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PALTEK CORPORATION

Summary of FY12/15 Financial Results and Follow-Up Interview

The PALTEK Corporation (hereinafter "PALTEK" or the "Company") announced its FY12/15 consolidated financial results and held an analyst meeting. The following is a summary of the results meeting and our follow-up interview with President Naohide Yabuki.

Summary of FY12/15 Consolidated Financial Results

The Company's consolidated financial results for FY12/15, announced on February 9, 2015, were better at net sales and operating income levels than the Company's forecasts revised at its 1H results reporting on August 5, 2015. Meanwhile, ordinary and net incomes were slightly below the forecasts due to foreign exchange losses posted in non-operating expenses.

As shown in Table 1, FY12/15 saw strong growth in sales and incomes, with net sales soaring by 24.6% YoY, operating income by 35.0% YoY and net income by 19.9% YoY. Sales in both mainstay Semiconductor and Design Service Businesses grew sharply and lifted consolidated operating income.

●【Table 1】FY12/15 Consolidated Financial Results

	FY12/14 Actual		FY12/15 Actual		YoY Changes	
(¥ million, %)	Amount	Composition Ratio	Amount	Composition Ratio	Amount	Ratio
Net Sales	23,155	100.0%	28,841	100.0%	5,686	24.6%
Gross Profit	3,713	16.0%	4,261	14.8%	548	14.8%
SG&A Expenses	2,704	11.7%	2,900	10.1%	195	7.2%
Operating Income	1,008	4.4%	1,361	4.7%	352	35.0%
Ordinary Income	1,052	4.5%	1,144	4.0%	92	8.8%
Net Income	563	2.4%	674	2.3%	111	19.9%

Source: Compiled by Trias Corporation from Company materials

By business segment, as Table 2 indicates, sales of Semiconductor Business increased by 24.5% YoY, while those at Design Service Business jumped by 21.3% YoY, and both grew sharply by more than 20%.

●【Table 2】FY12/15 Sales Breakdown by Segment

(¥ million, %)	FY12/14 Actual Amount	FY12/14 Actual Composition Ratio	FY12/15 Actual Amount	FY12/15 Actual Composition Ratio	YoY Changes Amount	YoY Changes Ratio
Semiconductor	21,898	94.6%	27,255	94.5%	5,355	24.5%
Design Service	1,118	4.8%	1,354	4.7%	238	21.3%
Other	139	0.6%	231	0.8%	92	66.6%
Total	23,155	100.0%	28,841	100.0%	5,686	24.6%

Source: Compiled by Trias Corporation from Company materials

In Semiconductor Business, sales in mainstay FPGA products increased on the back of acquisition of new clients, triggered by a takeover of commercial rights from Tokyo Electron Device Ltd. (TSE 1st Section: 2760; hereinafter "TED"), as well as strong demand from medical equipment clients. Sales also increased in analog semiconductors for industrial and measurement equipment use and standard ICs for office equipment, but decreased in ASSPs (application specific standard products) due maily to weaker computer applications. Design Service Business fared mostly well driven particularly by medical and measurement devices.

Gross profit margin (GPM) declined from 16.0% a year before to 14.8%. As shown in Table 3, while foreign exchange gains from US$-based credit notes from a supplier, values of which fluctuate in line with forex moves, rose from ¥327 million to ¥431 million, the adjusted GPM excluding this impact resulted in 13.3%, declining 1.3 points YoY.

The drop in profitability is mainly due to a 1.7% adjusted GPM erosion in Semiconductor Business. FPGA sales gained through the acquisition of TED commercial rights bear thinner margins as PALTEK was not involved in either the Design-In (products adopted through preproduction prototypes) or Design-Win (products adopted through mass production) processes, and also worked negatively was there were certain large-size, low-profitability transactions involving other semiconductors.

●【Table 3】Impacts to Gross Profit from Forex Rate Changes

(¥ million, %)	FY12/14 Actual Amount	FY12/14 Actual Ratio to Net Sales	FY12/15 Actual Amount	FY12/15 Actual Composition Ratio
Gross Profit	3,713	16.0%	4,261	14.8%
(Forex Impact)	327	1.4%	431	1.5%
Gross Profit (Excluding Forex Impact)	3,386	14.6%	3,830	13.3%

Source: Compiled by Trias Corporation from Company materials

SG&A expenses increased by ¥195 million YoY, comprising personnel expenses rising by ¥170 million due mostly to increased development and sales personnel resulted from acquiring FPGA commercial rights.

