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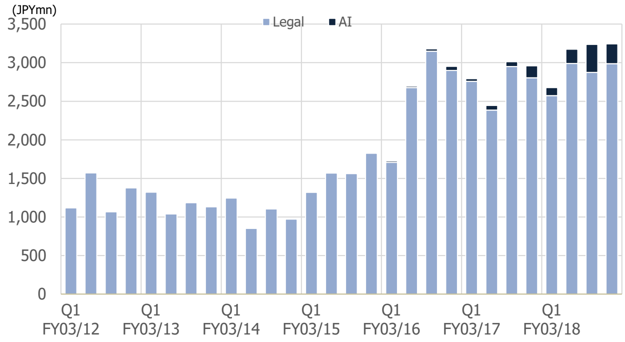
On **May 15, 2018,** FRONTEO, Inc.announced earnings results for full-year FY03/18.

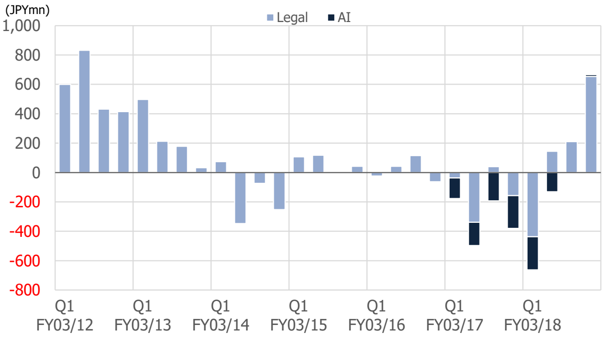
Income statement	FY03/16				FY03/17				FY03/18				FY03/16	FY03/17	FY03/18			FY03/19	FY03/20	FY03/21
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	FY	FY	FY	Rev. Est.	% of FY	Est.	Est.	Est.
Revenue	**1,727**	**2,695**	**3,179**	**2,953**	**2,793**	**2,445**	**3,011**	**2,959**	**2,677**	**3,174**	**3,237**	**3,243**	**10,553**	**11,208**	**12,332**	**12,600**	**97.9%**	**13,800**	**20,000**	**30,000**
Legaltech	1,708	2,678	3,150	2,899	2,759	2,386	2,949	2,805	2,574	2,990	2,873	2,986	10,434	10,897	11,421			12,000	14,200	18,200
Japan	903	925	965	934	913	943	1,009	855	923	987	735		3,727	3,718						
US	687	1,641	2,059	1,837	1,746	1,366	1,814	1,876	1,518	1,830	1,550		6,224	6,801						
Others	118	112	125	128	100	77	127	74	133	173	589		484	378						
AI Solutions	19	17	29	54	34	59	62	154	103	184	364	257	119	311	911			1,800	5,800	11,800
BI/DC														311	778			1,500	5,200	10,500
Healthcare														0	133			300	600	1,300
Japan					33	58	52	145	102	179	217		119	288						
Asia					1	1	10	9	1	5	147		-	23						
YoY	**30.9%**	**71.7%**	**103.5%**	**61.8%**	**61.8%**	**-9.3%**	**-5.3%**	**0.2%**	**-4.1%**	**29.8%**	**7.5%**	**9.6%**	**68.2%**	**6.2%**	**10.0%**	**12.4%**		**11.9%**	**44.9%**	**50.0%**
Legaltech	29.5%	70.6%	101.7%	58.8%	61.5%	-10.9%	-6.4%	-3.3%	-6.7%	25.3%	-2.6%	6.5%	66.3%	4.4%	4.8%			5.1%	18.3%	28.2%
Japan	8.3%	-0.8%	45.4%	38.0%	1.1%	2.0%	4.5%	-8.4%	1.1%	4.6%	-27.2%	-	-	-0.2%	-					
US	59.8%	207.0%	161.4%	78.0%	154.1%	-16.8%	-11.9%	2.1%	-13.0%	34.0%	-14.5%	-	123.5%	9.3%	-					
Others	114.0%	9.6%	13.8%	10.2%	-15.0%	-31.6%	1.3%	-42.4%	32.7%	125.1%	363.2%	-	26.0%	-21.9%	-					
AI Solutions	-	-	-	-	83.8%	248.0%	112.9%	183.4%	202.9%	211.9%	487.1%	66.9%	-	161.3%	193.1%			97.7%	222.2%	103.4%
BI/DC									-	-	-	-			150.4%			92.9%	246.7%	101.9%
Healthcare									-	-	-	-						125.6%	100.0%	116.7%
Cost of revenue	1,035	1,392	1,673	1,751	1,631	1,540	1,792	1,911	1,821	1,819	1,830	1,572	5,850	6,874	7,042					
Cost ratio	60.0%	51.7%	52.6%	59.3%	58.4%	63.0%	59.5%	64.6%	68.0%	57.3%	56.5%	48.5%	55.4%	61.3%	57.1%					
Gross profit	**691**	**1,303**	**1,506**	**1,202**	**1,162**	**905**	**1,219**	**1,047**	**856**	**1,355**	**1,407**	**1,671**	**4,703**	**4,334**	**5,290**					
