Alpha-Win Company Research Report

LOCKON CO., LTD. (3690 TSE Mothers)

【New name (starting 8/1/2019): YRGLM Inc.】 Issued:5/31/2019

● Summary

Research Dept., Alpha-Win Capital Inc.
http://www.awincap.com/

Business Description

・LOCKON CO., LTD. (hereinafter referred to as the "Company") plans, develops, and sells software related to Internet marketing. It was founded in 2001 by president Iwata during his college years. Its main product is its proprietary Internet advertising effect measurement system, provided via the cloud to middle-sized and large companies. The Company's main business is based on a subscription-based business model, meaning that although costs precede and temporarily cause an overall loss upon the acquisition of new customers, after a certain period of time, the initial costs are recovered and profit begins to steadily accumulate over time. Going forward, the Company is expected to enter a profitability-improvement phase by effectively using its accumulated information assets. The Company became listed on TSE Mothers in September 2014. It is a leading company in a niche market. Also, the Company will change its name to "YRGLM Inc." starting on August 1, 2019.

Current Financial Results

・After becoming listed on Mothers, the Company had increased sales and stayed in the black. However, from FY 2017 (the fiscal year ending in Sept. 2017), although the Company continued to increase sales, profit declined due to upfront investment for business expansion and expenses related to business restructuring. In FY 2018, sales increased but a net loss was posted and dividend payment was stopped. In its forecast for FY 2019 (this FY) that has been disclosed as ranges, the Company expects a double-digit sales growth and an improvement from operating loss to profit. In the first half (H1) of this fiscal year, the Company achieved sales of Y1,081 million, a 23% growth, and an operating profit of Y21 million. However, since litigation-related expenses were recorded as an extraordinary loss, a net loss of Y47 million was posted. H1 results were positive, with the settlement of a lawsuit that had been of concern and the improvement from operating loss to profit in the second quarter (January to March).

Competitiveness

・The Company's strengths are the management skill of the president who has a deep knowledge of advanced technologies in this field, products with proven and strong functions, and possession of and potential to utilize the big data that have been accumulated over the years. The Company's two main products both have the largest share in the domestic market. In the growing industry, the Company aims to further strengthen its products and secure an extraordinarily large market share.

Business Strategy

・Under the Marketing Robot Strategy, which aims to automate and improve the efficiency of Internet marketing, the Company plans to expand its business domain as a whole from advertising effect measurement to analysis and utilization, as well as overseas development. It plans to achieve Y3 billion in sales in FY 2020 (next FY). Toward this end, the Company plans to accelerate its growth by actively pursuing M&As and alliances with other companies.

Forecast on Financial Results (Alpha-Win Research Dept.)

・Before the Company's disclosure of its forecast for FY 2019, Alpha-Win Research Department had predicted sales to be Y2,150 million (+19.2% YOY) and net profit to be Y10 million (reversal from loss to profit). Based on the disclosure of the Company plan and the interim financial results, we revised this forecast – specifically, we made a slight upward revision (sales of Y2,260 million and operating profit of Y60 million). In addition to the large contribution to sales by the main product AD EBiS, further improvements in cost were made, raising the likelihood of the Company achieving a positive operating profit for the current full fiscal year. A net loss may be posted due to the recording of an unexpected extraordinary loss, but the amount of net loss is expected to be limited. With the business restructuring completed for the time being and AD EBiS continuing to perform strongly, we expect to see positive results from the existing and future businesses and corporate acquisitions as well as various measures that have been implemented. The growth potential is large, with an annual sales growth rate of about 20% expected over the medium to long term. In addition, since it seems that the Company will continue to conduct upfront investments "on the offensive" for business expansion over the medium to long term, we believe that it is possible for the Company to remain in the black and achieve a profit growth rate of 20-30% per year, exceeding the sales growth rate, on the condition that the Company succeeds in cost control.

Stock Price

・AdTech-related domestic growth stock. Stock price has risen and has been outperforming major indexes since February 2019 in response to the share buyback and the recovery of financial performance. The Company's stock value does not seem cheap when valuation indicators are compared with TOPIX and similar companies. However, since the Company's results have bottomed out and improved from loss to profit, there is increasing anticipation for a v-shaped recovery in profit. Going forward, factors that may affect stock price include the change in monthly sales, quarterly transition in profit and loss (change in the amount of profit), announcements of M&As or alliances or new functions, contents of the next announced medium-term plan, and forecasts on profit levels over the medium term. In particular, the unit price and the number of active accounts of the core AD EBiS business are key indicators (KPI) directly linked to financial performance and should be closely followed.

Shareholder Return

・In the previous fiscal year, the Company posted a net loss and terminated its dividend payment and shareholder benefit plan. Although the Company announced that this year's dividend is undetermined, the possibility of resumed payment is low and dividend payment is likely to be carried over into the next fiscal year or later. The Company currently believes that, because it is in its growth phase, it should raise shareholder value by recovering its financial performance through investments for growth rather than letting its cash flow out.

【3690 LOCKON CO., LTD. Sector: Information & Communication】 Figure A

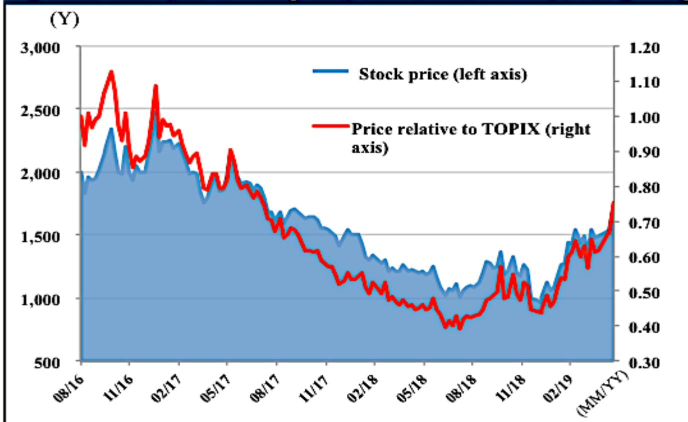
FY		Sales (Y mil)	YOY (%)	O.P. (Y mil)	YOY (%)	R.P. (Y mil)	YOY (%)	N.P. (Y mil)	YOY (%)	EPS (Y)	BPS (Y)	Dividend (Y)
2016		1,612	12.2	247	-29.2	250	-28.9	168	-26.9	26.79	189.08	5.0
2017		1,719	6.6	92	-62.6	106	-57.5	72	-56.8	11.56	195.60	5.0
2018		1,804	5.0	-98	-	-115	-	-88	-	-14.02	184.97	0.0
2019	CE	2,250～2,350	24.7～30.2	0～50	-	Not disclosed at this point						
2019	E	2,260	25.3	60	To profit	45	To profit	-25	-	-3.97	182.55	0.0
2020	E	2,750	21.7	120	100.0	100	122.2	92	To profit	14.62	197.17	0.0
2021	E	3,150	14.5	250	108.3	230	130.0	155	68.5	24.63	222.80	5.0
2018	H1	877	3.7	-70	-	-81	-	-58	-	-9.32	184.84	0.0
2019	H1	1,081	23.2	21	To profit	17	To profit	-46	-	-7.38	166.83	0.0

(Note) CE = the Company's estimate (forecast); E = estimate (forecast) by Alpha-Win Research Dept. All fiscal years discussed in this document are September-ending. For example, FY 2019 ends in Sept. 2019.

【 Stock Price and Valuation Indicators: 3690 LOCKON CO., LTD.】 Figure B

Item	5/24/2019	Item	P/E	P/B	Dividend Yield	Dividend Payout Ratio
Stock Price (Y)	1,731	Last FY (actual)	-	9.4	0.0%	0.0%
Shares Outstanding (thou.)	6,372	This FY (est.)	-	9.5	0.0%	0.0%
Market Capitalization (Y mil)	11,031	Next FY (est.)	118.4	8.8	0.0%	0.0%
Dilutive Shares (thou.)	0	Equity Ratio at Last FY-End		54.4%	Last FY's ROE	-7.4%

【 Stock Chart (end-of-week prices): 3690 LOCKON CO., LTD. 】 Figure C



【Performance】		
Period	Return	vs. TOPIX
1 month	16.2%	22.0%
3 months	24.4%	29.8%
6 months	41.4%	53.0%
12 months	43.7%	62.9%

(Note) From the fourth week of August 2016 to the fourth week of May 2019

(Note) Prepared by Alpha-Win Research Dept. The most recent stock price and TOPIX values used for the calculation of performance are values as of 5/24/2019. However, comparison between periods is based on the end-of-the-month stock price for each corresponding month.

Contents

Note: Upon translating to English, when the page numbers differed from the original Japanese version, they were adjusted to those of the English version of the Report.

1. Company Overview

- **As its business, the Company is developing the Marketing Robot that automates and improves the efficiency of marketing instead of humans. Currently, the Internet advertising effect measurement system, which is a part of this business, is its main product.**

- **As its main service, the Company provides Internet-marketing-related platform as a SaaS (cloud).**

(1) Internet advertising effect measurement system: A tool to comprehensively measure the effect of and evaluate various Internet ads and SEO strategies

(2) Paid-listing ads: Also referred to as search advertising. A method of displaying ads related to keywords searched or browsed by Internet users. Effectively displays ads in the users' areas of interest. A highly effective method for corporate advertising.

(3) SaaS (software as a service): A service where software is used via the Internet (almost synonymous with the cloud). Does not need purchasing of packaged products. Only the necessary functions, contents, and quantity of service are used via the Internet and paid for.

- **Changed its company name and symbol. The new name is "YRGLM Inc."**

◆ Leading Company in a Niche Market

LOCKON CO., LTD. (hereinafter referred to as the "Company") is an emerging company that plans, develops, and sells software related to Internet advertising and e-commerce. Susumu Iwata, the Company's president, started a web design business in Osaka as a college student and, upon business expansion, established the Company in 2001.

The Company has grown through the full-scale development of the Marketing Robot (registered trademark of the Company) business, developing proprietary software that automatizes and improves the efficiency of marketing instead of humans. Until now, it has grown its business in two areas – the marketing platform and the EC platform. The main products are AD EBiS, an Internet advertising effect measurement system[1], and THREe, an operating platform for paid-listing ads[2]. Software is provided as a SaaS[3] (cloud) to companies (B2B). The Company is a giant leading company in the niche market of the Marketing Robot business. It became listed on TSE Mothers in September 2014. Currently, the Company has two head offices, one in Osaka and one in Tokyo.

The current company name "LOCKON" (CO., LTD.) comes from "lock on," which is a military term in English meaning "a missile becoming ready to automatically follow a target." On August 1, 2019, its name will change to "YRGLM Inc." As five years have passed since becoming listed on the market and the Company will reach a milestone next year (2020) – the 20th anniversary of its founding which can be seen as its second start-up phase – the Company decided to reconfirm its goal and the value that it provides and aim for a further leap, and embedded this decision in its new name.

The Company created the word "YRGLM" to mean "an ideal world that has never been seen before" and made it its new name. "In order to present the image of an ideal future that does not exist in this world yet, we used 'a meaningless string of letters' that does not have any origin in existing words. It is a sole and unique name that we chose to reflect our goal to become a sole and unique company [excerpt from the Company's website]."

In addition, using "five rubber bands," the Company created a symbol that represents an organization aiming to realize the ideal world YRGLM. The rubber band symbolizes infinite possibilities since it has various meanings depending on the person who uses it. The overlapping shape represents a strong harmony among employees. Furthermore, the symbol expresses the respect for the individuality of each person and diversity and represents a strong and flexible organization that can elastically change. This new name and symbol have already been registered as trademarks.

◆ **Main products are its proprietary AD EBiS and EC-CUBE.**

The Company is specialized in providing the Marketing Robot and carries out the following two businesses (main product names listed after the colon).

(1) Marketing platform: AD EBiS, THREe, AdRepo (automatic report generation tool for programmatic advertising[4])
(2) EC platform: EC-CUBE

(4) Programmatic advertising: An advertising method where optimization of ads is conducted automatically or supported immediately. After submitting an ad, optimization is conducted, leading to better results.

The corporate group consists of a total of six companies: the Company, two consolidated subsidiaries, one nonconsolidated subsidiary, and two affiliates accounted for by the equity method.

Consolidated Subsidiaries
・LOCKON Vietnam Co., Ltd. (Vietnam Socialist Republic. An offshore development site. Conducts software development outsourced by the Company. 100% owned by the Company.)
・EC-CUBE Co., Ltd. (Established in Osaka City Kita Ward in October 2018. The Company has a 100% stake. Succeeded the EC-CUBE business from the parent company's EC platform business in January 2019）

Nonconsolidated Subsidiary
・LOCKON Marketing of U.S.A (Established for information-gathering purposes – a dormant company)

Affiliates Accounted for by the Equity Method
・SAI Co., Ltd. (LOCKON CO., LTD. acquired 20% of the shares in September 2015 and transferred its EC outsourced development business)
・Radical Opti Co., Ltd. (LOCKON CO., LTD. acquired 20% of the shares in May 2017 and, like SAI, transferred its EC outsourced development business)

◆ **Consolidated-to-parent-company ratios are about 1 for both sales and profit.**

The parent company’s sales and profit make up an extremely large portion of the total for the entire corporate group, with the consolidated-to-parent-company ratios staying at around 1. Total recurring profit/loss of the consolidated subsidiaries is also almost zero (Figure 1).

【 Figure 1 】 Comparison of Consolidated to Parent Company Recurring Profit by Fiscal Year

(unit: Y mil, %)

		FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
A	Consolidated R.P.	-	234	352	250	106	-115
B	Parent company R.P.	*75*	245	359	252	107	-110
A-B＝C	Consolidated R.P. - parent company R.P.	*75*	-12	-7	-2	-1	-5
C/B	Subsidiaries, etc.'s R.P. / parent company R.P.	-	-4.7%	-1.9%	-0.7%	-0.5%	-
A/B	Consolidated R.P. / parent company R.P.	*NA*	0.95	0.98	0.99	1.00	-

(Ref) Prepared by Alpha-Win Research Dept. from the Company’s securities report, financial results summary, financial results briefing materials, website, etc.
(Note) Hereinafter, unless otherwise noted, reference may be omitted if it is the same as the above. Also, since we generally round off the decimal places for the numbers used in this Report, the numbers may differ from those officially disclosed by the Company. Results are consolidated starting in FY 2014 (same applies to the rest of this document).

