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On **August 14, 2019**, FRONTEO, Inc. announced earnings results for Q1 FY03/20.

Income statement (JPYmn)	FY03/18				FY03/19				FY03/20	FY03/20	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	FY Est.	% of FY
Revenue	2,677	3,174	3,237	3,129	2,756	2,854	2,798	2,854	2,583	11,600	22.3%
Legaltech	2,573	2,990	2,873	2,872	2,607	2,602	2,383	2,243	2,303	-	-
Japanese and Asian accounts	1,055	1,142	1,277	1,439	1,213	1,168	1,053	1,439	1,191	-	-
European and US accounts	1,518	1,848	1,596	1,432	1,394	1,434	1,330	804	1,112	-	-
AI Solution	104	184	364	257	149	253	415	611	280	-	-
Business intelligence (BI; former BI/DC)	90	138	180	145	133	229	300	507	247	-	-
Healthcare	11	41	37	44	13	22	41	104	28	-	-
Overseas	2	6	148	2	3	2	73	0	4	-	-
Japan	102	179	217	256	146	251	342	611	276	-	-
Overseas	2	6	148	2	3	2	73	0	4	-	-
YoY	-4.1%	29.8%	7.5%	5.8%	2.9%	-10.1%	-13.6%	-8.8%	-6.3%	3.0%	
Legaltech	-6.7%	25.3%	-2.6%	2.4%	1.3%	-13.0%	-17.1%	-21.9%	-11.7%	-	-
Japanese and Asian accounts	-	-	-	-	14.9%	2.2%	-17.6%	-	-1.8%	-	-
European and US accounts	-	-	-	-	-8.2%	-22.4%	-16.6%	-43.8%	-20.3%	-	-
AI Solution	204.8%	211.9%	487.1%	66.9%	43.6%	37.3%	13.9%	137.8%	88.2%	-	-
Business intelligence (BI; former BI/DC)	-	-	-	-	47.6%	66.1%	66.7%	248.8%	85.8%	-	-
Healthcare	-	-	-	-	9.2%	-45.7%	12.6%	135.6%	126.7%	-	-
Cost of revenue	1,821	1,819	1,830	1,520	1,518	1,569	1,645	1,597	1,670	-	-
Cost ratio	68.0%	57.3%	56.5%	48.6%	55.1%	55.0%	58.8%	56.0%	64.7%	-	-
Gross profit	856	1,355	1,407	1,609	1,238	1,285	1,153	1,256	913	-	-
GPM	32.0%	42.7%	43.5%	51.4%	44.9%	45.0%	41.2%	44.0%	35.3%	-	-
SG&A expenses	1,519	1,341	1,194	996	1,080	1,247	1,109	1,253	1,357	-	-
YoY	13.5%	-4.4%	-13.0%	-30.2%	-28.9%	-7.0%	-7.1%	25.8%	25.7%	-	-
SG&A ratio	56.7%	42.2%	36.9%	31.8%	39.2%	43.7%	39.7%	43.9%	52.5%	-	-
Operating profit	-662	14	213	613	159	38	44	4	-444	200	-