GPM	**40.0%**	**48.3%**	**47.4%**	**40.7%**	**41.6%**	**37.0%**	**40.5%**	**35.4%**	**32.0%**	**42.7%**	**43.5%**	**51.5%**	**44.6%**	**38.7%**	**42.9%**					
SG&A expenses	714	1,261	1,391	1,265	1,339	1,402	1,372	1,427	1,519	1,341	1,194	1,005	4,631	5,541	5,058					
YoY	24.6%	64.0%	100.2%	52.6%	87.5%	11.2%	-1.3%	12.8%	13.5%	-4.4%	-13.0%	-29.6%	61.6%	19.6%	-8.7%					
SG&A ratio	41.4%	46.8%	43.8%	42.8%	47.9%	57.4%	45.6%	48.3%	56.7%	42.2%	36.9%	31.0%	43.9%	49.4%	41.0%					
Operating profit	**-23**	**42**	**115**	**-63**	**-176**	**-497**	**-153**	**-380**	**-662**	**14**	**213**	**667**	**71**	**-1,207**	**231**	**200**	**115.7%**	**700**	**2,065**	**4,238**
Legaltech	-23	42	115	-63	-36	-339	40	-157	-437	144	209	655	599	-492	570			650	1,420	1,820
Japan	83	-234	415	143	146	66	343	129	47	194	173		558	684	-2					
US	-106	279	-40	-94	-191	-381	-311	-250	-506	-63	-125		37	-1,133	-					
Others	1	-2	-5	10	9	-24	8	-36	22	13	162		4	-43	-					
AI Solutions	-	-			-140	-158	-193	-223	-225	-130	4	12	-527	-715	-339			50	645	2,418
BI/DC																		47	540	2,100
Healthcare																		3	105	318
Japan					-142	-159	-200	-228	-227	-135	-7	142	-527	-729	-					
Asia					2	1	7	5	2	5	10	-16		15	2					
Adjustments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			-	-	-
OPM	**-1.3%**	**1.6%**	**3.6%**	**-2.1%**	**-6.3%**	**-20.3%**	**-5.1%**	**-12.9%**	**-24.7%**	**0.4%**	**6.6%**	**20.6%**	**0.7%**	**-10.8%**	**1.9%**	**1.6%**		**5.1%**	**10.3%**	**14.1%**
Legaltech	-1.3%	1.6%	3.7%	-2.2%	-1.3%	-14.2%	1.4%	-5.6%	-17.0%	4.8%	7.3%	21.9%	5.7%	-4.5%	5.0%			5.4%	10.0%	10.0%
Japan	9.1%	-25.3%	43.0%	15.3%	16.0%	7.0%	34.0%	15.1%	5.1%	19.6%	23.5%	-	15.0%	18.4%	-					
US	-15.5%	17.0%	-2.0%	-5.1%	-11.0%	-27.9%	-17.1%	-13.3%	-33.4%	-3.4%	-8.0%	-	0.6%	-16.7%	-					
Others	0.8%	-2.2%	-3.9%	8.1%	8.8%	-31.6%	6.5%	-49.1%	16.2%	7.5%	27.5%	-	0.8%	-11.5%	-					
AI Solutions	-	-	-	-	-411.8%	-267.8%	-311.3%	-144.8%	-218.4%	-70.7%	1.1%	4.7%	-443.5%	-230.2%	-37.2%			2.8%	11.1%	20.5%
BI/DC	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			3.1%	10.4%	20.0%
Healthcare	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			1.0%	17.5%	24.5%
Non-operating income (expenses)	46	-45	5	-52	-69	-35	125	-70	-18	-20	7	-162	-46	-48	-194	-100		-100	-2,065	-4,238
Financial income	10	-5	-3	-5	11	-5	-7	-10	-2	-10	-17	-10	-3	-11	-39					
