profit margin improved impressively in FY12/16 thanks to contributions from highly profitable subsidiaries such as OS HRS and VERACITY, profit margin in FY12/17 will be diluted due to the change in revenue and profit composition from consolidating new subsidiaries.

Other Businesses: Operating loss of ¥298 million is expected, most likely due to upfront costs for establishing a joint-venture aimed to incorporate small- and medium-sized dispatching business operators subject to an industry shakeout.

Overall, total revenue from the two overseas businesses should increase 96.5% YoY to approximately

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¥104.5 billion, while total pre-adjusted operating profit should increase 101.7% YoY to roughly ¥4.2 billion, both doubling. In terms of contributions to consolidated growth, as shown in Table 8 on page 16, overseas business is expected to contribute significantly, accounting for 65.2% of consolidated revenue growth and 46.3% of consolidated pre-adjusted operating profit gain. Accordingly, the overseas component should account for 49.1% of consolidated revenue and 36.0% of consolidated pre-adjusted operating profit, up sharply from 39.6% and 29.3% respectively in FY12/16.

●[Table 8] Summary for FY12/17 Forecasts by Operating Segment

(¥ million)	FY12/16 Full-Year	FY12/17 Full-Year	YoY Changes		Earnings Contribution
	Actual	Forecasts	Amount	Ratio/pp	Ratio
Revenue before adjustments	**137,773**	**-**	**-**	**-**	**-**
Adjustments	3,490	-	-	-	-
Reveue	**134,283**	**213,000**	**78,717**	**58.6%**	**100.0%**
Domestic Engineering Outsourcing (OS)	40,182	48,666	8,484	21.1%	10.8%
Domestic Manufacturing OS	34,608	44,509	9,901	28.6%	12.6%
Domestic Service Operations OS	3,470	12,101	8,631	248.7%	11.0%
Domestic Administrative OS	873	1,098	225	25.8%	0.3%
Domestic Recruiting and Placing	1,378	1,501	123	8.9%	0.2%
Overseas Engineering OS	21,022	24,845	3,823	18.2%	4.9%
Overseas Manufacturing and Service Operations OS	32,150	79,645	47,495	147.7%	60.3%
Other	600	635	35	5.8%	0.0%
Domestic business revenue total	**81,111**	**108,510**	**27,399**	**33.8%**	**34.8%**
Overseas business revenue total	**53,172**	**104,490**	**51,318**	**96.5%**	**65.2%**
Operating profit before adjustments	**7,034**	**11,571**	**4,537**	**64.5%**	**100.0%**
Domestic Engineering Outsourcing (OS)	2,936	3,879	943	32.1%	20.8%
Domestic Manufacturing OS	1,329	2,330	1,001	75.3%	22.1%
Domestic Service Operations OS	(258)	492	750	-	16.5%
Domestic Administrative OS	278	702	424	152.5%	9.3%
Domestic Recruiting and Placing	647	302	(345)	-53.3%	-7.6%
Overseas Engineering OS	688	1,157	469	68.2%	10.3%
Overseas Manufacturing and Service Operations OS	1,376	3,007	1,631	118.5%	35.9%
Other	38	(298)	(336)	-	-7.4%
Domestic business operating profit total	**4,970**	**7,407**	**2,437**	**49.0%**	**53.7%**
Overseas business operating profit total	**2,064**	**4,164**	**2,100**	**101.7%**	**46.3%**
Ratio of operating profit before adjustments	**5.1%**	**-**	**-**	**-**	**-**
Domestic Engineering Outsourcing (OS)	7.3%	8.0%	-	+0.7pp	-
Domestic Manufacturing OS	3.8%	5.2%	-	+1.4pp	-
Domestic Service Operations OS	-7.4%	4.1%	-	+11.5pp	-
Domestic Administrative OS	31.8%	63.9%	-	+32.1pp	-
Domestic Recruiting and Placing	47.0%	20.1%	-	-26.9pp	-
Overseas Engineering OS	3.3%	4.7%	-	+1.4pp	-
Overseas Manufacturing and Service Operations OS	4.3%	3.8%	-	-0.5pp	-
Other	6.3%	-46.9%	-	+53.2pp	-
Ratio of domestic business operating profit	**6.1%**	**6.8%**	**-**	**+0.7pp**	**-**
Ratio of overseas business operating profit	**3.9%**	**4.0%**	**-**	**+0.1pp**	**-**
Adjustments	(1,471)	(2,071)	(600)	**-**	**-**
Consolidated operating profit	**5,563**	**9,500**	**3,937**	**70.8%**	-
Ratio of consolidated operating profit	**4.1%**	**4.5%**	**-**	**+0.4pp**	-
No. of worksite employees at term-end	**No. of Employees**	**No. of Employees**	**Changed No.**	**Ratio/pp**	
Domestic Engineering OS	6,066	8,456	2,390	39.4%	-
[Utilization rate for Domestic Engineering OS]	98.2%	-	-	-	-
Domestic Manufacturing OS	9,033	13,097	4,064	45.0%	-
Domestic Service Operations OS	1,609	3,836	2,227	138.4%	-
Overseas Engineering OS	1,836	1,982	146	8.0%	-
Overseas Manufacturing and Service Operations OS	24,290	39,456	15,166	62.4%	-