After becoming listed, the Company had been debt-free, but in FY 2018, as investment for the future, the Company raised about Y800 million in long- and short-term loans. The Company commented that this investment is for the development of the marketing platform and AI-related fields and in preparation for future M&As.

- **Essentially debt-free**

- **All fiscal years (FY) discussed in this Report are September-ending. For example, FY 2019 ends in Sept. 2019.**

Since the Company's long- and short-term debt totaled 840 million while its cash and deposits were about Y920 million as of the end of March 2019, the Company is essentially debt-free. In addition, while its total assets and market capitalization are relatively small – about Y2.2 billion and Y11 billion, respectively, as of the end of March (closing price was Y1,731 on May 24, 2019) – there is no problem with its financial condition, with an equity ratio of 47% and current ratio of 147%.

Intangible fixed assets, including goodwill (due to the transfer of the AdRepo business) and software, are Y530 million and deferred tax assets are Y110 million, totaling Y640 billion. This is smaller than the Company's net assets, which total Y1.05 billion, so there seems to be no problem for the time being.

◆ Business Philosophy, Basic Policies, Mission, and Action Guidelines

Although the Company's name is scheduled to be changed, its business philosophy remains unchanged as "Impact On the World." These words embody the Company's wish to "create a company with global influence and give dream and hope to as many people as possible."

- **The Company's business philosophy**

The Company conducts business under the following basic policy: "We will maximize our corporate value, contribute to the realization of a vibrant and affluent society, and comply with the laws and regulations as each individual delivers better-than-expected results under his or her role so that we can earn strong trust and reputation from our customers. Through these efforts, we will rapidly develop our organization and business and thereby give dream and hope to as many people as possible."

As its mission statement, the Company has established the following three policies: "For the happiness of all employees," "For the happiness of all customers," and "For the happiness of all suppliers." The Company has also set five action guidelines: "reliability," "speed," "uniqueness," "innovation," and "independence."

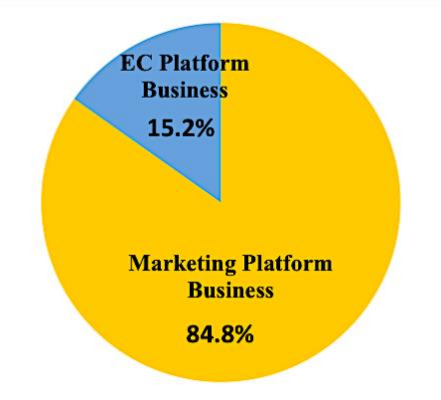
2. Business Description and Business Model

◆ **A B2B business, providing proprietary software via the cloud as its main business. Developing businesses based on two platforms. Focused on the marketing platform business.**

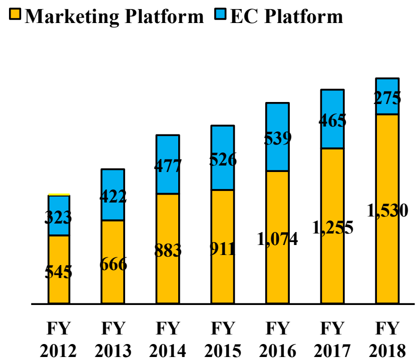
◆ Providing Originally Developed Marketing Robot via the Cloud

Based on the concept that a "marketing robot" that solves problems automatically and efficiently instead of humans is also necessary in the area of Internet marketing due to the aging and declining population, the Company provides proprietary Marketing Robot software via the cloud mainly to companies. The Company's business consists of two business segments: (1) the marketing platform business and (2) the EC platform business. The former accounted for approximately 88% of the total sales of the first half (H1) of this fiscal year (approx. 85% in FY 2018) and is the driver of sales growth (shown by fiscal year on Figures 2 and 3). Change in operating profit by business segment is shown below on Figure 4. Except for FY 2017, over the full year, the profit of the EC platform had underpinned the Company's financial performance amidst fluctuations in the profit of the marketing platform business.

【 Figure 2 】FY 2018 Full-Year Sales Breakdown by Business Segment

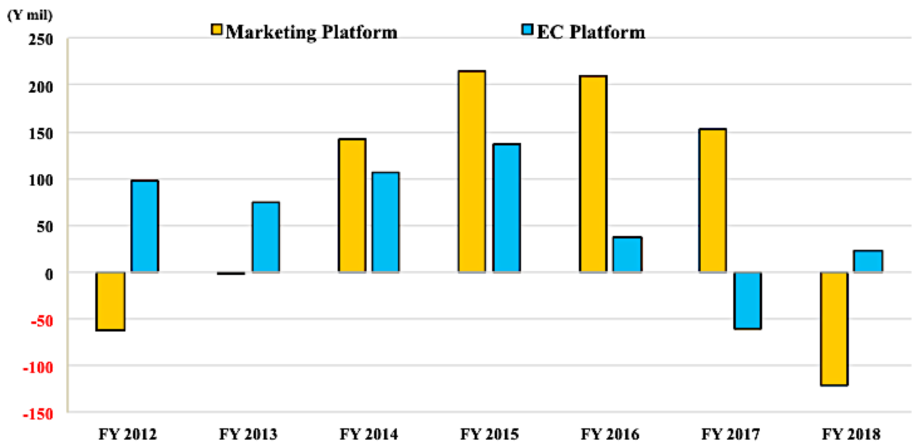


【 Figure 3 】Change in Full-Year Sales by Business Segment (unit: Y mil)



(Ref) Figures 2-4 were prepared by Alpha-Win Research Dept. from the Company's securities report, financial results summary, and financial results briefing materials.

【 Figure 4 】Change in Full-Year Operating Profit by Business Segment



◆ Restructuring and Strengthening of Business Portfolio

◆ **Pushing forward with restructuring of business portfolio. Concentrating business resources on AD EBiS of the marketing platform business.**

Since FY 2016, the Company has been actively restructuring and strengthening its business portfolio, focusing on its core business (AD EBiS in the marketing platform business) and separating its non-core business (EC platform business) (Figure 5). In the marketing platform business, the Internet advertising effect measurement system AD EBiS accounts for most of the total sales (a little less than 80% this H1). In the future, the Company plans to concentrate business resources on this product and related products to develop this business as an even greater driver of growth. Thereby, the Company plans to acquire an extremely large share in the market.

Specifically, in recent years, the Company has been conducting the following strengthening and restructuring of business.

(i) Strengthened the products of the marketing platform business. Offering products with enhanced capabilities by adding various optional functions to the AD EBiS such as the artificial intelligence functions Cross-Device Function[5] (patent-pending; provided starting in August 2018) and Customer Journey Analysis Function (visualizes and evaluates the user's action history; patent obtained).

(5) Cross-Device Function: A function to visualize user behavior across devices, applications, and browsers

(ii) Formed 31 new alliances with other companies against the target of 30, which had been a high-priority target of the Company's development strategy (FY 2018). As a result, with the utilization of external resources, the Company was able to obtain most of what is needed for the three components – measurement, analysis, and utilization – crucial to the Marketing Robot.

(iii) Acquired EVERRISE CO., LTD.'s automatic report creation tool AdRepo business in August 2018 and incorporated it into the marketing platform business.

(iv) Restructured the EC platform business, transferring the EC outsourced development business (actual sales were Y246 million in FY 2016) to its two equity-method subsidiaries and withdrawing from the outsourcing business.

(v) For the same EC platform business, the Company also transferred its EC-CUBE division to EC-CUBE Co., Ltd., its new consolidated subsidiary, on January 1, 2019 by a company split-up. Began providing the new version, EC-CUBE 4 (October 2018).

(vi) Similarly, the DMP[6]-related business of the EC platform business (previous fiscal year's sales were Y84 million) was transferred to the Company's marketing platform business in the previous fiscal year since it is closely related to AD EBiS.

(6) DMP: A method by which a corporate client analyzes its website

(i) Reinforced human resources to prepare for growth. From FY 2014 to FY 2018, the number of employees were increased from 68 → 71 → 98 → 122 → 144 (the number of employees at the end of the fiscal year) through new-graduate and mid-career recruitment. Over the past three years, the Company has been hiring about 20 more employees every year, doubling its size. In particular, the Company is reinforcing its engineering team for software development and sales team to strengthen sales activities. The number of employees at the end of this H1 was 150, which is only six greater than six months ago. Although this rate of hiring is slower than before, the Company plans to shift its human resources toward customer success in order to provide more value to customers. In H2, as 11 new graduates will be hired in addition to midcareer recruitments, the Company estimates that it will have about 160 employees at the end of the fiscal year.

As a result of the above actions, after the second quarter (Q2) of FY 2019, the Company (parent company) has been concentrating on the marketing platform business. However, since the company to which EC-CUBE was transferred is a consolidated subsidiary, on a consolidated basis, the Company plans to continue to classify its business into the same two segments as before.

【 Figure 5 】Business Restructuring and Segments (current situation of business segments is highlighted)

Business Segment	Main Product/Service	Business Subcategory	Change	Note
(1) Marketing Platform	1. AD EBiS			Parent Company
	2. THREe			
	4. DMP		Transferred from SOLUTION	
	4. AdRepo		Acquired	
(2) EC Platform	1. EC-CUBE		Transferred to EC-CUBE Co., Ltd. on 1/1/2019	Consolidated
	2. SOLUTION → terminated	*EC Outsourced Dev.*	*Were transferred to SAI Co., Ltd. and Radical Opti Co., Ltd.*	*Equity method*
		(DMP)	*Transferred to marketing platform*	

(Ref) Figures 5 and 6 were prepared by Alpha-Win Research Dept. from the Company's securities report, financial results summary, and financial results briefing materials.

◆ Details on the Business Contents

(1) Marketing Platform Business

The transition in the sales and profit of the marketing platform business by fiscal year is as follows.

【 Figure 6 】Change in Sales of the Marketing Platform Business and Operating Profit of This Business Segment

Sales	*FY 2012*	*FY 2013*	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	
(Y mil)	*stand-alone*	*stand-alone*	consolidated	consolidated	consolidated	consolidated	consolidated	% of Total
Marketing Platform	*545*	*666*	883	911	1,074	1,255	1,530	84.7%
1. AD EBiS	*499*	*567*	722	822	1,012	1,200	1,402	77.7%
2. THREe	*46*	*81*	161	89	62	54	43	2.4%
3. (DMP)							84	4.7%
Segment's O.P.	*-61*	*-1*	142	214	210	153	-121	
Segment's O.P. Margin	*-11.2%*	*-0.1%*	16.1%	23.5%	19.5%	12.2%	-7.9%	

◆ **AD EBiS is the Company's main product that accounts for approximately 78% of the Company's total sales (FY 2018).**

The marketing platform business consists of four businesses: 1) AD EBiS (Internet advertising effect measurement system), 2) THREe (in-house operation platform for paid-listing ads), 3) DMP, and 4) AdRepo. By combining THREe, which enables automatic optimization and automatic ad submission, and AD EBiS, which measures and analyzes the effectiveness of Internet advertising, the Company provides a one-stop platform for the three elements of marketing automation – from effect measurement to optimization to purchase/ad-submission.

Increasingly diversified and dispersed consumer behavior of today's Internet society has led to more sophisticated and complicated marketing and advertising, making technology-based operation more important.

Usually, an advertising effect measurement system is involved in the effect measurement, analysis, and evaluation of ads, and utilization (ad management) is normally not included. The Company's characteristic or strength is its ability to offer, at a reasonable price, software that can accurately evaluate and utilize the effect of Internet ads using various analysis functions and analytical methods, and its capability to provide excellent support.

- **AD EBiS is an Internet advertising effect measurement system.**
- **Provides services as a SaaS, adopting the subscription-based business model.**

(7) Impressions: The number of times an ad was displayed.
(8) Clicks: The number of times an ad was clicked.
(9) Conversions: The number of times that users, who visited the site and clicked on an ad, took actions that the advertiser considers as achievement, such as product purchase, information request, and inquiry.
(10) Subscription-based business model: A business model where users pay for the provided service according to the duration of use.

(i) AD EBiS

AD EBiS is the Company's core product and is an Internet advertising effect measurement system that allows the collective management, effect measurement, analysis, and visualization of the effect of Web ads, etc., to help assess the cost effectiveness of ads. It comprehensively provides a one-stop marketing environment for maximizing sales or acquiring prospective customers through proactive marketing by "using" marketing data accumulated by the "effect measurement" function. AD EBiS makes possible the visualization of marketing strategy (evaluation, improvement, etc.), letting advertisers measure and understand the series of behavior from the number of impressions[7] of the ads displayed on PCs, smartphones, etc., and the contacts, interests, and reactions toward the advertiser's ads to the number and history of clicks[8] for the paid-listing ads and the final purchase made at the advertiser's website (the number of conversions[9]).

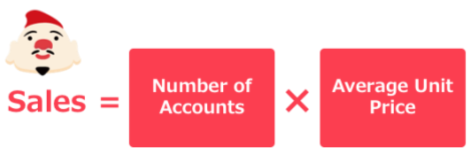
The service is provided as a SaaS under a subscription-based business model[10] (described in detail on page 14).

- **Number one in the domestic market for four consecutive years**

Since its release in 2004, AD EBiS has had a total of more than 9,000 installations and has had the largest share in domestic market for Internet advertising effect measurement system for four years in a row. Moreover, according to the Company's data, it is increasing its share year by year from 36.0% in FY 2015 to 40.0% in FY 2016, 42.9% in FY 2017, and 44.2% in FY 2018 (forecasted value). It is a B2B business with its major customers being ECC Junior, Aiful, Noevir, Zwei, Kobayashi Pharmaceutical, Z-kai, Yazuya, Setagaya Shizenshokuhin, etc.