Syndicated loan fees	-2	-3	-	-6	-2	-3	-2	-6	-1	-2	-2	-8	-10	-12	-13					
Stock and bonds issuance expenses	-	-	-	-	-	-	-16	0	-	-	-	-	-	-16	-					
Gains on foreign exchange	37	-37	11	-47	-92	-26	160	-57	-16	-14	14	-192	-36	-15	-208					
Other non-operating income	1	-0	-2	6	14	-2	-10	3	1	5	12	48	4	5	66					
Recurring profit	**23**	**-3**	**120**	**-115**	**-245**	**-532**	**-28**	**-450**	**-680**	**-7**	**220**	**505**	**25**	**-1,255**	**38**	**100**	**37.9%**	**600**	**-**	**-**
YoY	-76.8%	-	4.0%	-	-	-	-	-	-	-	-	-	-94.1%	-	-	-		1,483.5%	-	-
RPM	1.3%	-0.1%	3.8%	-3.9%	-8.8%	-21.8%	-0.9%	-15.2%	-25.4%	-0.2%	6.8%	15.6%	0.2%	-11.2%	0.3%	0.8%		4.3%	-	-
Extraordinary gains (losses)	-	-	-	-32	-19	-10	-32	-56	-	-308	-528	-13	-32	-116	-849					
Pre-tax profit	23	-3	120	-147	-263	-542	-60	-506	-680	-315	-308	492	-7	-1,371	-811					
Income taxes	41	119	77	-55	-90	-199	349	-488	-227	177	96	-142	182	-429	-97					
Implied tax rate	178.9%	-3,626.8%	64.3%	37.4%	34.3%	36.8%	-585.2%	96.5%	33.3%	-56.1%	-31.1%	-28.9%	-2,721.7%	31.3%	11.9%					
Non-controlling interests	0	3	1	1	1	2	3	-0	3	2	2	4	6	6	11					
Net income attributable to parent company shareholders	**-18**	**-125**	**42**	**-93**	**-175**	**-344**	**-412**	**-18**	**-456**	**-494**	**-405**	**630**	**-195**	**-948**	**-725**	**-895**	**-**	**300**	**-**	**-**
YoY	-	-	350.3%	-	-	-	-	-	-	-	-	-	-	-	-	-		-	-	-
Net margin	-1.1%	-4.6%	1.3%	-3.2%	-6.2%	-14.1%	-13.7%	-0.6%	-17.0%	-15.5%	-12.5%	19.4%	-1.8%	-8.5%	-5.9%	-7.1%		2.2%	-	-
EBITDA (OP before dep. and amortization)	**158**	**283**	**402**	**226**	**131**	**-225**	**140**	**-82**	**-327**	**303**	**516**	**930**	**1,069**	**-36**	**1,422**					
YoY	-30.6%	12.2%	146.4%	4.2%	-17.0%	-	-65.0%	-	-	-	267.8%	-	24.3%	-	-					
EBITDA margin	9.2%	10.5%	12.6%	7.6%	4.7%	-9.2%	4.7%	-2.8%	-12.2%	9.6%	15.9%	28.7%	10.1%	-0.3%	11.5%					
R&D expenses	21	24	23	23	21	29	19	14	54	72	3	-	92	84	-					
Depreciation	177	218	240	248	269	237	254	279	297	253	259	206	884	1,039	1,015					
Amortization of goodwill	4	23	46	40	38	35	39	19	38	36	44	57	114	131	175					
USD/JPY	121.4	122.3	121.5	115.3	108.2	102.4	109.5	113.6	111.1	111.0	113.0	108.3	120.1	108.4	110.9			105.0		
YoY	18.9%	17.8%	6.2%	-3.2%	-10.9%	-16.3%	-9.9%	-1.5%	2.7%	8.4%	3.2%	-4.7%	9.5%	-9.8%	2.3%			-5.3%		
USD/JPY at quarter end	122.5	120.0	120.5	112.7	103.0	101.1	116.5	112.2	112.0	112.7	113.1	106.8	112.7	112.2	106.8			105.0		