Operating income was ¥1,361 million, up 35.0% YoY, and its margin to net sales rose from 4.4% a year earlier to 4.7%. Operating income excluding foreign exchange impact stood at ¥929 million, up 36.4% YoY, and the adjusted operating income margin rose from 2.9% to 3.2%. Lowered burden of SG&A expenses relative to sharply increased sales is a major factor behind this improvement.

Ordinary income increased by 8.8% as the Company posted non-operating expenses of ¥129 million for foreign exchange losses induced by forex rate changes for dollar purchases at the time of posting payables, and other minor factors. Net income increased by 19.9% YoY due to lighter tax burdens.

As can be seen in Table 4, total assets increased by ¥3,940 million, or 32.7% up, from FY12/14-end largely on the back of acquiring commercial rights from TED.

For assets, accounts receivable - trade increased significantly by ¥2,870 million. This is attributed to sharply increased sales namely in products succeeded from TED. Among overall inventories, merchandise grew by ¥779 million from a year before, but decreased more than ¥200 million compared to the high level at ¥4,175 million at the end of 1H (September 2015) caused chiefly by additions of TED products.

Accounts receivable - other, included in other current assets, stood at ¥1,960 million, an increase of nearly ¥1 billion from the end of FY12/14. PALTEK's this account consists mostly of receivables associated to discounts of procurement of overseas products, and was hence also affected by the take-over of TED products. The amount of the receivables, however, decreased sharply from ¥3,039 million at the end of 1H as a large portion was collected in 2H.

As for liabilities, a big change was seen in short-term loans payable, increasing by ¥3,350 million from the end of FY12/14. This is to compensate for shortage in working capital due to the increase in accounts receivable - other. The Company had been preparing for the expected increase in financial burdens and product procurement accompanying the acquisition of commercial rights by establishing a commitment line of ¥10 billion at the beginning of FY12/15. This means the increase in the loans was in line with Company's plan.

The equity ratio declined from 72.7% at the end of FY12/14 to 56.6% at the end of FY12/15. There are, however, likely no concerns regarding its financial position for the time being as the ratio is sufficiently over 50% with dependency on loans among total assets remaining at approximately 26%.

●【Table 4】Summary of FY12/15-End Consolidated Balance Sheet

(¥ million)	FY12/14-end	FY12/15-end	Changes in Amount	Major Factors
Cash and Deposits	2,058	1,199	(859)	Decreased due to payment for account payable-trade
Accounts Receivable - Trade	4,496	7,367	2,870	Increased due to net sales increase
Merchandise	3,139	3,918	779	Increased to prepare for future sales increases
Other Current Assets	1,765	2,988	1,222	Significant increase in accounts receivable – other
Non-current Assets	577	504	(73)	
Total Assets	12,037	15,977	3,940	
Accounts Payable - Trade	784	1,047	262	
Short-Term Loans Payable	780	4,130	3,350	Increased due to payment for account payable - trade
Other Current Liabilities	1,398	1,468	69	
Non-current Liabilities	325	283	(41)	
Net Assets	8,748	9,048	299	
Total Liabilities and Net Assets	12,037	15,977	3,940	

Source: Compiled by Trias Corporation from Company materials

Summary of FY12/16 Consolidated Financial Forecasts

As can be seen from Table 5, the Company is guiding for net sales of ¥30.0 billion and operating income of ¥1.2 billion for the full-year FY12/16 consolidated financial forecasts. Despite a net sales growth of 4.0% YoY, operating income is forecast to decline as the Company darely increases SG&A expenses on staff reinforcement for future growth and does not assume any impacts from foreign exchange gains from overseas semiconductor procurements, which influenced FY12/15 incomes meaningfully.

●【Table 5】Summary of FY12/16 Consolidated Financial Forecasts

	FY12/15 Actual		FY12/16 Forecasts		YoY Changes	
(¥ million, %)	Amount	Composition Ratio	Amount	Composition Ratio	Amount	Ratio
Net Sales	28,841	100.0%	30,000	100%	1,158	4.0%
Gross Profit	4,261	14.8%	4,525	15.1%	263	6.2%
SG&A Expenses	2,900	10.1%	3,325	11.1%	424	14.6%
Operating Income	1,361	4.7%	1,200	4.0%	(161)	-11.9%
Ordinary Income	1,144	4.0%	1,100	3.7%	(44)	-3.9%
Net Income	674	2.3%	700	2.3%	25	3.7%

Source: Compiled by Trias Corporation from Company materials

As Table 6 shows, as for forecasts by business segment, the Company expects Semiconductor Business sales to increase 3.1% YoY and Design Service Business to jump by 18.1% YoY.