- **Unit price largely increased with the transition to the new pricing system with the packaged plan.**

AD EBiS allows users to add a variety of optional functions (Cross-Device Function, access history analysis function, etc.) to the basic function as necessary. In the past, its pricing plan was a pay-as-you-go based on multiple parameters. However, starting in June 2018, the Company simplified the plan and set up a pricing table with a flat rate for different upper limits to the monthly number of clicks and PV (page view), much like a mobile phone pricing plan. New contracts have already been transferred to the new pricing system. In the new pricing system, the implementation-support program and telephone support are packaged together with the basic functions and three main plans of S, M, and L (monthly basic charge: 100, 200, and 300 thousand yen, respectively) are offered. Options (various external linkage functions such as reporting, etc.) can be added to a plan.



As a reference, sales of AD EBiS are determined by average unit price × number of active users. Both figures are important indices (KPI) not only for this business but for the Company as a whole.

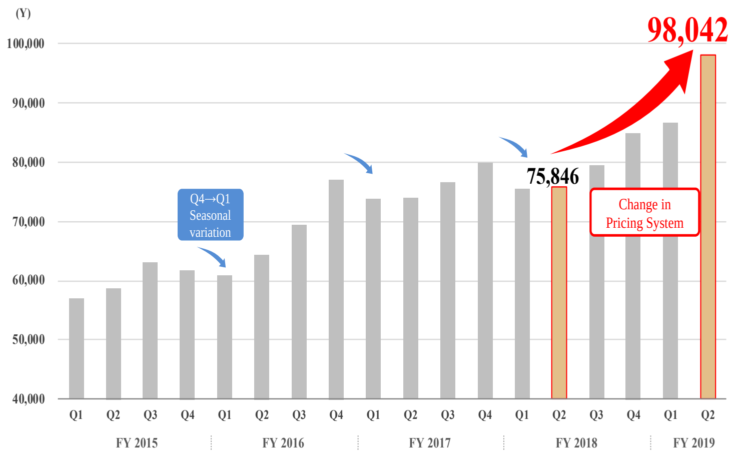
In Q2 of FY 2019 (January to March), the average monthly unit price (average unit price as of the end of the last month of each quarter; the same applies below) was Y98,042, which is Y22,196 or 29.3% greater than Y75,846 in the same period of the previous fiscal year. This price is also Y11,421 and 13.2% greater than in Q1.

- **AD EBiS's number of accounts and average unit price are the KPI.**
- **One of the goals is to reduce the contract cancellation rate.**

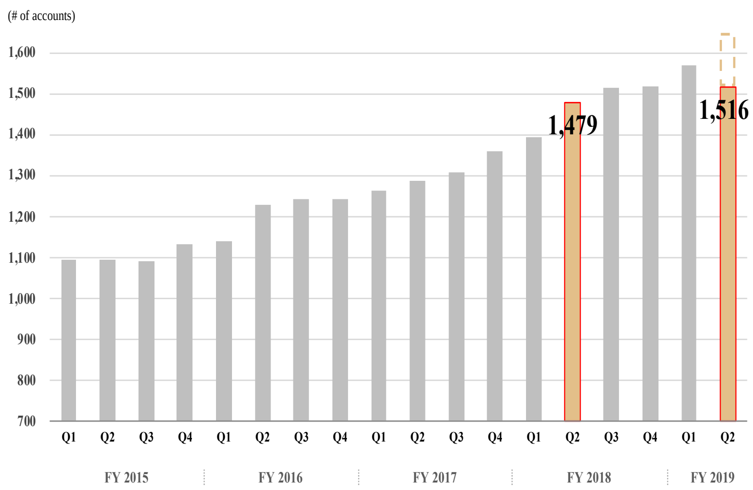
Meanwhile, AD EBiS's number of active accounts was 1,516, having increased only by 37 accounts or 2.5% compared to 1,479 in the same period of last fiscal year. Compared with the end of Q1, the number of accounts has decreased by 53 (Figure 8). This sharp rise in unit price and slight decrease in the number of accounts are due to the increase in cancellations by low-priced contracts when the existing customers' contracts were transferred to the new pricing system in March and April of 2019. However, the Company is not concerned about this change since it is a transient phenomenon associated with the pricing revision and the sales in the low price range where cancellations have increased are only 2% of total sales.

Since October 2018, the average unit price of AD EBiS for newly acquired contracts has been exceeding Y100,000. Nearly 90% of the existing customers have already transferred to the new pricing system, and large increases in unit price from the pricing revision have mostly ended. However, as the number of high-priced new customers increases and new functions and services (including the increase in revenue from providing option services through external partners) are added, the unit price is expected to continue to rise annually by around 5-10%.

【 Figure 7 】 Change in Average Unit Price of AD EBiS



【 Figure 8 】 Change in the Number of Active Accounts of AD EBiS



(Ref) Figures 7-9 were prepared by Alpha-Win Research Dept. from the Company's securities report and financial results briefing materials.

(ii) THREe

- **THREe's sales are very small. The Company plans to reduce business resources used for this business in order to concentrate on AD EBiS.**

(11) Human-like Portfolio: A bidding function that algorithmizes the bidding strategy of the operator. If budget and efficiency target are set, it will automatically perform optimal bidding as if operated by a person.

THREe is also a proprietary product – an operation platform for paid-listing ads. Of the many forms of Internet advertising, programmatic advertising is especially rapidly growing and is becoming more complicated and advanced. Consequently, manual operation is becoming difficult (about 70% of Internet ads are programmatic ads). Using THREe, it is possible to analyze big data accumulated through AD EBiS or various media, automatically optimize ads, and automatically submit ads. By enabling fully automatic operation (Human-like Portfolio[11]), including the optimal adjustment of bid unit price and addition of keywords, it can shorten the amount of time needed for operation and management and realize optimization. It has been used by more than 5,000 users. THREe is also provided as a SaaS.

However, THREe accounted for only a little less than 3% of total sales in FY 2018 and merely 1-2% in this fiscal year's H1. In order to concentrate business resources on AD EBiS, the Company intends to scale down this business in the future.

(iii) DMP Business

- **Moved the DMP business from the EC platform business**

The DMP business was transferred from the SOLUTION division of the EC platform business to a division of the marketing platform business in the previous fiscal year since it is closely related to AD EBiS. DMP is the abbreviation for "Data Management Platform." The private DMP provided by the Company is a method by which a corporate client can analyze its website. For instance, a client can investigate and verify the behavior history and stay time of users who visited its website. The Company has several major clients for this business including Lion. This H1, the business was only about 3% of the total sales, and the Company intends to scale down this business like THREe.

(iv) AdRepo Business

- **AdRepo's customers are advertising agencies. Enables automated creation of reports for programmatic advertising.**

In August 2018, the Company acquired the AdRepo business, an automatic report-generation tool for programmatic advertising, and has begun to fully develop this business starting this fiscal year. Annual sales are estimated to have been a little less than Y100 million in the last fiscal year. By acquiring new customers and creating a synergy with AD EBiS, the Company plans to develop this business as its growth business (sales of greater than Y100 million and growth rate of about 30% forecasted for this fiscal year). Its domestic market share is third place, following ATOM (TechLoCo Co., Inc.: not listed) and glu (ATALA LLC: not listed, a partner of the Company).

AdRepo is a tool to fully automate the generation of reports and is a cloud service developed to reduce the workload of advertising agencies in report creation for programmatic ads. By collaborating with key advertising platforms such as Google AdWords, Yahoo! Promotional Ads, Facebook Ads, and FreakOut, it can automate data aggregation and report generation for programmatic ads. In addition, by strengthening its coordination with AD EBiS, AdRepo enables the integrated management of all data from data measurement to reporting and automation of digital marketing work.

（2） EC Platform Business

Until FY 2018, the EC platform business had been composed of the following two divisions: (i) EC-CUBE and (ii) SOLUTION. However, starting this fiscal year, the SOLUTION division no longer exists due to a transfer.

【 Figure 9】Change in Sales of the EC Platform Business and Operating Profit of This Business Segment

Sales (Y mil)	*FY 2012 stand-alone*	*FY 2013 consolidated*	FY 2014 consolidated	FY 2015 consolidated	FY 2016 consolidated	FY 2017 consolidated
EC Platform	*323*	*422*	477	526	539	465
1. EC-CUBE	*150*	*207*	245	230	219	208
2. SOLUTION	*174*	*214*	232	296	319	257
(DMP)						104
Segment's O.P.	*98*	*75*	107	136	38	-60
Segment's O.P. Margin	*30.5%*	*17.8%*	22.5%	25.8%	7.1%	-12.9%

(i) EC-CUBE

EC-CUBE is an open source software[12] or platform whereby users can create and operate EC (e-commerce) websites on their own. The Company provides EC-CUBE as free packaged software for web design to companies who wish to begin selling and providing products and services on the web. It is characterized by both the user-friendliness as an ASP[13] and the convenience as a software enabling development – companies can directly and freely customize the program source. It has the largest share in the domestic market. EC-CUBE has features such as low cost, high customization (it can be changed according to the needs of users), and user-friendly interface, and has become a standard platform.

(12) Open source software: The source code, which is equivalent to the blueprint of software, is made available free of charge, letting anyone improve and redistribute it.

(13) ASP: A service that rents applications to customers through the Internet.

(14) Freemium Model: "Freemium" is a coined word that combines "free" and "premium." Refers to a business model that generates revenue by offering basic services free of charge while charging fees for more sophisticated or specially-added related services.

In return for offering EC-CUBE for free, the Company has set up a Freemium Model[14] where revenue is earned from peripheral services. Through this system, the Company makes profit from royalties from official partners in the Internet business (account settlement agent business, hosting businesses, etc.), function-addition fee from plug-ins (program to add functions to software), sales revenue of commercial license, etc. Other sales related to sales promotion and events are also included in the net sales.

- **The EC-CUBE business has been transferred to a consolidated subsidiary.**

However, as part of the restructuring of the business domain of the Company's group, the EC-CUBE business was succeeded by the 100% consolidated subsidiary, EC-CUBE Co., Ltd., on January 1, 2019. Because it is a fully consolidated subsidiary, there will be no change in the consolidated financial results, but the Company plans for the subsidiary to further expand and develop the business as a separate corporate entity, for instance, through partnerships with other companies. The development of the new version, EC-CUBE4, has been completed, and it has been provided since October 2018. Its cloud version was also released and the Company is examining various possibilities for future development.

(ii) Former SOLUTION business

- **SOLUTION business was transferred to affiliates accounted for by the equity method.**

Although the SOLUTION business had been composed of multiple businesses, with the restructuring of business, its main EC outsourced development business had been transferred to the two affiliated companies of which the Company owns 20% of shares each (reflected under non-operating profit/loss as profit or loss accounted for by the equity method). From this fiscal year and onward, this division of business will no longer exist.

◆ Subscription-Based Business Model

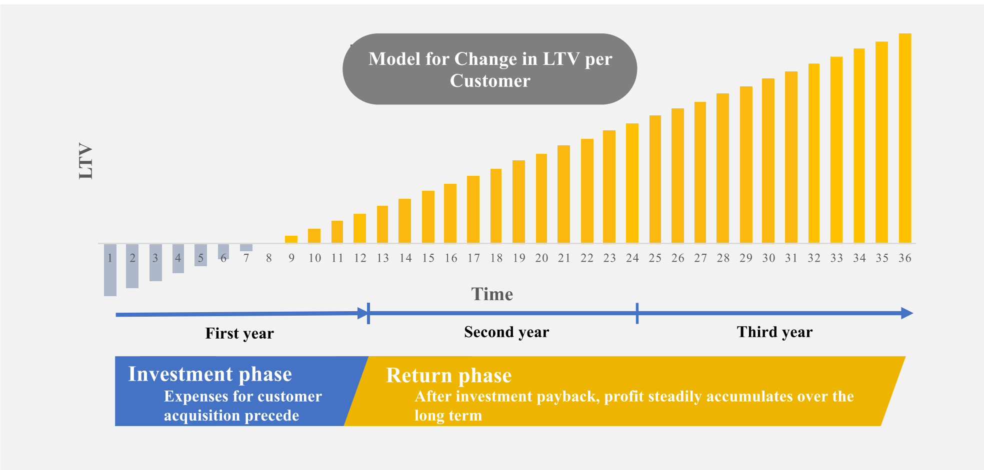
- **The Company's main business is based on a subscription-based business model. It lets the Company acquire continuous and stable profit by charging fees for every certain period of use.**

The marketing platform business, which accounts for approximately 90% of the Company's sales, is mostly based on the SaaS (cloud), flat-rate billing model. It is a subscription-based business where users pay a predetermined fee for the service contents or the use of system services such as AD EBiS during a certain contract period, such that the Company can continue to earn revenue until contract cancellation. Although expenses including marketing and sales expenses for customer acquisition and R&D expenses will precede at the beginning of a new contract, over a period of about three years (the period from the start to the end of a transaction with a customer), revenue can be accumulated continuously to increase the life time value (LTV: how much cumulative profit is generated within a customer's lifetime). Therefore, it is a business model that allows for stable growth.

- **A business model where there is an overall loss immediately after obtaining a new contract, but over time the cost is recovered and profit is steadily accumulated.**

Figure 10 below shows a model for the change in the Company's cumulative profit and loss over the average contract period of three years under the subscription-based business model. In the month that a new contract is made, all of the expenses are recorded, so that an overall loss is recorded for that month. However, since the Company then earns an almost fixed amount of sales revenue every month starting in the month of contract, the cumulative break-even point is reached after eight months. From the ninth month, the cumulative profit and loss (LTV) turns into a surplus and accumulates until the 36th month when cancellation is expected. In other words, while the number of contracts is increasing at an accelerating speed, on the surface level, there would seem to be a time lag, where the contribution to profit in the first year is small but profit accumulates on a continual and stable basis from the second year until the end of the contract. The Company considers the upper limit of the initial cost to be about 30% of the LTV (the final cumulative profit; the rightmost end of the graph in Figure 10) and controls the initial cost related to new contract acquisition accordingly.

【 Figure 10 】Model for the Change in LTV per Customer (cumulative profit and loss)



(Ref) Prepared by Alpha-Win Research Dept. from the Company's financial results briefing materials, website, etc.