Source: Shared Research based on company data

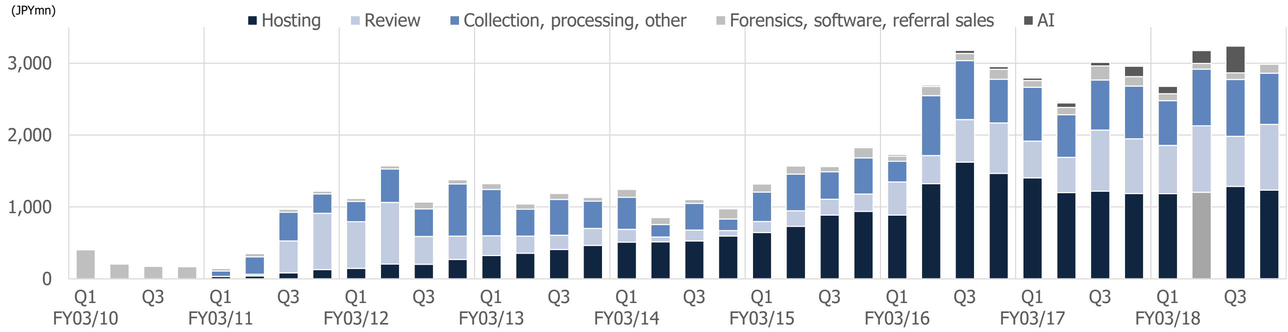
- Overview: At the Legal segment, the US business (whose primary targets are Japanese and Asian companies in the US market) finished the structural reorganization required to build a business structure that will lead to large contract wins in FY03/18; the AI segment has remained in the black on a quarterly basis after adding new clients and expanding relations with existing clients. New measures planned to keep business growing in both areas.
- FY03/18: Revenue up 10% YoY, moved into operating profit. Shifts to profitable structure as US structural reform completed. Operating profit of JPY670mn in Q4, full-year JPY200mn forecast exceeded. Sales in AI segment up 2.9x YoY with solid sales to financial and IP sectors. Builds operating profit in Q4 after move into the black in Q3
- Legal segment: Benefits of structural reform flowing through. After operating loss of JPY436mn in Q1, operating profit of JPY144mn in Q2, JPY208mn in Q3, and JPY653mn in Q4
  - Large contracts: Four new contracts in Q4 and full-year total of eight (versus full-year target of five). New contract wins reflect successful expansion marketing efforts using global office network, including US
  - US: Continued working to reorganize and consolidate operations, lowering CoGS ratio, and reducing personnel expenses. Moved into the black in Q4 due to thorough project management and cost-cutting efforts
  - New initiatives: Expects to progressively release development of next-generation Lit i View system, potentially sparking innovation within the industry
- AI segment: Moved into the black in Q3, maintained in Q4. Intellectual property, financial, and healthcare sectors drove results. Client company count continues to rise. Gains aided by sales from overseas offices.
  - Sales in uptrend: With the exception of overseas offices in start-up mode, trend of quarterly sales growth continues from Q1 onward. 78 client companies (up1.7x YoY)
  - Staying profitable: Expects to stay in the black in Q4 as growth in domestic demand (primary from financial institutions) offsets impact of lower sales from early-stage work under contracts in Asia
  - New initiatives: Develops Concept Encoder, AI engine to make best use of healthcare big data
- FY03/19: Legal segment to invest in business expansion and conduct structural reform. With upfront investment stage over, AI segment FY03/19 onward in aggressive stage
- Medium-term outlook: Newly announced targets for FY03/20: (sales JPY20.0bn, operating profit JPY2.1bn) and FY03/21: (sales JPY30.0bn, operating profit JPY4.2bn)

Quarterly performance (left: revenue, right: operating profit, JPYmn)





Revenue by service type (JPYmn)



Source: Shared Research based on company data

Earnings overview

Looking at the progress made by the company during the first nine months of FY03/18, we especially noted that: 1) at the Legal segment, the US business, whose primary business targeting the US market, is finally creating an organizational structure that will allow the company to win large contracts inform Japanese and Asian clients; 2) at the AI segment, operations moved into the black on a quarterly basis after adding new clients and expanding services provided to existing clients; and 3) new measures planned to keep business growing at both the Legal and AI segments. Judging from the progress made on these fronts, Shared Research believes the company is heading in the right direction from a medium- to long-term perspective.

Based on Q4 results, it is apparent that the results of structural reform in the Legal segment are steadily flowing through. The AI segment is also maintaining operating profit, and the company was able to exceed its full-year operating profit forecast of JPY200mn, suggesting that the above outlook was appropriate. According to Fronteo, FY03/19 will be an aggressive stage. The company also updated its medium-term outlook, and expects operating profit of JPY2.1bn in FY03/20 (up 3x YoY, JPY540mn from AI business) and JPY4.2bn in FY03/21 (2x YoY, JPY2.1bn from AI) with profit growth from both businesses. We will be keeping a close watch on progress.

Legal builds profit in Q4 after finishing structural reform and AI maintains profit in Q4 after turning to black in Q3
For FY03/18, the company report consolidated revenues of JPY12.3bn (+10.0% YoY) and operating profit of JPY231mn (versus year-earlier loss of JPY1.2bn). Versus full-year forecasts, sales fell slightly short (2.1%), but operating profit exceeded the JPY200mn plan. There was a notable contribution from improved profit in the Legal segment.

The year saw major fluctuations on a quarterly basis. Fronteo posted a loss of JPY662mn in Q1 (JPY437mn in Legal and JPY225mn in AI). With restructuring of US operations given priority in Q2 and Q3 and the head office taking the lead, the company achieved results in a short time, bringing operations back into the black at the consolidated level in Q2. The company continued working along these lines in Q3 and added further to consolidated operating profit as the Legal segment made good use of its global office network (including US offices) to win major contracts in South Korea (from existing client) and Taiwan (from new client), and the AI business moved into the black and consolidated operating profit increased. In Q4, restructuring of the US operations was completed and the US subsidiary moved into the black. The AI segment remained in the black, and the company posted consolidated operating profit of JPY666mn for the quarter, a major factor in meeting full-year forecasts.

The company accelerated the restructuring of its US business in order to achieve the desired earnings structure more quickly, and booked JPY277mn in restructuring-related charges (under extraordinary losses) in Q2, JPY493mn in charges in Q3, and JPY16mn in Q4 (for a full-year total of JPY786mn), consequently posting a net loss for the third year in a row (improving by JPY223mn YoY).