Source: Compiled by Trias Corporation from the Company IR materials

Note: Overseas businesses total suggests the total of 2 overseas businesses and domestic businesses total suggests the total of the rest of the businesses. The amounts shown are rounded off to the nearest million yen.

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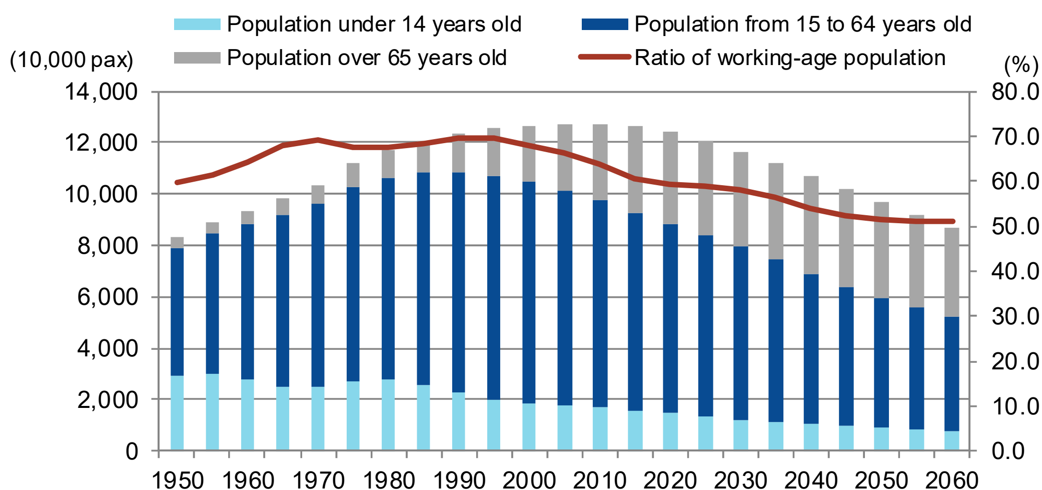
Meanwhile, total revenue from domestic businesses is expected to increase 33.8% YoY, or 24.4% YoY excluding contributions from AEC (revenue forecast: ¥7.6 billion), suggesting continued strong organic growth. Pre-adjusted operating profit margin should expand from 6.1% in FY12/16 to 6.8% (AEC included), largely exceeding total overseas profit margin of 4.0%. As Table 8 on page 16 illustrates, the contribution of domestic businesses to consolidated growth is expected to be 34.8% in revenue and 53.7% in pre-adjusted operating profit. The business should account for 50.9% and 64.0% of consolidated revenue and pre-adjusted operating profit, down from 60.4% and 70.7% respectively in FY12/16.