◆ **HubSpot, Inc., which adopts the same subscription-based model and is listed on the market in the US, has improved its financial performance, leading to large increases in stock price.**

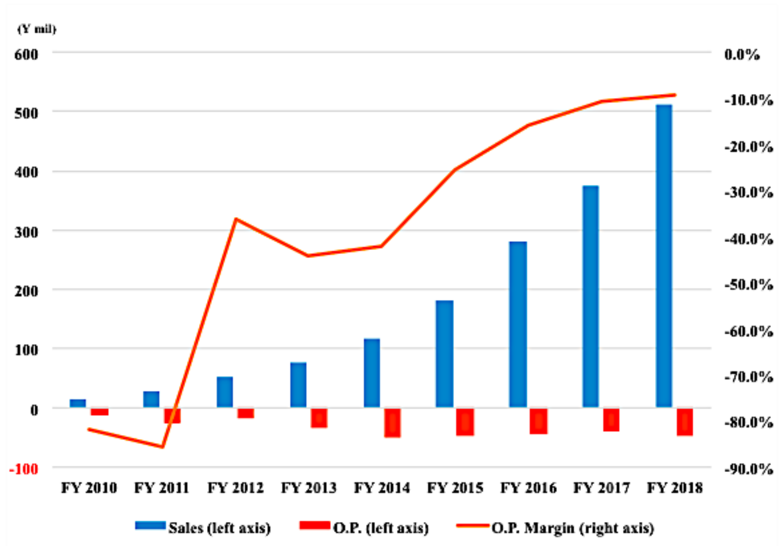
HubSpot, Inc. (hereinafter "HUBS"), listed on the US NYSE, is a company with the same subscription-based model as the Company that can be studied as reference. HUBS provides integrated software for inbound marketing[15] and sales via the cloud. This company charges a monthly fee based on the amount of use.

The transition in HUBS 's overall financial performance is shown on Figure 11, and the transition in profit margin, various expense ratios, and the number of customers are shown on Figure 12. Because of sales and marketing expenses and upfront investment costs such as research and development (R&D) expenses incurred during the business's growth phase, or the phase during which the number of customers rapidly increases, the operating margin resulted in a large negative percentage of -82% in FY 2010. However, due to the time lag in the number of contracts, sales, and profit inherent to the subscription-based model as described above, the operating margin sharply improved to -9% in FY 2018. In response, the stock price of HUBS also rose to about 7.7 times the price of its IPO (on October 2014), largely outperforming NASDAQ (by 3.1x) and S&P500 (by 2.6x) (as of May 18, 2019).

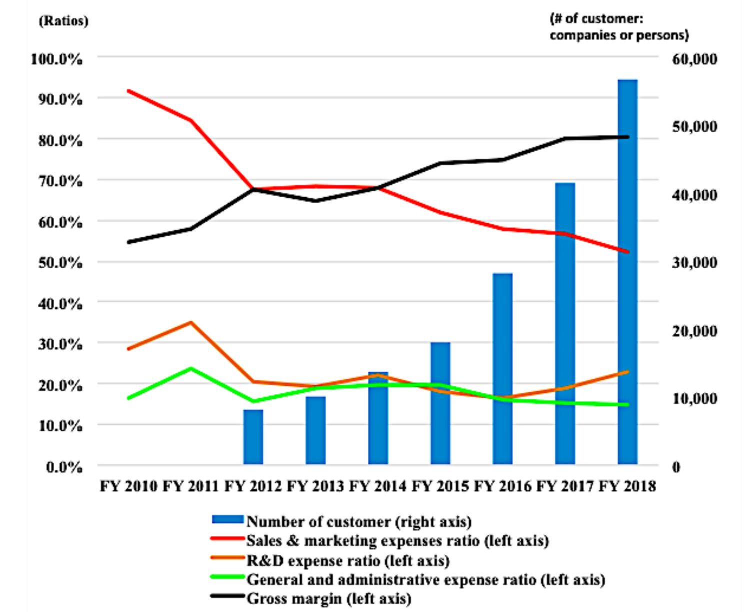
Similar to HUBS, the profit of the Company (LOCKON CO., LTD.) is predicted to tend to improve with a time lag as the number of contracts (net sales and active users) increases. Therefore, it would be important to follow up on the Company over multiple years rather than just a single year. In that sense, the number of active users and the average unit price may be considered as leading indicators of the Company's financial performance.

(15) Inbound marketing: A marketing concept where the relevant information (contents) are sent out to users who are already interested in them to some degree and are potential future customers of the advertiser, thereby encouraging purchase of the advertiser's products or services.

【 Figure 11 】Change in HUBS' Financial Performance (1)
Sales & Operating Profit (left axis): unit = USD mil **O.P. Margin (right axis)**: unit = %



【 Figure 12 】Change in HUBS' Financial Performance (2)
Gross margin & expense ratios over sales (left axis): unit = %
Number of customers (right axis): unit = companies or persons



(Ref) Figures 11 and 12 were prepared by Alpha-Win Research Dept. from HUBS' financial results materials, website, etc.

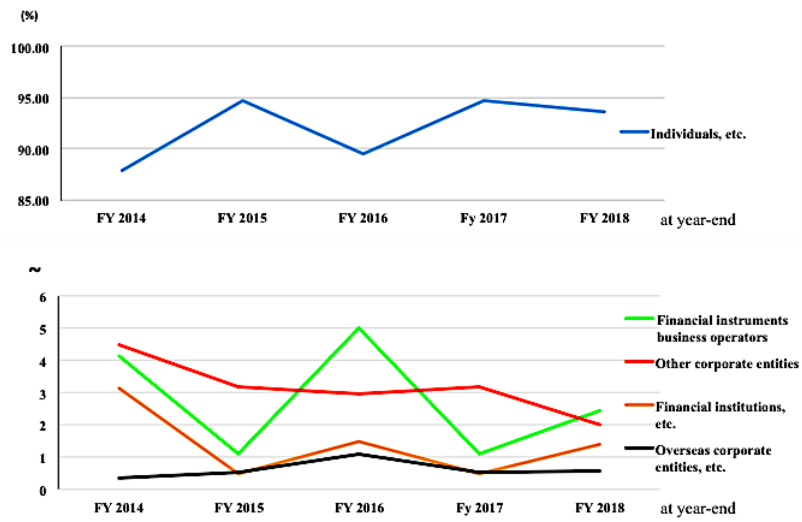
3. Shareholder Composition

◆ **The shareholding ratio of individuals is overwhelmingly high at about 94%.**

◆ Change in Composition by Shareholder Type

Regarding shareholder composition by shareholder type as of the end of September 2018 (Figure 13), "individuals, etc." accounts for an overwhelmingly large portion – about 94% of the total. "Other corporate entities" is about 2%, "financial instruments business operators" is also about 2%, and both the "overseas corporate entities, etc." and "financial institutions, etc." are small, at less than 1% and about 1%, respectively. The composition ratio has not changed significantly.

【Figure 13】Change in Shareholder Composition by Shareholder Type (unit = %)



(Ref) Prepared by Alpha-Win Research Dept. based on the Company's FY 2018 securities report

◆ Major Shareholder Composition

The major shareholders are shown on Figure 14. The following is supplementary information (as of the end of March 2019). When data over past periods are compared, we can see that the profiles of the major shareholders have remained mostly the same, except for the general individual shareholders.

◆ **There have been no large changes in the top major shareholders. Persons affiliated with the Company, including active and former executive officers and the employee stock ownership plan, own approx. 60% of the shares.**

・The largest shareholder owning greater than 40% of shares is Susumu Iwata, the current president, founder, and owner.

・Second and third largest shareholders are former executive officers of the Company. The shares of the former and present executive officers of the Company, plus the employee stock ownership plan at seventh place, amount to greater than 60 percent of the total shares.

・The fourth and fifth largest shareholders are both trust banks. The actual final investors' names and purposes of investment are unknown, but they have been buying more shares and climbing up the ranking of shareholders. Also, we have noticed that 189.5 thousand shares (equivalent to about 3% of LOCKON CO., LTD.'s outstanding shares) are included in the "MHAM Emerging Growth Stock Open" portfolio (also called "J-Frontier") as of February 25, 2019. Although we could not clearly and formally identify this portfolio as a major shareholder, it is highly likely that the portfolio is being invested in the name of a trust bank.

・The eighth largest shareholder is Hakuhodo DT Media Partners Inc., the Company’s distributor.

・The ninth largest shareholder is BNY GCM CLIENT ACCOUNT JPRD AC ISG, an account that is a major shareholder of a total of over 40 Japanese stocks – mainly small caps but also large caps. Its investment objective is unknown, but currently it portrays no activist-like behavior.

As of the end of September 2018, the number of treasury shares owned by the Company was 983 shares. The Company bought back its shares in February and March of 2019 (a total of about Y100 million with an average stock price of Y1,363), increasing its treasury shares to 78,396 shares (equivalent to 1.23% of outstanding shares). The Company intends to use these treasury shares for M&A and alliance strategies as well as stock-based compensation for its executives and employees in the future.

【 Figure 14 】 Major Shareholders’ Status

Unit for number of shares in the table: thou. shares %

	End of Sept. 2015	End of Sept. 2016	End of Sept. 2017	End of Sept. 2018	End of Mar. 2019	←Shareholding %	←Ranking
Susumu Iwata (president and CEO)	2,851	2,817	2,817	2,819	2,822	44.83	1
Hiroichi Fukuda (former executive vice president)	1,071	1,021	1,021	961	961	15.27	2
Kanako Mataza (director and senior executive officer)	415	415	352	354	353	5.60	3
Japan Trustee Services Bank, Ltd.	—	59	—	60	246	3.91	4
Trust & Custody Services Bank, Ltd.	—	—	60	29	111	1.76	5
Rakuten Securities, Inc.	—	—	—	72	110	1.75	6
LOCKON Employee Stock Ownership Plan	76	39	48	69	71	1.12	7
Hakuhodo DY Media Partners Inc.	60	60	60	60	60	0.95	8
BNY GCM CLIENT ACCOUNT JPRD AC ISG (FE-AC)	—	—	60	—	37	0.58	9
Tomonori Yamada (indiv.)	—	—	28	—	28	0.44	10
Katsuyuki Ito (indiv.)	—	—	—	52	—		
Akiko Takashima (indiv.)	—	—	—	29	—		
Kenichiro Wade (former outside director)	39	29	29	—	—		
Yoshio Takayama (indiv.)	—	—	28	—	—		
Kayoko Nagano (indiv.)	—	—	24	—	—		
SEPTENI CO., LTD	62	62	—	—	—		
Matsui Securities Co., Ltd.	—	36	—	—	—		
Japan Securities Finance Co., LTD	30	35	—	—	—		
Yoichi Nishikawa (indiv.)	34	—	—	—	—		
Akio Shiojiri (former director: audit committee member)	26	—	—	—	—		
(Number of treasury shares)	0	0	45	983	78,396		
(Ratio of treasury shares over all issued shares)			0.0007%	0.0155%	1.2302%		

(Ref) Prepared by Alpha-Win Research Dept. from the Company’s FY 2019 Q2 securities report

4. ESG

◆ Environment

The Company's business is not the kind that harms the environment. The Company aims to conserve energy by saving electricity, etc.

◆ Society

- **Actively engaged in CSR. Supporting future entrepreneurs, next-generation human resource development, and women working in the technology industry.**

The Company is actively engaged in CSR (corporate social responsibility: responsibility of a company to voluntarily contribute to society through business activities from an ethical point of view) and has been undertaking social initiatives based on the following view: "We believe that, regardless of the size of the company, it is the minimal responsibility as a corporate citizen to undertake social initiatives to the extent that is reasonably possible for each company. We believe that such activities will promote a company's growth. By putting this corporate philosophy into action, we will aim to heighten the value that we provide to our stakeholders including our customers, shareholders, employees, and the local community."

・"Osaka to the World" – regional development activities: *Osaka Startups* – providing a support program for startup companies based in Osaka and for those aiming to start a company.
・"Promotion of Women's Active Participation in Society" activities: *Girls in Tech Japan* – supporting the improvement of the status of women working in the technology industry based on the philosophy of Girls in Tech (GIT: a nonprofit organization launched in 2007 in San Francisco, USA).
・"Next-Generation Human Resources Development" activities: providing opportunities for students to learn the programming skills necessary for leading-edge technologies through actual job experience in order to foster a young generation of human resources.

In addition, the Company holds a general employee meeting twice a year as well as holding monthly company parties where all the employees gather on the last Friday of each month. It also has clubs. Through these activities, the Company provides the opportunity to exchange information and strengthen the relationship among employees.

The Company also puts efforts into enhancing unique employee benefit programs, such as the "Mountain-Retreat" Leave System where every employee must take nine consecutive days of leave every year, the Training Leave Program which allows employees to take leave for up to two years for self-development, and the LOCK-Off which is a facility (a house) for employees to communicate with each other and learn freely. Because of these efforts, the Company has been awarded with the following awards.

· Great Place to Work®[16] Best Workplaces Ranking: Best Companies Award (awarded for seven years in a row; a total of eight awards). Since the Company has grown in size, the award category has changed from "Small-sized companies (25-99 employees)" to "medium-sized companies (100-999 employees)," but it again received an award this year.

(16) Great Place To Work® Institute: An organization that conducts surveys and presents "Great Places to Work" in about 50 countries around the world every year.

· Selected by the Ministry of Economy, Trade and Industry as a Driving Company for the Regional Future for Fiscal Year 2017
· The 2nd GOOD ACTION contest sponsored by Rikunabi NEXT: Best Action Award
· The 8th Deloitte Technology Fast 500 Asia Pacific Award
· The 7th Japan Technology Fast 50 Award

◆ Governance

The Company has adopted a company system with an audit and supervisory committee and delegates decisions on executions of important business matters to directors to enable quick decision-making. In addition, by incorporating an executive officer system (five officers), the Company aims to improve management efficiency and speed by separating business execution and supervision.