With respect to the company's financial position, we note that in January 2018 it reached an agreement on a JPY1.3bn committed line of credit arranged by The Bank of Tokyo-Mitsubishi UFJ, and drew a loan of JPY1.0bn under this credit line. The interest rate on the loan was TIBOR+0.50%; the funds may be borrowed for as much as one year but the loan agreement comes with restrictive financial covenants.

Financial covenants (based on Q3 FY03/18 earnings report and FY03/17 annual securities report)

(JPYmn) (As of FY03/17) Signed in (Borrowed in Jan. 2018)	Syndicated loan Jan. 2018	Syndicated loan Jul. 2016	Syndicated loan Sep. 2016	Long-term loan Nov. 2015	Long-term loan Nov. 2015	Long-term loan Nov. 2015	Long-term loan Nov. 2015
Current portion of long-term debt		133	30	187	189	23	22
Long-term debt		867	270	1,500	1,509	199	188
Short-term debt	*1,000						
Financial covenants							
Parent and consolidated net assets at the end of each FY to remain:							
Over 75% of net assets at the end of previous FY and at end-FY03/17	○						
Over 75% of net assets at the end of previous FY and at end-FY03/16		○	○				
Over 75% of net assets at the end of previous FY and at end-FY03/15				○			○
Consolidated net assets at the end of each FY to remain:							
Over 75% of net assets at the end of previous FY and at end-FY03/15					○	○	
In parent and consolidated earnings results:							
No recurring losses in two consecutive FYs	○	○	○	○	○	○	○

Source: Shared Research, based on company data

FY03/19 and medium-term outlook

For FY03/19, the company forecasts sales of JPY13.8bn (+11.9% YoY), operating profit of JPY700mn (up 3x), net income of JPY300mn (in the black for the first time since FY03/15), and a dividend of JPY3 (first since JPY3 in FY03/16). The company expects both the Legaltech (name changed from Legal) and AI segments to post sales and profit growth. In the Legaltech segment, Fronteo expects full-year contributions from the establishment of a global cross-border sales structure it was working on through FY03/18 as well as the benefits of structural reform in its US subsidiary. In the AI segment, the company expects business intelligence to continue driving profit. In healthcare, the company plans to provide business improvement consulting services to the pharmaceutical industry and medical equipment manufacturers. By focusing on winning joint research and development projects under contract, the company said it expected the healthcare sector to move into the black on a stand-alone basis. It assumes a forex rate of JPY105/USD.

Fronteo also updated its medium-term forecasts in light of the results. Under the latest forecasts, the company expects sales and profit growth from both segments, for operating profit of JPY2.1bn in FY03/20 (up 3x YoY) and JPY4.2bn in FY03/21 (2x YoY). In addition to improved margins in the Legaltech segment (OPM of 10% from FY03/20 onward) the company expects significant sales growth and profit contribution from the AI segment.

It has the following initiatives and forecasts. Legaltech: it plans to build up large contracts for companies in Asia including Japan, and accelerate growth leveraging its strengths as a tech company by expanding the scope of AI technology applications and upgrading its proprietary Lit i View software. AI (business intelligence and digital communications): grow by developing new fields as core sources of earnings to follow patent research and financial sector, and expand sales channels (partners) to tap into burgeoning demand. AI (healthcare): sector to turn to operating profit on stand-alone basis in FY03/19 driven by Concept Encoder, healthcare specialist artificial intelligence engine. Products under development to contribute to profit from FY03/21 onward. Shared Research will be keeping a close watch on quarterly progress.

In the AI segment, revenue from financial institutions grew from under JPY100mn in FY03/17 by 2.8x to JPY200–300mn in FY03/18. The company’s KIBIT technology was selected for the Financial Services Agency “FinTech Experiment Hub” Support Project, the first to use artificial intelligence. The company said it has a new area of focus for development, HR solutions. Winning contracts in such areas looks promising.

Full-year outlook, US business (as of Q3, for reference purposes):
At the time of the downward revision to the company's forecast at the end of Q2, the company was thinking the effects of cost reductions, centered on FRONTEO’s US subsidiary, would contribute for most of the duration of 2H (contributed for only about a month in 1H), so the company expected to secure stable earnings and remain solidly in the black. Based on this assumption, the company had expected an operating profit of JPY849mn in 2H, breaking down into roughly JPY550mn for US subsidiaries, JPY400mn for Japan and other regions, and an operating loss of JPY100mn in the AI business. Profit growth is attributed to structural reforms in the US and sales growth of the AI business. In the October-December 2017 quarter (Q3) the company reported a consolidated operating profit of JPY213mn as cross-border sales efforts led to higher sales and earnings in Asia, leading to a Q3 operating profit of JPY209mn for the Legal segment as a whole (versus JPY144mn in Q2) even though losses at the US subsidiary were up QoQ. The AI segment moved into the black in Q3 with the help of first-time sales in Asia. To meet its full-year target the company will need an operating profit of JPY635mn in Q4; we plan to ask about this at the results presentation.