Topic: Labor Shortage and OS Group's Recruiting Strategy

Japan's labor market continues to tighten as the economy recovers. The shortage of labor has become protracted and thus, securing personnel is now a key managerial issue for companies. Strong recruiting capabilities have become a source of competitive advantage in the field of dispatching as well. The shortage in labor has been driven not only by the economic recovery, but also the structural issue of a declining working-age population (aged 15-64) in Japan, as shown in Graph 1. The working-age population peaked at 86.9 million in 1997, and according to the National Institute of Population and Social Security Research, is projected to decline to 44.18 million by 2060.

●[Graph 1] Japan's Population



Source: Compiled by Trias Corporation from Ministry of Internal Affairs and Communications, "National Census" and "Demographic Forecast," National Institute of Population and Social Security Research, "Japan's Population Projection (Jan 2012)," and Health, Labour and Welfare Ministry, "Population Survey Report," etc.

Let us look at the labor market condition surrounding the OS Group's mainstay domestic outsourcing businesses. According to the "Survey Results on the Latest Trends and Projection of IT Personnel" released by the Ministry of Economy, Trade and Industry (METI) in June 2016, the shortage of IT personnel in 2017 is estimated to be 218,000. IT labor supply is projected to peak in 2019, declining

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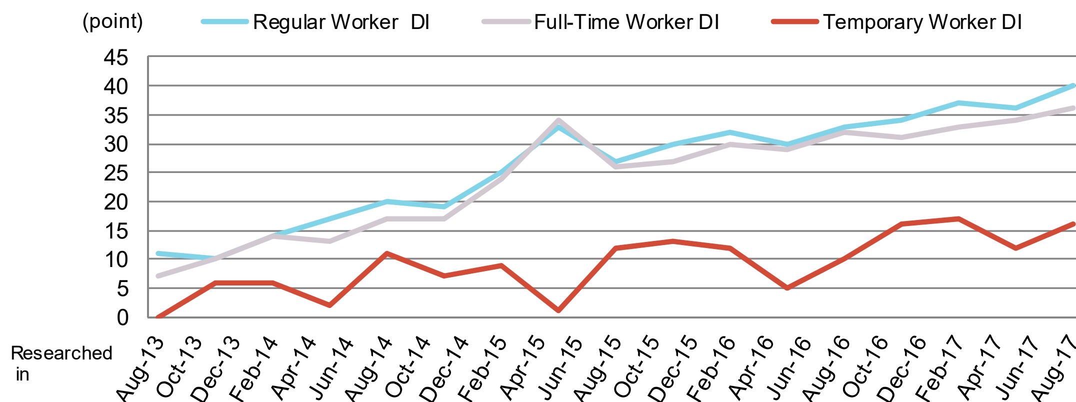
thereafter, reaching a shortage of 590,000 by 2030.

As shown in Table 6 on page 10, Domestic Engineering Outsourcing Business accounted for 22.0% of OS Group's total revenue for Q3 YTD FY12/17. Within Domestic Engineering Outsourcing Business, IT-related revenue accounted for 30.8%, making it the largest sub-segment. The number of IT-related worksite employees was 2,110, or 26.5% of the entire segment as of the end of Q3 FY12/17, increasing 45.8 % YoY and suggesting strong demand.

Meanwhile, the share of manufacturing in Japan's GDP has declined due to the changing industrial structure, yet still accounts for approximately 20% of GDP. The number of manufacturing workers also accounts for nearly 20% of the labor market. As shown in Graph 2, the labor surplus/shortage D.I. which subtracts labor surplus (%) from labor shortage (%), has increased not only for regularly employed workers, but also for dispatched workers. This is due to companies bringing back offshore manufacturing to Japan, in addition to the economic recovery.