Legaltech	-448	134	208	567	237	35	43	-204	-357	-	-
AI Solution	-214	-120	5	46	-78	3	1	60	-87	-	-
Adjustments	-	-	-	-	-	-	-	-	-	-	-
OPM	-24.7%	0.4%	6.6%	19.6%	5.8%	1.3%	1.6%	0.1%	-17.2%	1.7%	
Legaltech	-17.4%	4.5%	7.3%	19.7%	9.1%	1.3%	1.8%	-9.1%	-15.5%	-	-
AI Solution	-206.6%	-65.2%	1.4%	17.9%	-52.6%	1.3%	0.2%	9.8%	-31.2%	-	-
Non-operating income (expenses)	-18	-20	7	-162	63	39	-74	-69	-35	-84	-
Financial income	-2	-10	-17	-10	2	-10	-8	-6	10	-	-
Syndicated loan fees	-1	-2	-2	-8	-8	-13	-13	-29	-1	-	-
Stock and bonds issuance expenses	-	-	-	-	-	-	-	-	-	-	-
Gains on foreign exchange	-16	-14	14	-192	79	62	-37	-25	-43	-	-
Other non-operating income	1	5	12	48	-10	-0	-16	-9	-1	-	-
Recurring profit	-680	-7	220	450	222	77	-31	-66	-479	116	-
YoY	-	-	-	-	-	-	-	-	-	-42.9%	-
RPM	-25.4%	-0.2%	6.8%	14.4%	8.1%	2.7%	-1.1%	-2.3%	-18.6%	1.0%	-
Extraordinary gains (losses)	-	-308	-528	-8	17	-1	-7	18	26	-	-
Pre-tax profit	-680	-315	-308	442	239	76	-37	-47	-453	-	-
Income taxes	-227	177	96	-89	99	28	12	29	-13	-	-
Implied tax rate	33.3%	-56.1%	-31.1%	-20.1%	41.6%	36.6%	-33.0%	-60.1%	2.9%	-	-
Net income attrib. to non-controlling interests	3	2	2	4	0	2	5	3	4	-	-
Net income attributable to parent company shareholders	-456	-494	-405	527	139	46	-54	-79	-444	10	-
YoY	-	-	-	-	-	-	-	-	-	-80.9%	-
Net margin	-17.0%	-15.5%	-12.5%	16.8%	5.1%	1.6%	-1.9%	-2.8%	-17.2%	0.1%	-
EBITDA (OP before dep. and amortization)	-327	303	516	876	404	279	291	242	-	-	-
YoY	-	-	267.8%	-	-	-8.1%	-43.7%	-72.3%	-	-	-
EBITDA margin	-12.2%	9.6%	15.9%	28.0%	14.7%	9.8%	10.4%	8.5%	-	-	-
R&D expenses	54	72	3	-10	22	14	13	14	-	-	-
Depreciation	297	253	259	206	207	202	208	200	-	-	-
Amortization of goodwill	38	36	44	57	38	39	39	38	-	-	-
USD/JPY	111.1	111.0	113.0	108.2	109.1	111.4	112.9	111.0	107.8	-	-
YoY	2.7%	8.4%	3.2%	-4.7%	-1.8%	0.4%	-0.1%	2.6%	-1.2%	-	-
USD/JPY (quarter-end)	112.0	112.7	113.1	106.3	110.5	113.6	110.9	111.0	107.8	-	-