Of the five directors, three are outside directors who are also audit and supervisory committee members (from Kobe Steel, Ltd. and MUFJ Bank, Ltd.; certified public accountants). There is no woman among the directors or executive officers.

In addition, as transfer-limited stock-based compensation, the Company has a program where shares are allotted to directors (including directors who are audit and supervisory committee members), executive officers, employees, etc., as an incentive.

Also, the Company has not adopted any anti-takeover measures.

5. History of Growth

◆ Company History

- **Founded by president Iwata in 2001**

President Susumu Iwata traveled around the world as a backpacker during his college days. After returning home, he started a restaurant but withdrew and then started a travel-related business. Through this business, he acquired the skills and know-how for Internet and web design. He then individually started a web design business. This business grew and, in June 2001, when Mr. Iwata was 21 years old, he founded the Company. After foundation, upon recognizing the business potential, interactivity, and real-time nature of the Internet, as well as the importance of data mining, he began to make a transition to a web integration business.

- **Developed and launched unique products that can be differentiated from other companies**
- **Listed on Mothers in September 2014**

In September 2004, the Company released the EBis (predecessor of AD EBiS), a proprietary Internet advertising effect measurement system, based on the concept of "From 'a Website to Show' to 'a Website to Use.'" Then, in September 2006, it released Japan's first open platform software EC-CUBE, and released the paid-listing ad management service THREe in October 2012. Amidst the rapid increase of Internet ads and the related market needs for adverting effect measurement and EC, the Company pioneered in the creation of unique products, steadily expanding its business by cultivating a new market. It became listed on the TSE Mothers market in September 2014.

◆ Transition in Past Financial Results

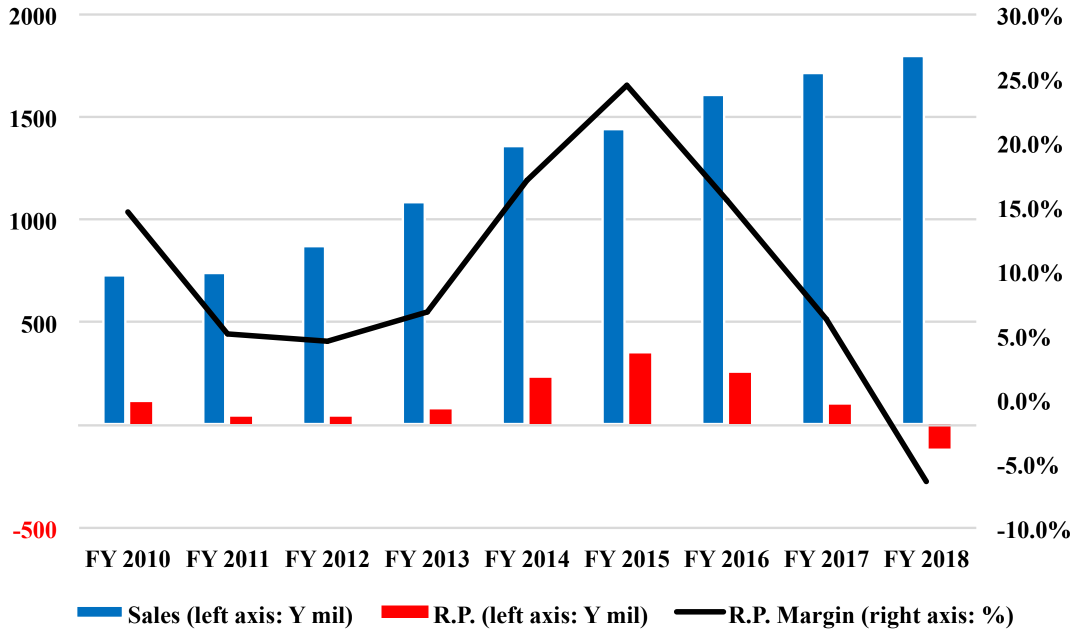
- **In FY 2015, record-high profit was recorded. All-time highs are being consecutively achieved every year for sales.**

From FY 2010 to FY 2013, during which account settlement was nonconsolidated, the Company increased sales for fourth consecutive fiscal years. From FY 2014, when consolidated account settlement began, record-high sales were achieved for four consecutive fiscal years up to FY 2018 (from what is available in the disclosure material, we can see that sales have been hitting record-highs for at least eight consecutive fiscal years). During this period, sales increased by about 2.5 times from about Y730 million to about Y1.8 billion. This success was brought by the rapid expansion of the marketing platform's AD EBiS business and the steady growth of the EC platform's EC-CUBE and SOLUTION businesses.

- **Since FY 2016, the Company has been restructuring its business and conducting upfront investment for future growth as its priority, rather than focusing on profit. A net loss was recorded in FY 2018.**

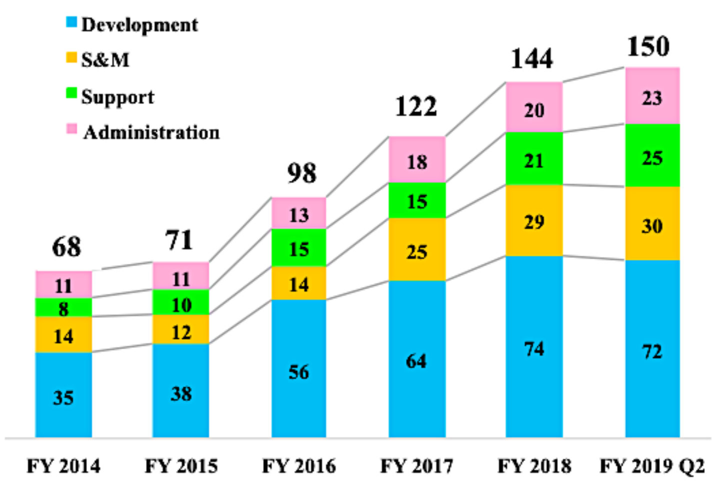
Meanwhile, for profit, the Company had sustained profitability both on a nonconsolidated and consolidated basis until FY 2017. In FY 2015, a record-high operating profit of Y350 million and a record-high net profit of Y231 million were achieved. However, since FY 2016, the Company's focus on business restructuring and upfront investment has increased the expenses, leading to a consecutive decline in profit despite increasing sales. In the previous fiscal year, or FY 2018, the Company recorded a net loss (of Y88 million) for the first time since becoming listed on the market (for details on FY 2018's results, please refer to the first report (English version): "Alpha-Win website: issued January 31, 2019") due to the upfront investment cost mainly for the expansion of human resources for divisions such as development and sales.

【 Figure 15 】 Transition in Past Financial Results (unit: Y mil, %)



(Ref) Prepared by Alpha-Win Research Dept. from the Company's securities report and financial results summary
(Note) Consolidated results starting in FY 2014; nonconsolidated prior to this point.

【 Figure 16 】 Change in the Number of Employees (unit: persons)



(Ref) Prepared by Alpha-Win Research Dept. from the Company's financial results briefing materials

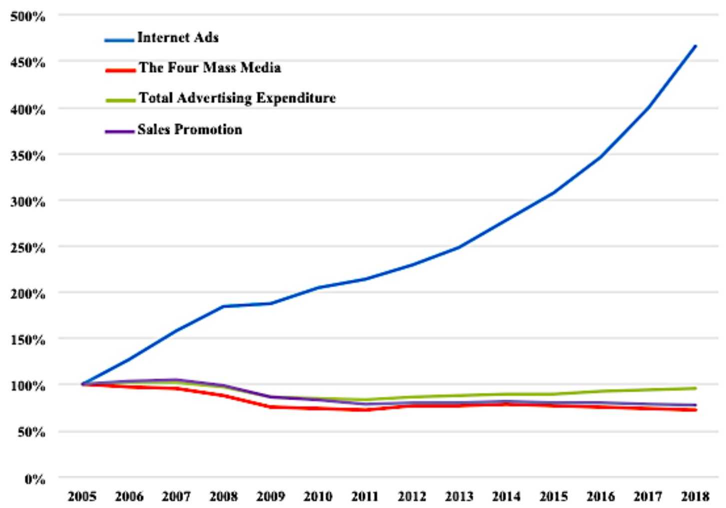
6. Business Environment

- **The Internet advertising expenditure increased by about 4.6x from 2005 to 2018. The average annual growth rate (simple average) is high at about 12.8%.**

◆ Trends in Japan's Advertising Industry

Total advertising expenditure in Japan in 2018 (calendar year; the same applies to this entire chapter) was about Y6.5 trillion. Over the long term, the market has been flat. However, since 2012, market growth has been observed for seven years in a row, indicating that the market as a whole is on a slight uptrend (the annual growth rate, based on a simple average, is 1.9%). This growth was brought by the growth of the Japanese economy supported by factors such as strong earnings of companies and improvement in employment conditions. Internet advertising expenditure is also driving the growth of the overall advertising expenditure. Of the total advertising expenditure, Internet advertising expenditure (total of medium cost and production cost) was about Y1.76 trillion (+16.5% YOY, growing at a double-digit rate for five consecutive years), which is about 26.9% of the total (ref: Dentsu Inc.'s "2018 Advertising Expenditures in Japan"). Its share in the market is steadily increasing by 1-3% every year, growing to a level close to the share of 29% for television advertising, the largest among the four types of mass-media advertising (newspaper, magazine, radio, and television). Internet advertising expenditure has grown by about 4.6 times from 2004 (point of comparison, set at 100) to 2018, rapidly increasing at an average annual growth rate of about 12.8% (Figure 17).

【 Figure 17 】Change in Advertising Expenditure by Medium
(index value: year 2005 set at 100)



(Ref) Prepared by Alpha-Win Research Dept. from Dentsu Inc.'s "2018 Advertising Expenditures in Japan"

- **Internet advertising is expected to continue its double-digit growth in the future.**

In fact, Internet advertising expenditure is expected to continue to grow at a double-digit rate. According to the data on the number of Internet users and population penetration rate disclosed by the Ministry of Internal Affairs and Communications, 83.5% of Japan's population already uses the Internet and the Internet has become a necessity of life. In the near future, Internet ads are highly likely to become the most influential advertising medium. Since more people are expected to use the Internet as technology becomes more advanced in the future, demand for Internet advertising is expected to grow.

In particular, of the Internet advertising expenditure, programmatic advertising expenditure which is highly relevant to the Company's business amounted to about Y1.2 trillion (+22.5% compared to the previous year; approximately 70% of the total Internet advertising expenditure) and is growing at a higher rate than the average of Internet advertising. Since programmatic advertising makes possible the control of budget, delivery period, and delivery method and allows users to obtain data in real time, for the time being, the growth of this market is expected to help keep the business environment favorable for the Company in developing its business based on Internet advertising effect measurement and utilization.

◆ LOCKON CO., LTD.'s Competitors

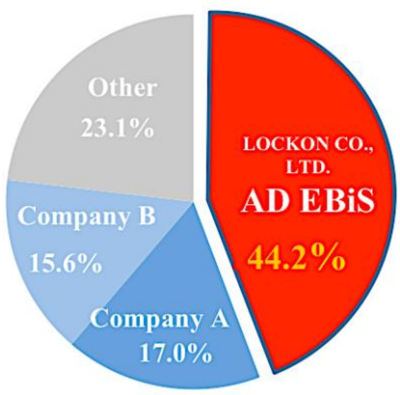
There seems to be no Japanese listed company that could be directly compared with the Company. For advertising effect measurement and analysis tools, the competing products are Google Analytics[17] and Adobe Analytics[18] widely used by domestic SMEs (small- and medium-sized enterprises), ADPLAN (implemented in a cumulative total of over 1,500 companies) offered by the listed company OPT Holding Group (TSE First Section 2389; hereinafter "OPT HD"), and Web Antenna (implemented in more than 600 companies, including major companies as well as venture companies) provided by the unlisted company beBit, Inc. However, the other companies are not specialized in the field, and their product's functions, measurement targets, analysis contents, and support system are limited. In comparison, the Company's products are superior in terms of specifications and the development and support systems, which explains why the Company has a large share and is number one in the market. Also, the Company's target customer zone is the middle zone, different from the high-end zone targeted by the paid versions of Google Analytics and Adobe Analytics (estimated to be about ten times the Company's price setting).

(17) Google Analytics: A website access analysis tool provided by Google targeting SME users. Analysis is only conducted within Google's website, and mostly the free version is popular. The high-spec paid version seems to be in the high-price zone.

(18) Adobe Analytics: An access analysis tool that is installed in many large websites. It can analyze complicated and large data, is highly customizable, and has multiple and high-quality functions, but the price is high.

◆ AD EBiS – No. 1 in domestic share for four consecutive fiscal years. Its share is on an increasing trend.

【Figure 18】Each Vendor's Share of Advertising Effect Measurement Market by Sales Volume (forecast for 2018)



(Ref) The Company's financial results briefing materials

7. This Fiscal Year's H1 Results and Full-Year Forecast

◆ Financial Results for FY 03/2019 (this fiscal year's H1)

◆During this H1, net loss was posted due to upfront investment for future growth, but operating loss turned into profit. Record-high sales were achieved in H1 for another consecutive period.

◆However, net loss was posted due to extraordinary loss.

In the first half (hereinafter "H1": October 2018 to March 2019) of FY 2019, consolidated results were as follows: sales of Y1,081 million (+23.2% YOY), operating profit of Y21 million (in the same period of last fiscal year: operating loss of Y70 million), recurring profit of Y17 million (last fiscal year: a recurring loss of Y81 million), and net loss attributable to the parent company of Y46 million (last fiscal year: a net loss of Y58 million). Regarding sales, sales increased sharply in H1, reaching an all-time high for another consecutive period. Although the Company had been posting an operating loss since Q4 of FY 2017 for six consecutive quarters due to upfront investment costs and structural reform, it turned into the black during this fiscal year's Q2. However, because of the Y60 million recorded as litigation-related loss and the Y11 million recorded as loss on retirement of fixed assets, totaling Y71 million in extraordinary loss, the Company posted a net loss.

◆The main AD EBIS business's unit price rose and contributed to the sales increase.