According to METI's "Monozukuri Hakusho 2017," a research conducted in 2016 showed that 11.8% of offshore manufacturing has returned to domestic sites during the past year. Two researches conducted prior to 2016 show similar results. Due to this trend, meeting demands for technically skilled personnel has become a challenge, dominating 55.9% of companies' managerial issues.

● [Graph 2] Labor Surplus/Shortage in Manufacturing



Source: Compiled by Trias Corporation from Health, Labour and Welfare Ministry, "Survey on Labour Economy Trend"
Note: The no. of "full-time w orkers" is included in the no. of "regular w orkers"

One measure against labor shortage has been to raise the labor force participation of seniors and women. Another has been to promote the use of dispatched workers in response to diversifying employment methods. Recently, securing technically skilled personnel has become difficult not only for full-time employees, but also for dispatched workers.

Against this backdrop, the OS Group has been recruiting new graduates in addition to mid-career workers, and developing a unique recruiting scheme ahead of its competitors. For the past several

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years, the Group has focused on human resource development while recruiting more new graduates. The number of new graduates recruited in its Domestic Engineering Outsourcing Business was a little over 200 in FY12/15, and increased to nearly 400 in FY12/16. Although the Group was a later starter in domestic engineering outsourcing, it recruited some 550 new graduates in FY12/17—about the same as industry leaders MEITEC CORPORATION and TechnoPro, Inc.

This was achieved by increasing recruiting/offering expenses and recruiting staff, as well as by covering a wide range of industries and job descriptions. The Group offers various job opportunities ranging from research and development in manufacturing of transportation equipment or electrical and electronics, to designing buildings or plants, developing software and conducting various performance tests.

The Group also offers job opportunities in advanced work; i.e., research and development of robots or new medicine, and clinical trials, which is why it has also seen favorable results in recruiting technically skilled mid-career workers—an area where competitors are struggling. The Group is also reinforcing new graduate recruitment in its Domestic Manufacturing Outsourcing Business; recruiting some 150 in FY12/17, and looking to recruit over 200 in FY12/18.

Aside from recruiting new graduates, the Group launched a scheme in 2015 to train inexperienced workers at its subsidiary, KEN School, and to dispatch those trained workers. The scheme's model was enhanced to better accommodate the recruiting environment, and the number of recruited workers has risen markedly since its full-scale rollout in FY12/16.

Under the KEN School scheme, nearly 400 were recruited in FY12/15, some 1,200 in FY12/16, and 1,011 in Q1-Q3 FY12/17, dominating over half of the recruitment in the Domestic Manufacturing Outsourcing Business. The Group initially planned to recruit 1,300 under the scheme in FY12/17, and considering the fast pace thus far, is expected to achieve this plan.