Source: Shared Research based on company data

Note: The company changed reporting segments in Q3 FY03/18 and figures are retroactively restated (same hereafter).

The company has changed reporting segments and has corrected results several times previously. Figures in this report are retroactively restated as far as possible. However, in some cases, figures may not be consistent with historic data.

Q1 FY03/20 results

Earnings overview

- ▷ In Q1 FY03/20, revenue was JPY2.6bn (-6.3% YoY), operating loss was JPY444mn (operating profit of JPY159mn in Q1 FY03/19), recurring loss was JPY479mn (recurring profit of JPY222mn in Q1 FY03/19), and net loss attributable to parent company shareholders was JPY444mn (net income of JPY139mn in Q1 FY03/19). GPM was 35.3% (-9.6pp YoY).
- ▷ Progress toward the full-year FY03/20 revenue target was 22.3%.
- ▷ FRONTEO made no revisions to its full-year FY03/20 forecast as announced on May 15, 2019. As an important subsequent event, the company announced personnel reduction at FRONTEO USA, Inc. starting on August 1, 2019 with the aim of improving management. FRONTEO expects expenses related to this action to occur in Q2 or after, and is therefore currently analyzing the details.

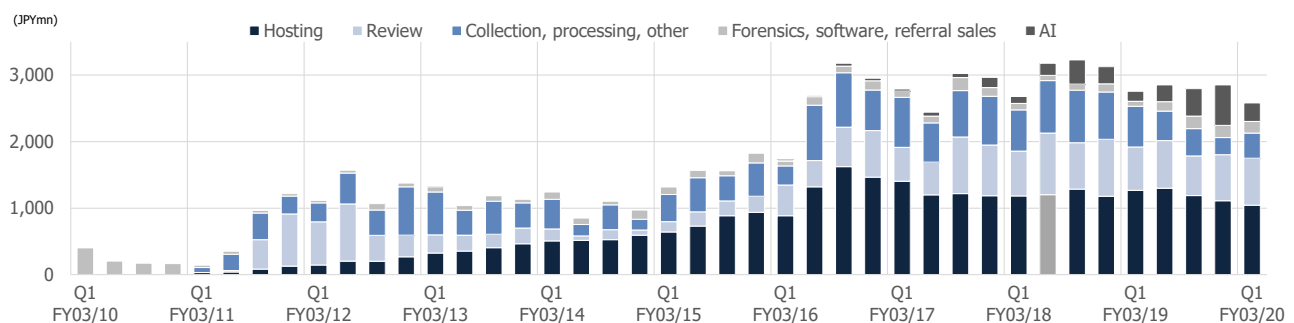
Legaltech AI segment

- ▷ Legaltech AI revenue was JPY2.3bn (-11.7% YoY).
- ▷ eDiscovery services: Revenue was JPY2.1bn (-16.0% YoY). Authority over provider selection that had traditionally been entrusted to law firms is now being handled by client companies themselves, and these companies typically have a greater awareness of quality and cost factors. Subsidiaries, especially in the US, have been slow to respond to this change in the business practice.
- ▷ Forensic services: Revenue was JPY175mn (+133.5% YoY). In Japan, the company won large research projects utilizing AI technologies, including research projects conducted in cooperation with third-party committees. The number of payment card forensic investigations and consulting service projects also increased.
- ▷ Revenues by home country of clients were down YoY in Japan and Asia (-1.8% YoY) and in the US and Europe (-20.3% YoY).
- ▷ There was an operating loss of JPY357mn for the segment (operating profit of JPY237mn in Q1 FY03/19). Revenue from high-margin hosting services declined (-17.6% YoY). In addition, personnel expenses increased on investment to strengthen FRONTEO's senior management team.

AI Solution segment

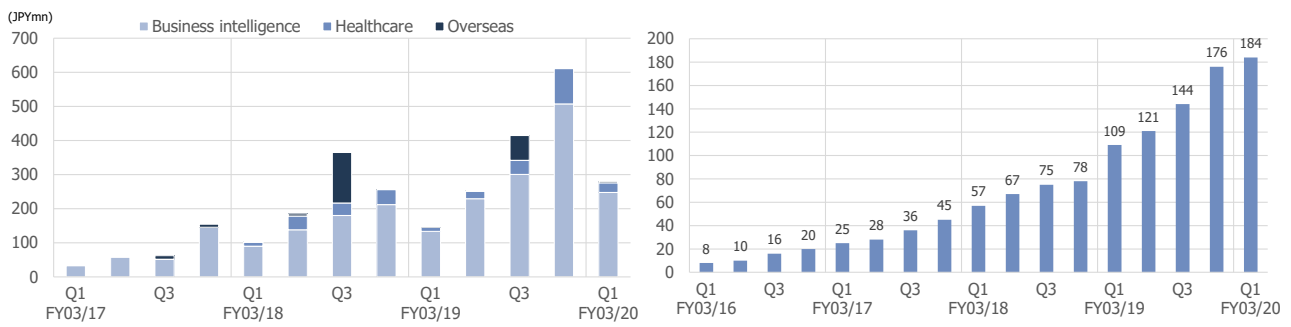
- ▷ AI Solution revenue was JPY280mn (+88.2% YoY). Earnings have steadily increased in both the business intelligence and healthcare fields as projects have grown in size and the number of companies adopting AI products has increased.
- ▷ Operating loss was JPY87mn (operating loss of JPY78mn in Q1 FY03/19), impacted by an increase in overhead expenses accompanying revenue growth.
- ▷ The cumulative number of companies using AI products was 184 (1.6x the Q1 FY03/19 figure; +8 from end March 2019).

Revenue by service type



Source: Shared Research based on company data

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



Source: Shared Research based on company data

Other

Serious shortcoming in internal controls related to financial reports that require disclosure

The company reported that there was a serious shortcoming in FY03/19 internal control reporting that require disclosure, making internal controls related to the company's financial reports ineffective. Rectification of this serious shortcoming has already been reflected in the company's FY03/19 consolidated financial statements, and the accounting auditors provided an unqualified opinion in the financial statement audit report.

This note is the most recent addition to the [full report](#).

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