By segment, although overall sales in H1 had increased by Y204 million YoY, this was mostly due to the marketing platform business which contributed Y226 million to sales and also contributed significantly to the improvement in profit by Y90 million (operating loss of Y82 million last H1 → operating profit of Y9 million this H1) (Figure 19). As mentioned above, this is explained by how the average unit price of AD EBiS rose sharply due to the pricing revision as well as its number of active accounts. The EC platform business's sales decreased by 15.1% YOY (decreased by Y22 million), partly due to business restructuring including business transfer. However, its operating profit had stayed mostly the same, from Y11 million last H1 to Y12 million this H1.

【 Figure 19 】 This Fiscal Year's H1 Financial Results

(Ref) Prepared by Alpha-Win Research Dept. based on financial results briefing materials and securities report

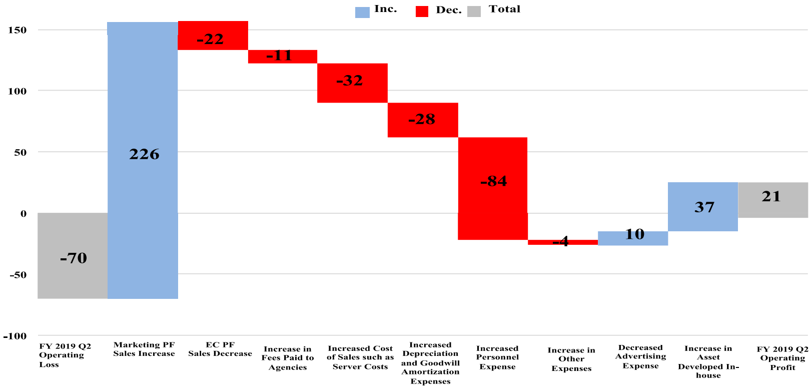
	FY 2018		FY 2019		FY 2018	FY 2019	FY 2019 H1 YOY	
(Unit: Y mil)	Q1 (Oct-Dec)	Q2 (Jan-Mar)	Q1 (Oct-Dec)	Q2 (Jan-Mar)	H1 (Oct-Mar)	H1 (Oct-Mar)	Amount	% Change
Total Sales	433	444	520	561	877	1,081	204	23.2%
Marketing Platform	353	377	460	496	729	956	226	31.0%
EC Platform	80	68	59	67	148	126	-22	-15.1%
Gross Profit	286	296	344	404	582	748	166	28.4%
Gross Margin	66.1%	66.7%	66.1%	72.0%	66.4%	69.2%		
SG&A Expenses	334	319	370	356	653	727	74	11.3%
SG&A Expenses Ratio	77.1%	71.8%	71.3%	63.5%	74.4%	67.2%		
Operating Profit (segment)	-48	-23	-27	48	-70	21	92	To profit
Marketing Platform	-44	-37	-21	29	-82	8	90	To profit
EC Platform	-3	15	-5	18	11	12	1	10%
Operating Margin	-11.0%	-5.1%	-5.1%	8.5%	-8.0%	1.9%		
Marketing Platform	-12.5%	-9.9%	-4.6%	5.9%	-11.2%	0.8%		
EC Platform	-4.2%	21.3%	-9.2%	26.6%	7.5%	9.7%		
Recurring Profit	-47	-34	-30	47	-81	17	*98*	*-1*
Net profit	-32	-27	-36	-10	-59	-46	*13*	*-0*

◆With the increase in sales, SG&A expenses ratio decreased and margins improved.

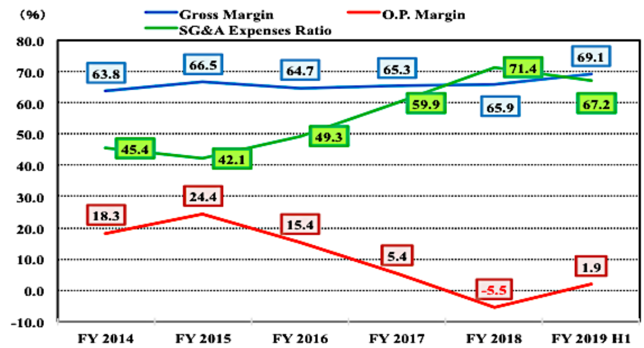
The improvement in overall profit had been largely caused by the increase in sales, which offset the rise in personnel expenses by Y84 million due to increased hiring, etc., the rise in cost of sales by Y32 million because of server costs, etc., and the increase of Y28 million in goodwill and depreciation expenses (Figure 20).

The gross margin had been stably high at about 65% since FY 2014, but during this H1, it improved to 69.1%, which is 2.7 points greater than the previous fiscal year's H1. Meanwhile, SG&A expenses (-to-sales ratio) had risen sharply from Y796 million in FY 2016 (49.3%) → Y1,030 million in FY 2017 (59.9%) → Y1,298 million in FY 2018 (71.4%), but decreased to 67.2% this H1 (last fiscal year's H1: 74.4%) due to reduced advertising expenses, etc. (Figure 21).

【 Figure 20 】Reasons for Change in O.P. in FY 2019 H1 (unit: Y mil)



【 Figure 21 】Transition in Margins and Ratios (unit = %)



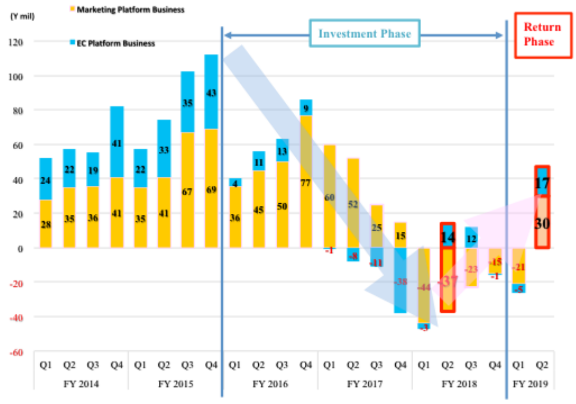
(Ref) Figure 20 is from the financial results briefing materials. Figure 21 was prepared by Alpha-Win Research Dept. from the Company's securities report.

- **Operating loss turned into profit for the first time in seven quarters.**
- **Business restructuring and transition to a flat-rate business model will lead to a stable business structure with little seasonal variability.**
- **Free cash flow is still negative.**

Looking at the quarterly change in operating profit and loss, from Q4 (July to September) of FY 2017 to Q2 (January to March) of FY 2019, the value has changed from -23 → -48 → -23 → -12 → -16 → -26 → +47 (unit: million yen), showing that the Company gained profit for the first time in seven quarters (Figure 22). This is due to the increase in sales of AD EBiS, withdrawal from unprofitable business, acquisition of promising business, conversion of business model from the pay-as-you-go system to a flat-rate billing system, elimination of seasonal variability through these measures, and other factors leading to a stable sales growth. Another reason is that the SG&A expenses ratio has been improving since Q2 of FY 2018 thanks to cost control and the gross margin has been improving since Q3 of FY 2018. As for free cash flow (FCF), on a semi-annual basis, FCF has stayed negative (Figure 23).

【 Figure 22 】Quarterly Transition in Operating Profit

(Ref) Prepared by Alpha-Win Research Dept. from the Company's securities report and financial results briefing materials



【 Figure 23 】Quarterly Transition in Cash Flow

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary

Unit: Y mil	FY 2015		FY 2016		FY 2017		FY 2018		FY 2019
	H1	H2	H1	H2	H1	H2	H1	H2	H1
Operating CF ①	15	148	48	93	121	23	7	9	7
Investment CF ②	-5	-27	-80	-69	-88	-106	-94	-118	-94
Financing CF	-3	0	-16	3	-31	-0	169	542	169
FCF (①+②)	9	121	-32	24	33	-83	-88	-110	-88
Cash and Deposits	666	787	738	762	764	681	760	1,194	924

◆ LOCKON CO., LTD.'s Financial Results Forecast for FY 2019 (this fiscal year: FY 09/2019)

- **For the current full fiscal year, the Company plans for sales and profit increase and an improvement from operating loss to profit.**

Since the Company plans to continue to actively invest during this fiscal year (FY 2019), it had previously kept its forecast on financial results and dividend undisclosed, explaining that accurately predicting the outcome of investment at the beginning of the fiscal year is difficult. On February 6, 2019, at the same time as the disclosure of Q1 results, the Company disclosed its forecast on sales and operating profit as ranges. Specifically, the Company expects sales to be Y2,250 million to Y2,350 million (Y1,804 million last fiscal year) and operating profit to be Y0 million to Y50 million (loss of Y98 million last fiscal year). Forecasts on recurring profit and net profit remain undisclosed and dividend is undetermined. Subtracting the actual H1 results from the Company's full-year forecast, we find that the Company predicts H2 sales to be Y1,169 million to Y1,269 million (Y927 million in last fiscal year's H2) and operating profit or loss to be -21 million yen to +29 million yen (operating loss of Y28 million in last fiscal year's H2).

- **Recent monthly sales have been excellent.**

Figure 24 shows the change in monthly sales for this fiscal year as disclosed by the Company. Total sales in April, or the first month of H2 of this fiscal year, was 28% greater YOY, having made significant progress. Although sales of the EC platform had been declining due business transfer, etc., the negative effects have disappeared and its sales are beginning to improve when compared year-on-year. Meanwhile, sales of the marketing platform business have stayed strong, continuing to grow by nearly 30%.

The Company aims to create customer success by providing more value to its existing customers and is planning to strengthen its business around two areas – customer success and development. For the former, the Company plans to reduce contract cancellation rate and reinforce hiring and training of its customer success division. As for the latter, the Company has stated that it will develop upsell products (more expensive products and services) for its existing customers, improve UI/UX[19], and develop a three-layer model for the Marketing Robot (measurement, analysis, and utilization).

(19) UI: Abbreviation for user interface. The part directly touched by the user. UX: Abbreviation for user experience. Experience gained by users upon using products or services.

【 Figure 24 】Recent Monthly Transition in Sales (flash report)
(upper row: sales, unit = Y thou, decimal places cut off)
(lower row: YOY change, unit = %)

	2018			2019				This Fiscal Year	
FY 2019 Monthly Sales	Oct	Nov	Dec	Jan	Feb	Mar	Apr	H1 Cumulative	Oct-Apr Cumulative
Marketing Platform	149,201	150,478	160,409	158,319	165,994	171,330	168,971	955,731	1,124,702
	126.9	130.9	133.7	132.9	132.9	129.0	133.0	131.0	131.3
EC Platform	21,839	18,683	18,936	25,060	19,460	21,990	23,467	125,968	149,435
	78.3	67.6	76.5	96.8	82.9	117.2	100.8	84.9	87.0
Entire Company	171,041	169,161	179,345	183,379	185,455	193,321	192,439	1,081,702	1,274,141
	117.6	118.6	124.0	126.4	125.0	127.5	128.0	123.2	123.9

(Ref) Prepared by Alpha-Win Research Dept. from the news release on the Company's website.
(Note) The values shown are preliminary data before auditing by an auditor and may be revised in the future.

8. Growth Strategy

- **With the growth strategy focused on the Marketing Robot, the Company aims for sales of Y3 billion in FY 2020. Towards this end, the Company is steadily expanding its business.**
- **Actively cooperating with other companies**
- **Focused on making progress with the development of the Marketing Robot and enhancing the marketing & sales division**

(20) BI (Business Intelligence): A method whereby business data accumulated by business intelligence companies and others in information systems are analyzed and processed by users as needed and utilized for business and management. Or, software and information systems to practice this method.

(21) API (Application Programming Interface): A protocol that defines procedures, data formats, etc., for accessing and using functions of computer programs and data to be managed from other external programs.

◆ LOCKON CO., LTD.'s Medium-Term Business Plan and Strategy

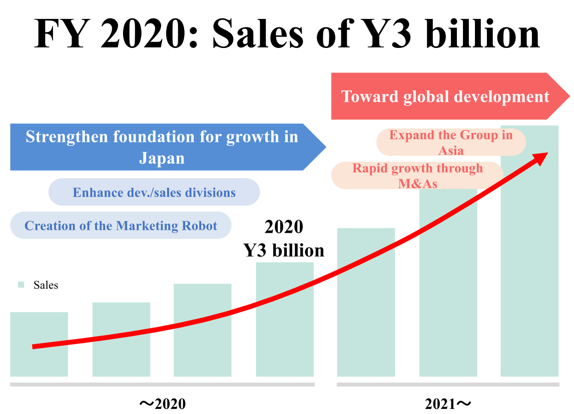
There have been no changes to the medium- and long-term business plan and business has been growing steadily as measures have been solidly implemented in line with the Company's plan. The Company is developing its business along president Iwata's long-term business plan as described by his words, "By creating a completely new product that can be differentiated from other companies in the field of Internet marketing, we hope to acquire an extremely large market share in Japan and then develop our business globally to become a company with a strong presence." Specifically, the Company has set the Marketing Robot as the focus of its growth strategy, aiming for sales of Y3 billion in FY 2020 (+66% compared to FY 2018; +28% to +33% compared to the Company's forecast for FY 2019) (Figure 25). To accelerate business development, the Company has already created new alliances with 31 other companies (met the initial target of 30 companies) (Figure 26). Reinforcement of alliance will increase AD EBiS 's product strength by enhancing its optional functions, leading to an increase in the number of contracts, an increase in unit price, and prevention of contract cancellation. Furthermore, the Company is working on the following measures in order to achieve its target.