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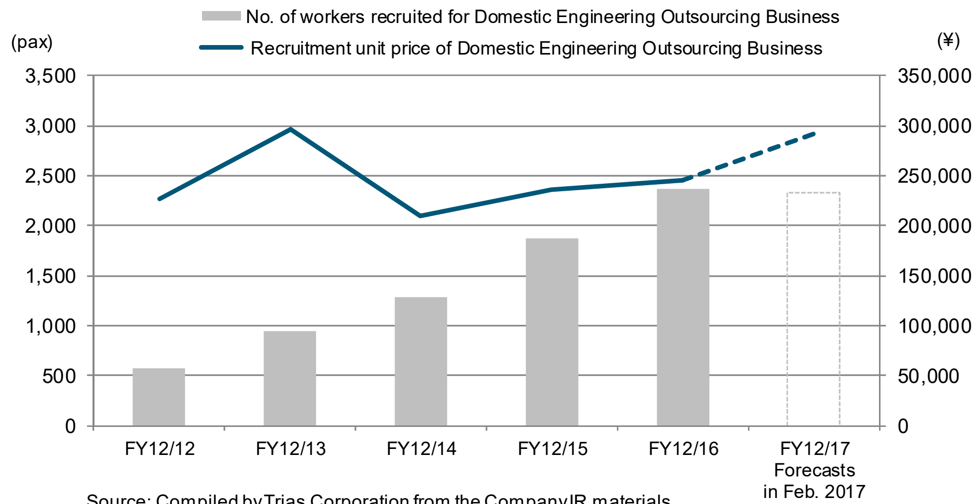
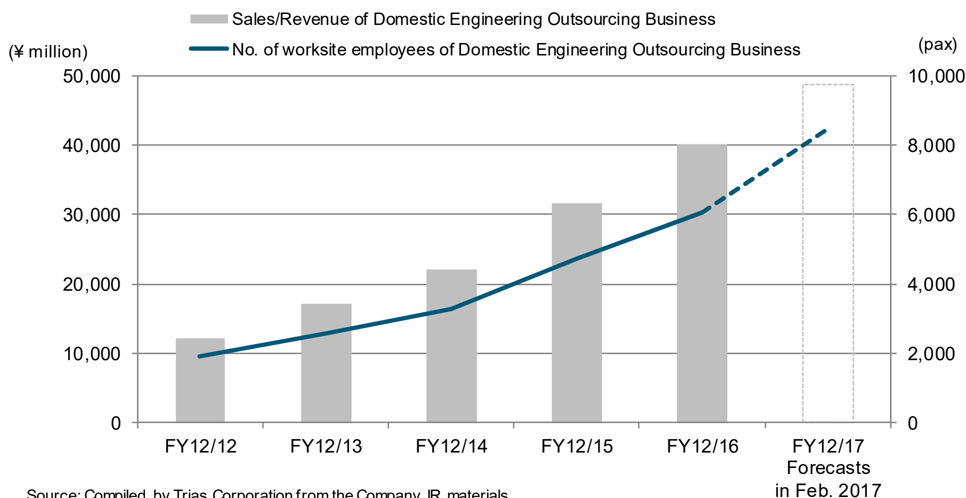
● **[Graph 3] No. of Workers Recruited and Recruitment Unit Price in Domestic Engineering Outsourcing Business**



Source: Compiled by Trias Corporation from the Company IR materials

● **[Graph 4] Sales Revenue and No. of Worksite Employees in Domestic Engineering Outsourcing Business**



Source: Compiled by Trias Corporation from the Company IR materials
Note: Shows net sales (J-GAAP) up till FY12/14 and sales revenue (IFRS) from FY12/15 onward since the valuation basis for net sales and sales revenue are the same.

The Group currently operates eight KEN School classrooms nationwide, and is increasing the number of classrooms and curricula to boost recruitments. Going forward, the Group plans to offer training contents and periods that meet clients' needs in order to nurture personnel who fulfill such needs and to expedite their dispatch.

As for expected changes in the business environment, from September 2018, "Specified Dispatches" which allowed notification-based dispatching, will be abolished, and all dispatches will follow the licensing system under the Revised Worker Dispatching Act. Under the licensing system, requirements such as company's standard asset amount will become stricter. Therefore, some small-

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and medium-sized dispatching service providers that cannot meet these requirements will have difficulty continuing their business.

It should also be noted that engineering outsourcing started around the 1960s, and hence, the industry faces issues such as the aging of business founders and the lack of successors. OS Groups supports such companies through capital alliance, business acquisitions and other methods, and has been accepting and recruiting their personnel. The number of workers recruited through such industry reorganization was some 50 in FY12/15, and increased to some 100 in FY12/16. This number reached 346 in Q1-Q3 FY12/17; already exceeding the full-year goal of 315.

In the Domestic Manufacturing Outsourcing Business, recruiting via the PEO scheme has progressed steadily. The number of persons enrolled under the PEO scheme was some 3,000 as of the end of FY12/15, a little over 5,000 as of the end of FY12/16, and 8,235 as of the end of Q3 FY12/17. As of Q3-end, those recruited through the PEO scheme accounted for 77% of all 10,684 worksite employees in the segment. The Group originally planned to recruit 10,000 in FY12/17.