●【Table 6】 Summary of Net Sales Forecasts by Segment

	FY12/15 Actual		FY12/16 Forecasts		YoY Changes	
(¥ million, %)	Amount	Composition Ratio	Amount	Composition Ratio	Amount	Ratio
Semiconductor	27,255	94.5%	28,100	93.7%	844	3.1%
Design Service	1,354	4.7%	1,600	5.3%	245	18.1%
Other	231	0.8%	300	1.0%	68	29.4%
Total	28,841	100.0%	30,000	100.0%	1,158	4.0%

Source: Compiled by Trias Corporation from Company materials

The sharp slowdown in percentage growth of Semiconductor Business to the forecast 3.1% from 24.5% in FY12/15 is solely due to impact from taken-over products from TED, and excluding these, the sales growth is in fact faster in FY12/16.

The size of client projects succeeded from TED is worth about ¥4.0 billion, and the Company could realize the sales worth ¥3.0 billion in FY12/15. In FY12/16 full scale sales worth ¥4.0 billion are likely to be posted. Excluding these, growth of Semiconductor Business would expand from slightly over 10% for FY12/15 to slightly less than 12% for FY12/16. This growth will be driven by FPGAs and their associated analog semiconductors.

Overall gross profit is expected at ¥4,525 million, or up ¥263 million YoY, with GPM rising from 14.8% in FY12/15 to 15.1%. With no foreign exchange gains/losses assumed from the aforementioned UF$-based credit notes, adjusted GPM excluding this impact is to rise more significantly by 1.8 points from 13.3% in FY12/15. This is due to expected sales decreases in low-margin products, or those succeeded from TED and involved in large-size transactions, in Semiconductor Business and heavier sales in high-margin Design Service Business relative to total net sales.

SG&A expenses are forecast to increase sharply by ¥424 million from ¥2,900 in FY12/15 to ¥3,325 million. The reasons are salary increases caused by full contribution of staff reinforcement during FY12/15 and further increases in R&D personnel planned for FY12/16. The Company aims to expand businesses by capitalizing gain in new clients, even sacrificing near term profits somewhat.

As a result, operating income would decline by 11.9% YoY, or by ¥161 million, to ¥1,200 million. The drop at the ordinary income level, however, should moderate to 3.9% YoY as any foreign exchange gains/losses (a loss of ¥129 million in FY12/15) are not assumed in non-operating items. Net income is to keep increasing, by 3.7% YoY, because a valuation loss of investment securities worth ¥30 million posted in FY12/15, should be absent.

However, forex moves must be carefully monitored. When USD-JPY exchange rates move sharply, PALTEK's earnings could be affected. In FY12/15, when yen's depreciation advanced, an positive impact of ¥431 million was posted as shown in Table 3. With current ongoing yen's appreciation, however, a negative forex impact can be expected from now on. According to the Company, one-yen appreciation is likely to cause a negative impact of ¥10 million on operating income.

Topic 1: Promising Products Using Own Technologies to Bear Fruits

Among products for which PALTEK Group has been focusing on development using its own technologies, mass-marketing of signal processor IC for infrared human sensors as well as

high-definition Codec solutions is expected in the coming quarters.

Signal Processor IC for Infrared Human Sensors

This product is a signal processor IC designed by PALTEK Group for the use of human sensors. Its development was originated by a Group company Technology Innovation, Inc., which is a unique development-driven company having expertise in sensor and MEMS technologies.

Product performance of an infrared human sensor is heavily dependent on how much it can remove noises emitted from very weak signals. The subsidiary developed an exceptionally high-performance signal processor IC, expecting its release for a client within FY12/16.

H.265/HEVC Codec Device

The product is a device efficiently compressing and transmitting high-resolution videos. While video technologies employed in broadcasting and medical fields are headed toward 4K/8K (4/16 times that of full high-vision video), it requires huge investment to build infrastructure for the formats. As a pre-stage, therefore, needs have been growing for efficiently transmitting high-vision quality videos.

The current product has been developed by a Group subsidiary Explorer Inc. taking advantage of its accumulated know-how. The product is expected to be applied in a wide variety of fields including broadcasting and surveillance cameras for its superior cost effectiveness.