(1) Focus on the development of the Marketing Robot and accomplish its creation
- Conduct big data analysis utilizing artificial intelligence and actively cooperate with other companies to develop and sell new functions
- Move engineers to the core business (AD EBiS) and cut off the other businesses
- Increase development staff (especially for the AI, BI [20], and API[21] sections)

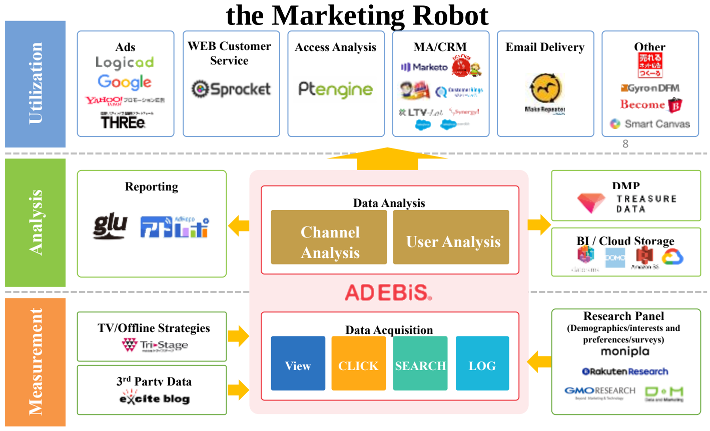
(2) Strengthen the marketing & sales division
- Enhancement of the marketing system
- Increase the number of experts and sales representatives

(Hire 20-30 more people every year by new-graduate and mid-career recruitment)

【 Figure 25 】 Medium- to Long-Term Targets



【 Figure 26 】 Progress with the 30 Alliances for the Marketing Robot



(Ref) Figure 25 and 26 were prepared by Alpha-Win Research Dept. from the Company's financial results briefing materials

◆ **Over the medium term, the Company will strengthen its domestic business foundation. Over the long term, it will aim for global expansion.**

Furthermore, for the long-term strategy (FY 2021 to FY 2023), the Company plans to increase development and sales sites mainly in Asia. Also, the Company intends to accelerate its growth not only by organic growth, but also by M&As, alliances, etc. However, specific target figures such as those concerning the breakdown of sales and the actual means for achieving them have not been disclosed. Since the Company has been raising funds ahead of plan, it may actively conduct M&As or acquire businesses from other companies in the future.

◆ **Will restructure its business to concentrate on its core business (marketing platform business)**

◆ **Cost structure of the marketing platform business is improving.**

Regarding the cost structure of the core marketing platform business, the structure is controlled in four parts and medium- to long-term target ratios have been set for each (Figure 27). According to this information, in the future, the Company intends to achieve an operating margin of 10-20%. For the marketing platform business, the Company had achieved high operating margins of around 16-24% from FY 2014 to FY 2016. Then, in FY 2017, because the Company increased the amount of investment related to marketing & sales and the development of software functions, the operating margin began decreasing. However, in FY 2018, the operating margin began to bottom out. In FY 03/2019 or H1, the ratios of expenses over sales have already reached the target ranges set out in the medium- to long-term target model for three categories excluding other overheads (marketing & sales, development, and customer service expenses). Ratio of other overheads over sales is also expected to decrease along with the increase in sales and is likely to reach the target range during next fiscal year or later.

◆ **Aiming for O.P. margin of 10-20% over the medium to long term**

Over the medium to long term, the Company plans to increase sales and significantly lower the expenses for this business to stabilize the operating margin of this business at around 10-20%. Since this level of operating magin has been achieved in the past, it seems to be an achievable goal.

【 Figure 27 】 Cost Structure of the Marketing Platform (MPF) Business (actual and medium/long-term targets)

Expenses of MPF Business-To-Sales Ratio	FY 2016	FY 2017	FY 2018	FY 2019 Q2	Medium- to Long-Term Targets
Marketing & Sales	24%	29%	32%	30%	30%
Development	21%	24%	36%	29% *2	25-30%
Customer Support (before: "Support")	11%	11%	**11%**	**15%**	10-15%
			Inc. investment		
Other Indirect Exp.	24%	25%	28% *1	25%	15-20%
Operating Profit	**20%**	**12%**	**-8%**	**1%**	**10-20%**

*1 Due to increased allocation of common expenses to the segment following the sales decline of the EC platform caused by business restructuring
*2 Due to the transfer of of operation staff from development to CS

(Ref) Financial results briefing materials

◆ Alpha-Win Research Dept.'s Financial Results Forecast for FY 2019

- **We have made analysis that the Company's estimates for H2 are somewhat conservative and operating profit could be revised slightly upward. However, we expect that the final profit/loss will be affected by the extraordinary loss, resulting in a small net loss.**

Based on the H1 results and the Company's disclosure of its full-year forecast, we have revised our forecast for H2 and our original forecast for the full year. We believe that business restructuring and active upfront investment activities have peaked out for now.

We have made upward revisions to our forecast for FY 2019 as follows (in the order of original forecast → current forecast): sales of Y2,150 million (+19.2% YOY) → Y2,260 million (+25.3% YOY) and operating profit of Y30 million (turned into profit) → Y60 million.

However, although we had previously expected that the Company will gain a net profit of Y10 million in a positive turnaround, we have changed the forecast to a net loss of Y25 million due to the posting of an extraordinary loss that was not originally expected (Figure 28).

- **This H1 was marked by a sharp rise in the unit price of AD EBiS and the temporary slowdown in the rate of increase of the number of active accounts of AD EBiS.**

The Company's progress in H1 in terms of its full-year plan (when compared to the median of the range) was 47% for sales and 84% for operating profit. Results for the second quarter of this fiscal year (January to March 2019: Q2) were particularly excellent; sales and especially the average unit price of AD EBiS grew more than expected and operating loss improved to a profit of Y47 million. Sales continued to be strong in H2. The Company's forecast for H2 – an operating loss or profit of -21 million yen to +29 million yen – seems conservative.

- **Operating profit expected to be maintained in Q3 and Q4.**

The Company has already improved its results from operating loss to profit in Q2, and given the current situation, we expect that it will continue to post an operating profit in Q3 (April to June) and Q4 (July to September). However, we expect Q3 and Q4's operating profit to be both smaller than Q2's since recruitment expenses, increased personnel expenses due to increased staff, and expenses associated with the general employee meeting and the company name change are expected to be incurred. Taking into account the prediction that no additional extraordinary loss will arise in H2, the amount of net loss may be limited for the full year.

Since we can expect the changes in the pricing system of the main product, AD EBiS, to raise its average unit price over the long term, we predict that the gross margin will also improve. The marginal profit ratio of this business is estimated to be around 70%, and most of the increase in sales is expected to contribute to an increase in profit, excluding variable expenses such as fees paid to distributors and server costs. As described before, due to the nature of the subscription-based business, it takes about eight months after making a new contract under the new pricing system to make actual contribution to profit. Although contribution to profit may be small in H1, it is expected to gradually increase starting in H2 and in the next fiscal year.

In addition, it is estimated that the contract cancellation rate of AD EBiS is currently a few percent per month (not disclosed). In the future, the Company hopes to reduce this cancellation rate by enhancing the attractiveness of its products and services through the addition of optional functions in collaboration with other companies or functions that have been developed in-house.

【 Figure 28 】Alpha-Win Research Dept.'s Financial Results Forecast for This Fiscal Year and Over the Medium Term

(Y mil)	FY 2018 A	FY 2019 CE	FY 2019 Old E	FY 2019 New E	FY 2020 CE	FY 2020 E	FY 2021 E
Sales	1,805	2,250～2,350	2,150	2,260	3,000	2,750	3,150
Marketing PF	1,530		1,870	2,020		2,490	2,875
EC PF	274		280	250		260	275
Gross Profit	1,190		1,430	1,560		1,750	2,050
Gross Margin	65.9%		66.5%	69.0%		63.6%	65.1%
SG&A Expenses	1,289		1,400	1,500		1,630	1,800
% over sales	71.4%		65.1%	66.4%		59.3%	57.1%
Operating Profit	-98	0～50	30	60		120	250
% over sales	-5.5%		1.4%	2.7%		4.4%	7.9%
Recurring Profit	-115	非公表	10	45		100	230
% over sales	-6.4%		0.5%	2.0%		3.6%	7.3%
Net Profit	-89	非公表	10	-25		92	155
% over sales	-4.9%		0.5%	-1.1%		3.3%	4.9%
KPI	Annual Average A	H1 Average A	Annual Average E	Annual Average E		Annual Average E	Annual Average E
AD EBiS: # of active accounts	1,476	1,547	1,624	1,546		1,670	1,837
% change for the above			10.0%	4.8%		8.0%	10.0%
AD EBiS: average unit price	78,938	92,332	87,315	98,666		112,000	120,000
% change for the above			10.6%	25.0%		13.5%	7.1%
Sales (YOY growth rate)	5.0%		19.1%	25.2%		21.7%	14.5%
Marketing PF	21.9%		22.2%	32.0%		23.3%	15.5%
EC PF	-41.1%		2.2%	-8.8%		4.0%	5.8%
Gross Margin (diff. from last FY)	-0.3%		0.6%	3.1%		-2.9%	1.4%
SG&A Expense (growth rate)	25.1%		8.6%	16.4%		8.7%	10.4%
Operating Profit (growth rate)	To loss		To profit	To profit		100.0%	108.3%
Recurring Profit (growth rate)	To loss		To profit	To profit		122.2%	130.0%
Net Profit (growth rate)	To loss		To profit	To loss		To profit	68.5%

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary. (Note) AD EBiS's average unit price and number of active accounts used in the forecast/estimate (E) are average values for the fiscal year and differ from the values used by the Company in its disclosure (averages as of the end of the last month of each quarter). A is actual result (simple average of figures at the end of each quarter).

The difference between the Company's financial results forecast (initial version) and the actual results in the past is shown on Figure 29. In recent years, the Company has kept its forecast undisclosed at the beginning of the fiscal year, and has instead released a disclosure after judging that a reasonable forecast can be made. Consequently, the difference between the disclosed forecast and the actual results has been small. For the current fiscal year, the forecast figures for the full fiscal year was disclosed at the same time as the disclosure of Q1 results.

【 Figure 29 】Change in Financial Results Forecast and Actual Results

FY	Forecast release date	Sales	O.P.	R.P.	N.P.
FY 2015	11/10/2014	1,545	350	350	203
	Actual result (Y mil)	1,437	350	352	230
	Difference (%)	-7.0	0.0	0.6	13.3
	Difference (Y mil)	-108	0	2	27
FY 2016	5/12/2016	1,600	200	201	130
	Actual result (Y mil)	1,612	247	250	168
	Difference (%)	0.75	23.5	24.4	29.2
	Difference (Y mil)	12	47	49	38
FY 2017	5/9/2017	1,650～1,700	10～100	-	-
	Actual result (Y mil)	1,719	92	106	72
	Difference (%)	1.1～4.2	-8.0～820.0	-	-
	Difference (Y mil)	19～69	8～92	-	-
FY 2018	2/6/2018	1,800	-150	-	-
	Actual result (Y mil)	1,804	-98	-115	-88
	Difference (%)	0.2			
	Difference (Y mil)	4	52		
FY 2019	2/6/2019	2,250～2,350	0～50	-	-

(Ref) Prepared by Alpha-Win Research Dept. CE is the Company's estimate (forecast). E is Alpha-Win Research Dept.'s estimate (forecast).

◆ Alpha-Win Research Dept.'s Financial Results Forecast for the Medium Term

Although we have not largely changed our basic views regarding the previously prepared medium-term financial forecast for next fiscal year

- **We reviewed the medium-term results forecast and made upward revisions to sales and profits.**

and onward, we have revised the financial forecast (Figure 28 on a previous page). We predict the following results, in the order of previous forecast → current forecast (unit: million yen): for next fiscal year (FY 2020), sales of 2,600 → 2,750 and operating profit unchanged at 120; for FY 2021, sales of 3,000 → 3,150 and operating profit of 230 → 250. These revisions reflect the change in the assumed values for the unit price and the number of active accounts of AD EBiS.

- **Alpha-Win Research Dept. predicts an annual sales growth rate of around 20-30% over the medium term.**

Going forward, we expect to see positive results from the investment and business restructuring that the Company had conducted. In addition, we expect AD EBiS's unit price to continue to increase and its number of active accounts to grow steadily. Therefore, the marketing platform business has a large growth potential and is expected to become a growth driver, leading to an annual sales growth rate of around 20 to 30% over the medium to long term.

- **Business model with a high marginal profit ratio. Alpha-Win Research Dept. expects the profit growth rate (when leveled out) to be around 30% per year over the medium to long term, exceeding the sales growth rate.**

Meanwhile, we also predict that the Company will continue its active upfront investment for future growth. The final profit and loss will depend on the Company's cost control and its eagerness to achieve the bottom line of its target figures. In FY 2020 and FY 2021, changes in the cost structure coupled with sales increase are expected to improve profit and loss in a clearly V-shaped recovery trend, causing profit to change sharply. Over the long term, we believe that the Company will be able to maintain a net profit, and since the Company's business has a high marginal profit ratio, we expect to see a profit growth rate of nearly 30% per year (when leveled out), exceeding the sales growth rate.

- **Whether the Company can achieve its goal for sales – Y3 billion in FY 2020 – will depend on its M&A and tie-up strategies.**

We believe that the Company's goal of Y3 billion in sales for FY 2020 seems to be generally within an achievable range if the M&A and alliance strategies are successful. However, since it is a high goal, and since we cannot predict at this point whether an M&A will actually be conducted or how it will contribute to profit, we made a somewhat cautious prediction. The assumptions or estimates used in our forecast are as follows.

(i) In the previous report, we had stated: "The average unit price of AD EBiS, which makes up the majority of the marketing platform business, is expected to increase since new contracts should have the effect of raising the unit price and because about 20% of the existing contracts will be switched to new contracts under the new pricing system. Also, the number of active users is expected to increase by 10% per year." However, in Q2 to Q3 of FY 2019, the unit price of AD EBiS rose sharply since about 90% of the existing AD EBiS contracts switched to the new pricing system almost at the same time. Therefore, we made a prediction that the unit price will increase by about 10% per year from next fiscal year and onward due to the full contribution to the average unit price by the increase in the number of new contracts that are greater than Y100,000 and the effect of the addition of options and new functions on the unit price. In addition, we predict that the number of active members will increase by 8 to 10% annually due to the acquisition of new customers and the enhancement of functions through stronger alliances with other companies leading to a lower contract cancellation rate.