Some 200 manufacturers are currently participating in the PEO scheme. Most major domestic manufacturers are participating in the PEO scheme, and as they accept more employees after April 2018, which marks the fifth year since revisions were made to the Labor Contracts Act, the Group aims to recruit more personnel under the PEO scheme. The operating rate of participating manufacturers was 20% as of the end of FY12/16, but has now risen to 30-40%. Much of the rise derived from increased activity of major automakers, and the Group expects the operating rate of participating manufacturers to rise further next year.

As mentioned thus far, recruiting and offerings have trended favorably, but what about the utilization and retention rates? The utilization rate in domestic engineering, including for new graduates, has maintained a high level, reaching 98.4% in FY12/15, 98.2% in FY12/16, and 97.8% in Q3 FY12/17. Although the retention rate has not been released, it also seems to be relatively high. Considering the significant increase of personnel recruited—1,879 in FY12/15 (up 46.5% YoY) and 2,360 in FY12/16 (up 25.6% YoY)—one can argue that OS Group has managed to recruit more workers while sustaining a high utilization rate and effective recruiting operations.

The Domestic Manufacturing Outsourcing Business maintains full utilization since the Group dispatches workers in response to clients' demands. The retention rate is also likely to be high since workers recruited through the PEO scheme were originally fixed-term contract employees, and have received career consulting at the time of transfer.

Recruiting and offering expenses for Domestic Engineering Outsourcing Business for Q3 YTD FY12/17 was some ¥950 million, and the number of workers recruited was 2,950. In contrast,

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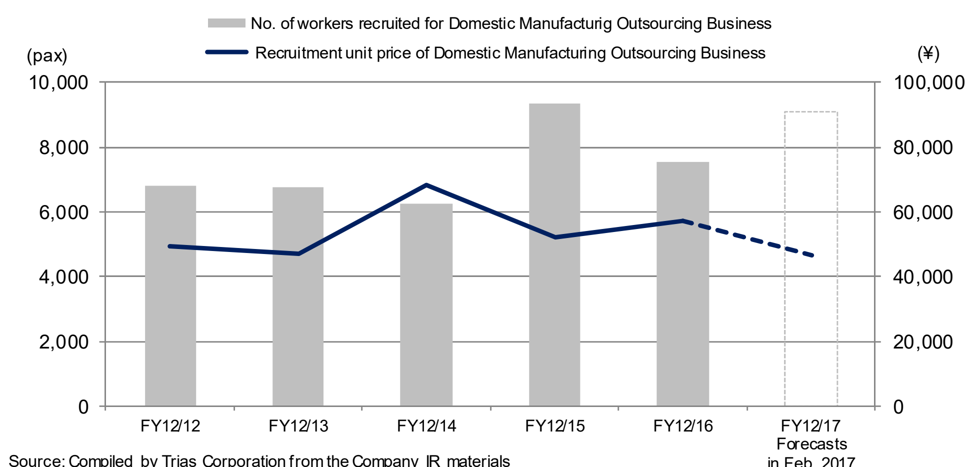
expenses were slightly over ¥400 million and the number of workers recruited was 1,918 for Q3 YTD FY12/16. While recruiting and offering expenses doubled due to the increase in new graduate recruitments, which require more expenses for participating in job fairs and setting up booths, the number of workers has increased by 1.5 times, and as mentioned, the utilization rate is also high.

The CAGR of recruitment unit price was 1.9% during the five years between FY12/12 and FY12/16. The CAGR for the number of workers recruited was 42%, while the CAGR for sales revenue was 35%. As shown in Graphs 3 and 4 on pages 19 and 20, respectively, the Group has been able to boost the number of workers recruited and sales revenue while suppressing expenses, owing to the KEN School scheme.