More progress on reforms of organzational and earnings structure of US business, fostering improvement in earnings structure for legal segment as a whole (including Japan and Asia)
At first glance it might appear the company was not making much progress towards restructuring its US business but in fact the structural reforms are moving along steadily. The earnings structure of the US business has been markedly improved with the implementation of measures to bring down production costs and cut SG&A spending, however, in Q3 US operations saw sales down JPY280mn, as a result operating loss increased JPY62mn QoQ. Meanwhile, the company's Legal business in Asia scored a JPY416mn increase in sales and JPY149mn increase in operating profit thanks to the support of sales and operational personal from the US. This means the US business, which is primarily tasked with growing business with Japanese and Asian companies in the US, is finally creating an organizational structure that will help the company win large contracts. This positive development also means that profit or loss at the US business on a standalone basis will be less significant.

That said, the US business is still in the process of streamlining and strengthening its business structure. This goes beyond simple cost-cutting, it means changes to its business structure that will make it capable of sustaining a 10% operating profit margin. One of the additional measure taken during Q3 was scaling back of its New York office that did review work. The closure was based on a strategic decision that the company wanted to do less low-profit review work (which it had accepted in the past simply to keep up overall sales) as this kind of work was likely to become increasingly automated in the future.

The company said cost cutting was proceeding in line with plan. At its Q3 result presentation the company noted that the SG&A expense ratio at its US subsidiary (on a standalone basis) was down from 53% in Q1 to 37% in Q3. Applying those figures to US sales, this means the company cut about JPY230mn in expenses. The company sees the benefits from the cost-cutting being even larger in Q4, and is currently projecting a USD2.5mn reduction in Q4 costs in versus Q1 (equal to JPY270mn decline based on an exchange rate of JPY108/USD). For the earnings structure to be improve much further the company will need to increase sales (it is currently aiming for JPY2.5bn to JPY3.0bn per quarter). However, as discussed previously, there will undoubtedly be many cases in which major contracts are won with the help of the US business but it is the Japan and Asian businesses that book the sales. For the Legal segment as a whole, going forward we will be watching closely to see whether it stays securely in the black and eventually realizes an operating profit margin of 10%.

AI segment not only winning new clients, expanding relations with existing clients as well
Thanks in part to the addition of sales from early-stage analytical work in Asia, the AI segment moved into the black in the October-December 2017 quarter (Q3). The company had originally expected the segment to move into the black in Q4 but reached this goal earlier than expected thanks to a new contract for government-related work in South Korea and sales from early-stage sales following the introduction of AI products. In Japan alone, the AI business recorded a loss of a few million yen. At the results presentation meeting, the company said that even domestic operations were likely to be in the black in Q4. The company sees sales in the Business Intelligence field growing rapidly, and also emphasized that it sees growth coming not just from new clients, but from broadening and deepening relationships with existing client companies so that they make use of its AI-based services in other areas. As part of this effort the company sponsors events such as study groups. Through these study groups, users gains insights into potential new applications from the interact with other users, which in turn seems to expand the usage of its AI technology.

For the company to achieve its full-year target for consolidated operating profit, it will need JPY635mn in earnings in Q4. The AI segment is expected to contribute to some extent, but the lion's share is still expected to come from the Legal segment, where the restructuring of US operations is also expected to lead to new contract wins from Japanese and Asian clients.

Outlook for FY03/19
Assuming the company continues working to improve profitability under the current initiatives, we can expect greater contributions to earnings from both the Legal and the AI segments. At the Legal segment, Shared Research sees new contracts wins stemming from the creation of a business structure in the US that will help the company win large contracts from Japanese and Asian clients. At the AI segment, we see the company growing sales both at home and aboard while maintaining a business structure where fixed costs rise very little. We will also be keeping a close eye on the new growth initiatives the company plans to undertake in both areas.