(ii) Expecting new or future acquired companies to contribute positively to results, we have not changed our estimate that the sales of the marketing platform business will grow annually by about 20%.
(iii) In addition, the marginal profit ratio of the platform business is estimated to also be about 70% in the next fiscal year and onward. The number of employees is estimated to increase by about 20 every year, raising general and administrative expenses including personnel expenses by about 10% annually. SG&A expenses to sales ratio are expected to gradually decline, such that the operating margin will improve and eventually reach the target of 10%.
(iv) Regarding the EC platform business, its sales are solely contributed by EC-CUBE. As of this point in time, the Company has not launched fundamental measures to expand this business. However, considering the expansion of the EC market and the new product version, we change our estimate, now predicting a gradual increase by about 4-6% per year (previous assumption: 10% growth).
(v) Excluding this fiscal year, in making the medium-term financial forecast, we have assumed that there will be no extraordinary profit or extraordinary loss such as contingent liabilities.
(vi) We anticipate that M&A(s) will expand business and contribute to about 1/3 to 1/2 of the increase in sales, but we do not expect it to contribute to profit in the short term.

- **Whether the Company can make an overall transition in business from its specialization in advertising effect measurement system to the Marketing Robot is an important point.**
- **Over the medium term, resumed dividend payment and an all-time high in profit are possible.**

Over the medium to long term, whether the Company can make an overall business transition from its specialization in the Internet advertising measurement system to the Marketing Robot is a crucial point in assessing the Company's business going forward. So far, the Company has been steadily expanding its business in line with its plan. In fact, we believe that dividend payment will be resumed within the next two to three years, record-high profit will be achieved over the medium term (about three to five years), and the shareholder benefit plan will be resumed.

9. Analyst's View

◆ SWOT Analysis

◆ **The Company's strengths are the president's management skills, product strength, and the potential to accumulate and utilize big data.**

The Company's SWOT analysis result is shown on Figure 30. The Company's main strengths are (1) its president's management skill and expertise with advanced technologies in the Internet marketing field, (2) its main products and support system with proven and strong functions, and (3) its possession of big data accumulated over many years since the start of its service and potential for utilization of such data. In particular, the fact that president Iwata himself possesses a deep knowledge of Internet-related techniques – he has been building skills related to the field since the foundation of the Company – is considered to be an advantage over other companies. In addition, since the Marketing Robot market is still in its early stage, it has a high growth potential, from which the Company may be able to enjoy benefits. The Company seems to have the potential to accelerate its growth through overseas development as well as expansion of the scope of the Marketing Robot business from measurement of ads to analysis and utilization.

◆ **Is in a position to be able to enjoy the benefits of future market expansion. Plans to expand into new business areas and overseas.**

【 Figure 30 】 SWOT Analysis

Strength	・Big data accumulated since foundation; potential for use ・Well-known, strong customer base, experience, product strength (No. 1 share in Internet ad effect system tool) ・The main marketing platform business is subscription-based so that stable revenue can be expected ・Management skill of the president who has a deep knowledge of advanced technologies in the business ・Enhanced working environment and high employee retention rate; accumulation of talents and know-how
Weakness	・Specialized in a niche market; small in scale ・Business management is dependent on the president ・Employee shortage (engineers and sales reps) ・Funding power (equity financing risk associated with continued upfront investment and future business expansion)
Opportunity	・Potential for growth of Internet advertising marketing market and accelerated growth of existing products ・Utilization of resources of external partners; collaboration ・Overseas development ・Development of new products and services
Threat	・Release of competing or alternative products/services, emergence of rivals, declining competitiveness of existing products ・Defects in prducts/services, delays in developing or providing services with new function ・Large system troubles such as computer system stoppage

(Ref) Prepared by Alpha-Win Research Dept.

◆ Shareholder Return

In the second fiscal year after becoming listed (FY 2015), the Company's dividend was Y4.5 per share. Dividend was then increased by Y0.5 in FY 2016 to Y5.0 per share. In FY 2017, dividend was paid out for the third year in a row, again at Y5.0 yen per share (Figure 31). However, in FY 2018, no dividend was paid out since a net loss was posted that year, and the Company abolished the shareholder benefit plan as well. Since the Company is currently in its growth phase, rather than letting its cash flow out through dividends and benefit plans, the Company hopes to increase shareholder value by focusing on investments for future growth to recover its financial performance. Dividends for this fiscal year are undetermined and, for the short term, dividend payment and shareholder benefit plan are

◆ **We expect that there will again be no dividend for this fiscal year and that dividend payment will be resumed during next fiscal year or later.**

(21) AdTech: Abbreviation for ad technology. A generic term for information technology used in advertising business, it refers to digital technology used in Internet ads, etc.

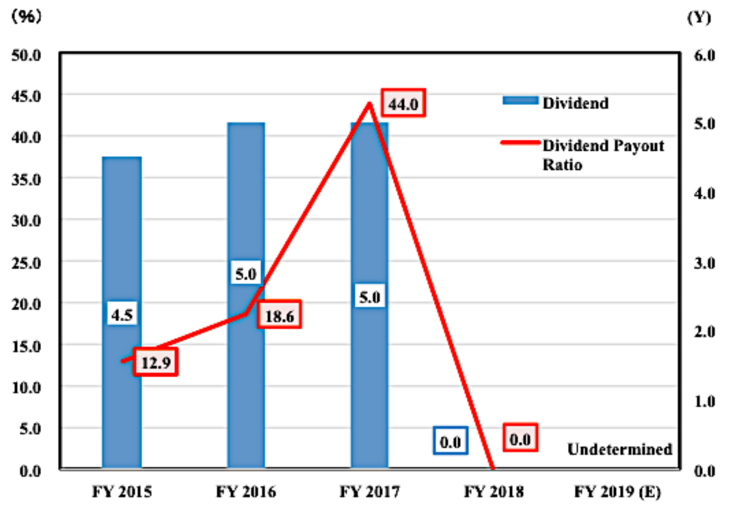
(22) P/S (Price to Sales Ratio): Ratio of stock price to sales. A valuation indicator where market capitalization is divided by annual sales. P/S is often used as an indicator to measure the stock value of emerging companies with a high growth potential or a net loss.

(23) PEG Ratio (Price Earnings Growth Ratio): A valuation indicator that measures the stock value while taking into consideration a company's medium-term profit growth rate. It is calculated by dividing the expected price-earnings ratio (P/E) by the expected medium-term profit growth rate (%) per share. Generally, a PEG ratio of less than 1 means the stock is undervalued, and overvalued if it is more than 2.

- **Stock price jumped up in response to the disclosure that results improved in Q2 from loss to profit. For the most recent 12 months or so, it has been largely outperforming the TOPIX.**
- **The Company's stock value is not cheap. The current stock price seems to partially reflect the expectations for recovery in business performance.**
- **Stock price going forward will be affected by the expected level of profit over the medium term.**

unlikely to be resumed. Alpha-Win Research Department believes that dividend payment may possibly be resumed in FY 2021.

【 Figure 31 】Change in Dividend and Dividend Payout Ratio



(Ref) Prepared by Alpha-Win Research Dept. from the Company's securities report, financial results summary, and financial results briefing materials

◆ Stock Price and Characteristic and Factors that May Affect Stock Price

The Company's stock is a small AdTech[22]-related stock listed on the TSE Mothers market with a highly volatile stock price. Figure C on page 2 of this Report shows the stock price and relative stock price with respect to TOPIX for the past approximately two years and nine months. Until one year ago, the Company's stock price had been decreasing, largely underperforming the TOPIX. Reasons for the decline in stock price may be that (1) as seen from the TSE Mothers Index, the market environment was unfavorable, with small- and medium-cap stocks in the emerging markets being generally weak and (2) in order to achieve the goals of the growth strategy concerning the Marketing Robot, the Company had been restructuring its business and conducting upfront investment to focus on its core business, resulting in the posting of a net loss, no dividend, abolition of the shareholder benefit plan, etc. However, in recent months, the stock price has risen sharply, and have remained firm since then, thanks to the improvement from loss to profit and the share buyback.

As a reference, we compared the size, business contents, and valuation indicators of 22 companies listed on the market, including the Company, under the AdTech category or with a business partly similar to the Company's (Figure 32). In this comparison, as far as P/E, P/B, P/S[23], and dividend yield are concerned, the Company's stock value is not cheap. This may be due to the fact that the stock price reflects the anticipation of future recovery of business performance and growth to some extent.

Also, under the condition that a PEG ratio[24] of up to 2 is tolerated and the medium-term growth rate for the normalized EPS is expected to be 20%, the P/E comes out to be about 40 at maximum (60 if the growth rate is assumed to be 30%). Calculating back from the current market capitalization of about Y11 billion, we can deduce that the necessary net profit (after income tax) is about Y280 million (Y180 million if P/E is 60). If business performance recovers such that a net profit greater than this level can be anticipated, then the stock price may also possibly jump up.

- **For the time being, the key points of interest are the unit price and the number of active accounts of AD EBiS, the quarterly profit / loss, M&A, the timing when dividend is resumed, etc.**

Looking ahead, we should pay attention to changes in monthly sales and especially watch out for quarterly changes in net profit and when dividend payment is resumed. In addition, as the most important management indicators (KPI), we should continue to watch the unit price and the number of active accounts of AD EBiS, which is a key factor of the company's sales. It is also speculated that news releases on M&As, business alliances, new products and services, etc., may also affect the stock price. Over the medium to long term, the Company's Marketing Robot business, as well as the Internet advertising market, has much potential for growth; the Company seems to be in a good position to be able to benefit from the growth. Going forward, we hope to continue to see the Company grow as an AdTech-related, domestic growth stock that is not directly affected by trade wars and exchange rates.

【 Figure 32 】 Comparison of Similar Companies (22 companies related to AdTech, etc.)

AdTech-Related Companies		Markets: TSE1=TSE 1st Section, TSE2=TSE 2nd Section, TM=TSE Mothers, JQS=JASDAQ		Unit: Y mil			%	Ratios			%	Closing Price (5/24)
Code	Company Name	Business Area	Market	Market Cap.	Sales	O.P.	O.P. Margin	P/S	P/E	P/B	Dividend Yield	Stock Price
2159	Full Speed	Internet marketing, AdTech (Internet Ad delivery tech)	TSE2	7,910	20,200	1,200	5.9	0.39	12.76	2.23	0.00	508
2389	OPT Holding	Internet ad agency / ad measurement tool	TSE1	34,059	ND	ND	-	-	-	1.08	0.00	1,430
2461	F@N Communications	Affiliate (pay-per-performance) ad	TSE1	38,157	34,200	3,700	10.8	1.12	14.56	1.98	3.83	496
2491	ValueCommerce	Affiliate (pay-per-performance) ad	TSE1	91,279	24,500	4,350	17.8	3.73	29.29	9.12	1.06	2,648
3134	Hamee	Mobile accessories / EC cloud support	TSE1	11,164	10,031	1,026	10.2	1.11	15.53	2.79	0.94	694
3655	BrainPad	Internet marketing, data analysis	TSE1	59,696	5,650	1,130	20.0	10.57	72.80	24.62	0.00	8,830
3688	CARTA HD	Ad platform	TSE1	42,157	26,000	2,500	9.6	1.62	23.53	1.87	0.96	1,660
3690	LOCKON CO., LTD.	Internet ad measurement tool	TM	11.031	2,260	60	2.7	0.00	-	10.38	0.00	1,731
3923	RAKUS	Cloud service, Email delivery, IT engineer dispatching	TM	95,364	ND	ND	-	-	-	20.76	0.30	2,105
4293	SEPTENI HD	Internet ad agency, smartphone marketing support	JQS	46,395	17,200	2,000	11.6	2.70	32.49	2.69	0.00	334
4395	Accrete	SMS delivery service	TM	4,421	1,600	270	16.9	2.76	24.38	4.97	0.00	807
4751	CyberAgent	Internet ad agency, smartphone, games	TSE1	576,505	440,000	20,000	4.5	1.31	287.33	7.31	0.72	4,560
4784	GMO AD Partners	Internet ad agency and related platform	JQS	7,055	35,000	560	1.6	0.20	23.16	1.39	2.16	421
6026	GMO TECH	App-installation-type charging ad, SEO	TM	2,141	2,900	30	1.0	0.74	18.76	2.57	2.67	1,945
6045	Rentracks	Pay-per-performance Internet ad service	TM	4,630	10,800	522	4.8	0.43	13.92	2.16	1.55	582
6081	Allied Architects	SNS-related marketing support	TM	7,667	4,210	251	6.0	1.82	52.40	5.44	0.00	546
6094	FreakOut HD	Internet ad delivery (DSP)	TM	30,044	19,000	100	0.5	1.58	53.62	3.94	0.00	1,889
6175	Net Marketing	Pay-per-performance ad agency	TSE1	6,323	14,465	373	2.6	0.44	24.48	3.02	1.15	434
6533	Orchestra HD	Digital marketing for companies	TM	10,616	9,500	570	6.0	1.12	27.07	9.02	0.49	1,230
6550	Fringe81	Internet ad agency, media monetization support	TM	6,231	7,295	-525	-7.2	0.85	Loss - NA	4.21	0.00	635
6553	SoldOut	Web marketing support for mid-tier companies/SMEs	TM	26,295	22,000	1,150	5.2	1.20	33.06	10.06	0.78	2,552
6562	Geniee	Automatic trading of media ad space, AdTech biz	TM	9,327	15,572	23	0.1	0.60	Loss - NA	3.44	0.00	522
22 AdTech-related companies: simple average				51.294	36,119	1,965	6.5	1.71	44.66	6.14	0.76	
TOPIX (closing price on 5/24/2019): average									13.36	1.14	Simple 2.10	1,541.21
											(Weighted 2.56)	

(Ref) Prepared by Alpha-Win Research Dept. from the companies' websites, securities reports, financial results summaries, and financial results briefing materials.
(Note) Generally, each company's forecasted values as of the latest financial results disclosure (latest quarterly financial results) or the most recent actual results (BPS, etc.) were used (based on disclosed data available as of May 24). For forecasts disclosed as ranges, the median was generally used for calculations. Concerning dividend, if a company has not disclosed a forecast, the previous fiscal year's actual dividend was used. For the Company, Alpha-Win Research Dept.'s forecast was used. For other companies, values not disclosed are marked by "ND" (not determined) or "-". The average was calculated using only valid figures.

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