As the KEN School scheme accounts for over half of the recruitments, more inexperienced workers are being dispatched. Therefore, the rise in dispatching contract unit price has not directly led to an increase in sales revenue. Still, sales revenue has increased steadily. Inexperienced workers can expect a 30% raise in unit price by being promoted to an engineer one year after being dispatched. However, since the number of workers recruited via the KEN School scheme is also rising, the increase in worksite employees should translate into higher sales revenues.

In Domestic Manufacturing Outsourcing Business, during the five years from FY12/12 to FY12/16, the CAGR of recruitment unit price was 4%, the CAGR for the number of workers recruited was 3%, and the CAGR for sales revenue was 9%. Graphs 5 and 6 show that the Group has been able to increase the number of workers recruited and sales revenue while suppressing expenses, thanks to the PEO scheme. The PEO scheme offers a high dispatching contract unit price and is an effective way to secure personnel since media expenses are not required and workers' skills are high to begin with.

●[Graph 5] No. of Workers Recruited and Recruitment Unit Price in Domestic Manufacturing Outsourcing Business



Source: Compiled by Trias Corporation from the Company IR materials

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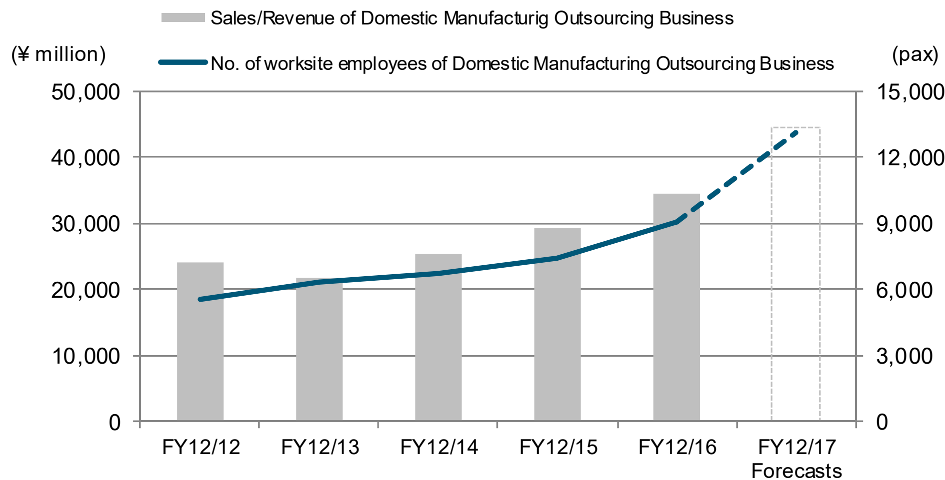
●[Graph 6] Sales Revenue and No. of Worksite Employees in Domestic Manufacturing Outsourcing Business



Source: Compiled by Trias Corporation from the Company IR materials
Note: Note: Shows net sales (J-GAAP) up till FY12/14 and sales revenue (IFRS) from FY12/15 onward since the valuation basis for net sales and sales revenue are the same.

Going forward, the challenge is to better respond to mismatches between workers and their jobs. To match workers' skills with their work, the Group aims to develop a flexible support system including for skill enhancements and job transfers, thereby raising the retention rate. (For details on law revisions, the PEO scheme, and KEN School, please refer to the FY12/16 IRTV memo.)

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References

Consolidated Key Financial Data

No. of shares issued	Jun-17	20,303,200
No. of treasury shares	Jun-17	98
Market value (¥mn)	21-Dec-17	41,703
BPS (¥)	Jun-17	1,184.33
ROE (%)	Dec-16	25.7
ROA (%)	Dec-16	4.6
PER (times) FY12/16 fcst.	21-Dec-17	7.2
PCFR (times) 1H FY12/17 actual	21-Dec-17	15.9
PBR (times) 1H FY12/17 actual	21-Dec-17	1.7
Share price (¥)	21-Dec-17	2,054
Unit share (shares)	21-Dec-17	100
Average daily volume (shs)	21-Dec-17	1,652,700

Note: The amounts shown are rounded off to the nearest million yen.