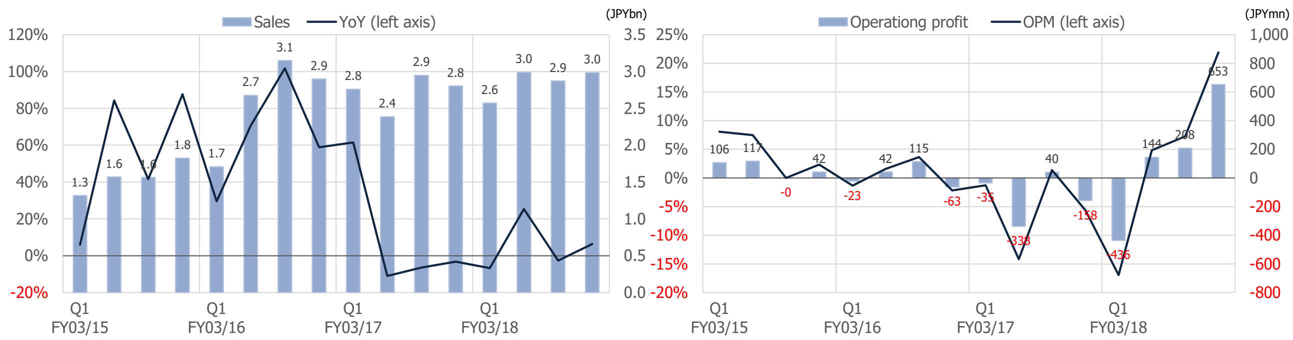
Laying the groundwork for future growth

One key initiative at the Legal segment is the major upgrade of the company's proprietary Lit i View software, a comprehensive platform that allows users to carry out all parts of the eDiscovery process. According to the company, it aims for the upgrade which could spark innovation within the industry. The company aims to launch the upgraded version of Lit i View in FY03/19, and then it seems to intend to roll out a new and innovative solutions service. As this will serve to reduce the need for a costly document review process, during Q3 the company moved in advance to scale back its New York office that did review work.

At the AI segment, the company is working with partner companies to set up joint-programs that will lead to faster growth in the future. This initiative has a number of goals. The first is to expand the range of applications; to do this the company plans to offer KIBIT products that make use of the expertise of its various partner companies. The second goal is to expand sales; this will be done by expanding sales of solution services that have already been established. The third goal is geographic expansion; to do this the company plans to tap the client networks of its partner companies. There will be some expenses related to the establishment of these partnerships in FY03/19, but once the partnership structure has been formed then the company will be able to grow sales and earnings with very little increase in fixed costs. Up until now the AI segment has done business under the KIBIT brand and has refrained from using sales agents. This is because the business was such that, once a business foundation was established to a certain extent, the company felt it could maintain and expand the KIBIT brand by building up its own organization and eliminating the middleman. Shared Research believes the company will be successful in its efforts to grow sales by establishing such partnerships going forward.

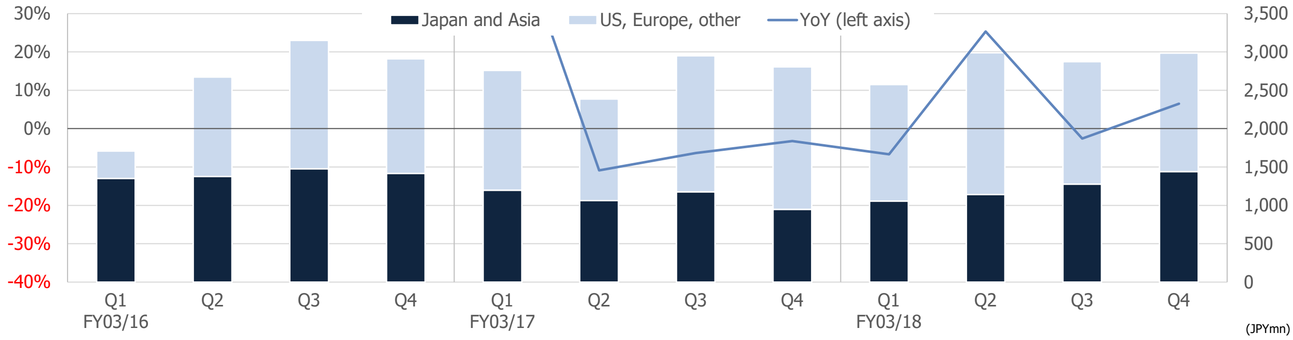
Legal segment

Legal segment performance (left: revenue, right: operating profit, JPYmn)



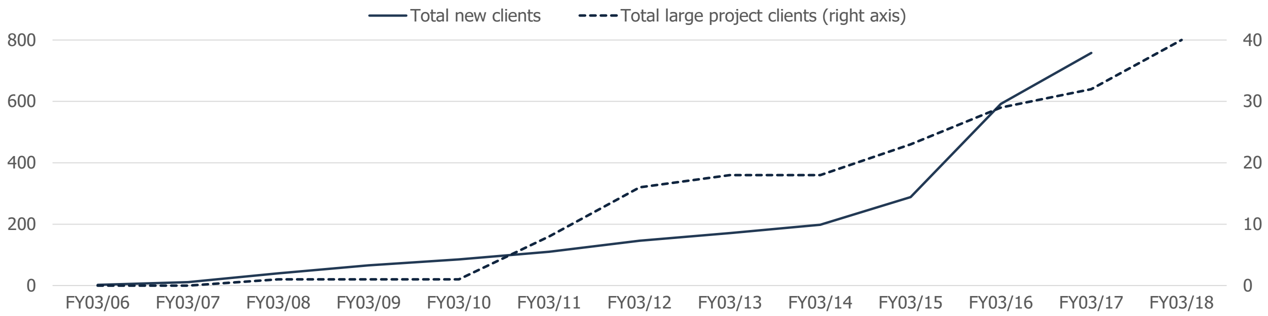
Source: Shared Research based on company data