Total assets (¥mn)	Jun-17	115,942
Equity attributable to owners of the Company (¥mn)	Jun-17	24,046
Interest-bearing debt (¥mn)	Jun-17	(*) 50,422
Ratio of equity attributable to owners of the Company to total assets (%)	Jun-17	20.7
Ratio of interest-bearing debt (%)	Jun-17	209.7
Free cash flows (¥mn)	Jun-17	(1,774)

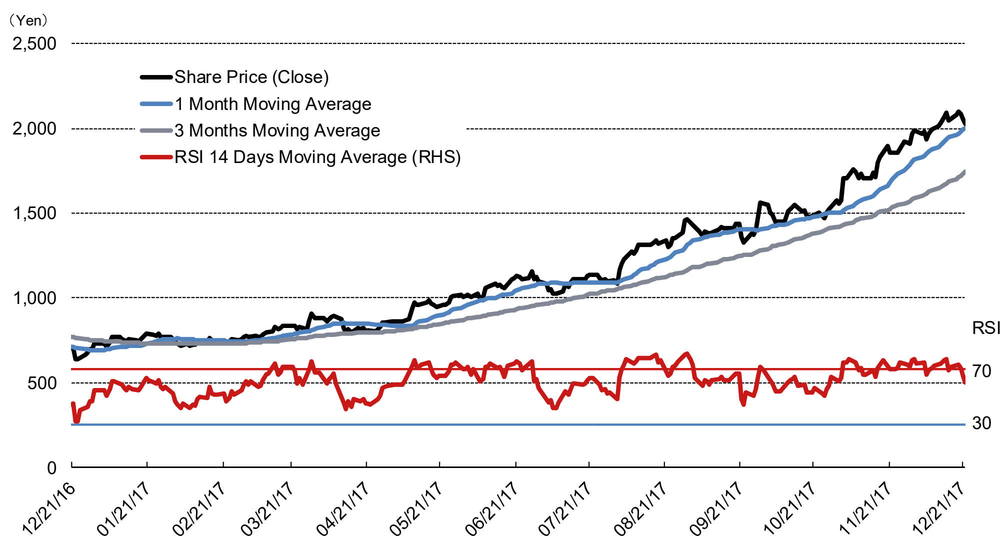
ROE = Profit attributable to owners of the Company / Averaged equity attributable to owners of the Company
ROA = Profit attributable to owners of the Company / Averaged total assets
PCFR = Market value / (Profit attributable to owners of the Company + Depreciation)
Ave. daily vol. = Ave. daily vol. (from 21-Dec-16 to 21-Dec-17)
Interest-bearing debts* ratio = I.B.D. / Equity attributable to owners of the Company
Free cash flows = Operating CF + Investment CF
*Incl. current portion of accounts payable-installment purchase

Consolidated Financial Results

Consolidated (¥million) J-GAAP	Net Sales	Operating Income	Ordinary Income	-	Profit Attributable to Owners of Parent	EPS (¥)	DPS (¥)
FY12/13	47,384	1,203	1,357	-	1,122	77.54	13.00
FY12/14	59,421	2,010	2,197	-	1,317	89.81	35.00
FY12/15	80,860	3,125	3,225	-	1,810	110.15	35.00
FY12/16	134,482	3,737	3,380	-	664	38.11	42.00
IFRS	**Revenue**	**Operating Profit**	**Profit Before Tax**	**Profit for the Year**	**Profit for the Year Attributable to Owners of the Parent**	**EPS (¥)**	**DPS (¥)**
FY12/17 1H	105,811	3,562	3,241	1,879	1,529	79.83	-
FY12/17 full year fcst.	213,000	9,500	8,900	5,800	5,100	283.52	85.00

Note 1: FY12/17 forecasts announced on February 14, 2017.
Note 2: The amounts shown are rounded off to the nearest million yen.

Stock Price Charts and RSI (December 21, 2016 – December 21, 2017)



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

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