Revenue breakdown by client home country



Source: Shared Research based on company data

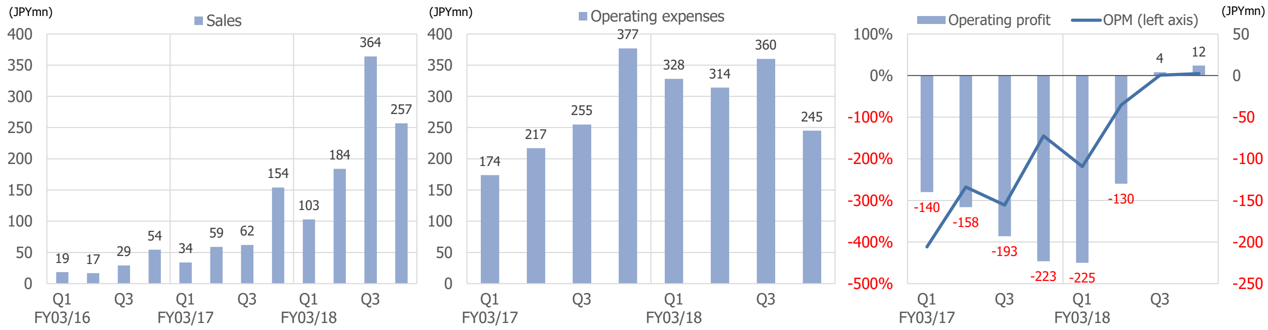
Number of large projects



Source: Shared Research based on company data

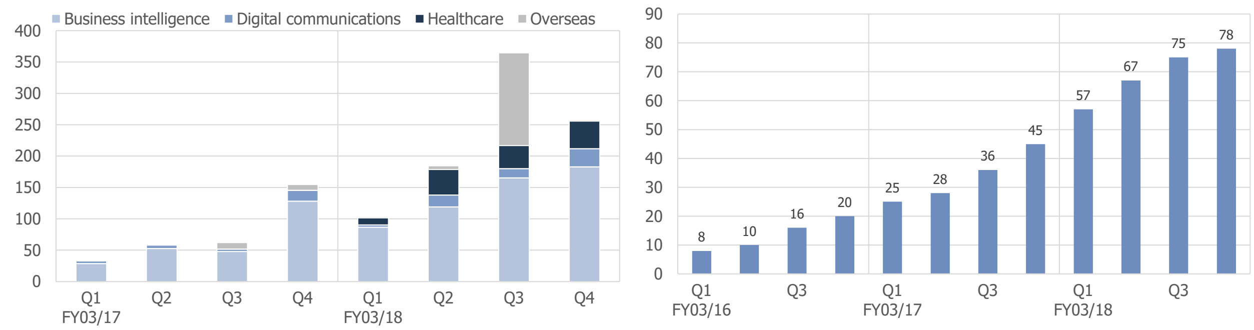
AI segment

AI segment performance (left: revenue, center: operating expenses, right: operating profit, JPYmn)



Source: Shared Research based on company data

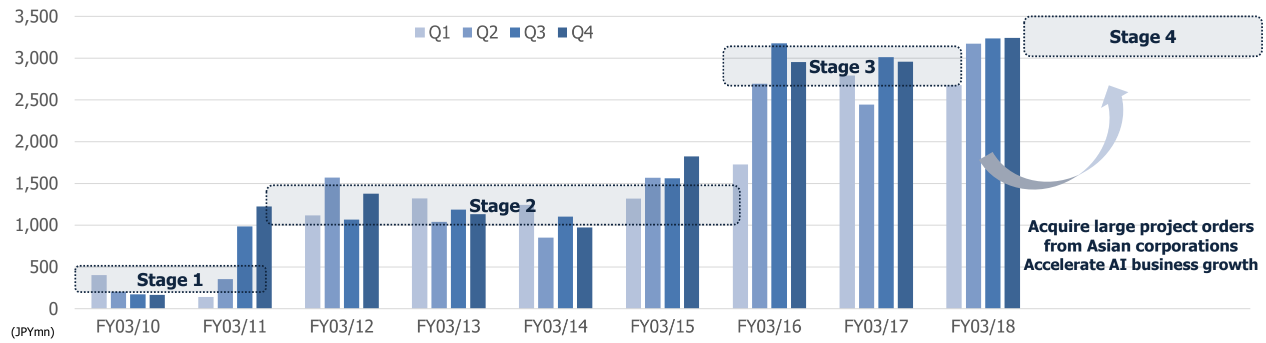
Revenue by category (left, JPYmn), cumulative total of customer companies (right)



Source: Shared Research based on company data

Reference

Consolidated revenue (JPYmn)



Source: Shared Research based on company data

This note is the most recent addition to the full report.

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