Topic 2：”Second Pillar” Semiconductor Products to Contribute More to Profits

Semiconductor products that PALTEK positions as the “Second Pillar” are enjoying strong demand. Importance of such products is likely to grow more as client needs become increasingly sophisticated and complicated, and as the Group itself employs them in their proprietary products.

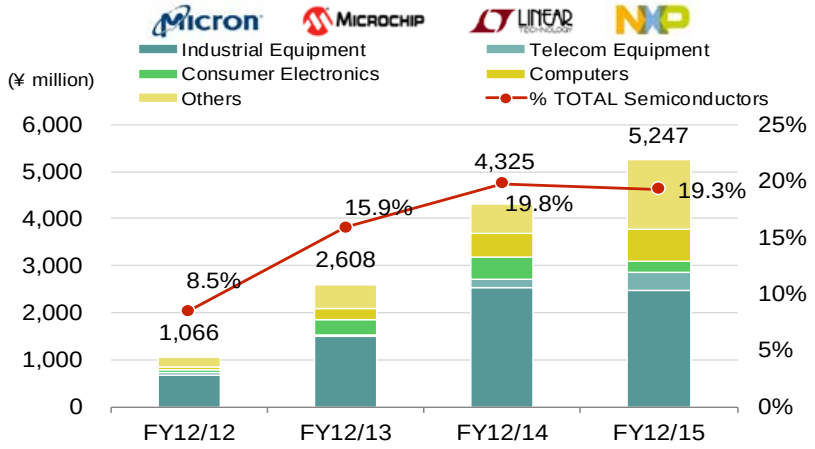
The “Second Pillar” refers to semiconductor products provided by 4 overseas vendors: Micron Technology, Inc. (the U.S.-based, NASDAQ：MU), Microchip Technology Inc. (the U.S.-based, NASDAQ：MCHP), Linear Technology Corporation（the U.S.-based, NASDAQ：LLTC） and NXP Semiconductors N.V. (the Netherlands-based, NASDAQ：NXPI).

Sales and percentage weights in total semiconductors in the past 4 years are shown in Chart 1, which indicates sales soared by 21.3% YoY to ¥5,247 million in FY12/15. Demand from telecom and computer industries were robust and memory sales to agents grew significantly.

Compared to 3 years before, sales were about five-fold and the weight among total semiconductors neared to 20%. These products are growing in line with President Yabuki’s expectation at the time of initiating, i.e. to sell them to achieve sales of at least ¥2.0-3.0 billion per vendor.

These semiconductors previously tended to be sold as individual components. Now devices using FPGAs have become increasingly sophisticated and complicated, and the "Second Pillar" semiconductors seem contributing to PALTEK's businesses for satisfying client needs or enriching its proposals to clients. A good example is Linear Technology's analog semiconductors, which are very suitable to power supply portion of FPGAs supplied by Xilinx, Inc. (the U.S.-based, NASDAQ XLNX). Because of this, the Group hired additional analog engineers when it increased R&D personnel in accordance with the commercial rights acquired in FY12/15.

● 【Chart 1】"Second Pillar" Semiconductors: Sales and % of Total Semiconductors



Source: Compiled by Trias Corporation from Company materials

Topic 3：Promising M2M/IoT Markets and PALTEK's Initiatives

Currently in the limelight is Internet of Things (IoT) including "Machine to Machine (M2M)" communications, or networks of various sensors and equipment, while global M2M/IoT markets are forecast to reach a ¥20 trillion scale.

PALTEK's major vendor XILINX, for example, positions 6 fields as newly developing markets: Advanced Driver Assistance System (ADAS)/Self-driving vehicles, Industrial IoT, 5G Wireless, Software Defined Networks (SDNs)/Network Function Virtualization (NFV), and Cloud Computing.

Xilinx foresees that vision systems are to evolve into smart vision systems in which previously isolated systems used in the broadcasting and security business fields can now work together. In addition, ADAS will enable communications among vehicles and with infrastructure such as roads in the future. ADAS will be able to optimize traffic flows by controlling traffics therefore.

These technologies will be fundamental blocks for building an industrial IoT market, including smart factories, smart grids and smart cities. In order to function the blocks fully, gigantic processing

power will be needed for telecom networks. Xilinx views the power will be supplied by cloud computing and 5G wireless as well as their counterpart SDNs and NFV.

To develop these major markets, Xilinx plans, from hardware standpoint, to launch 20 nanometer (nm) and 16nm new products in the next 2 years, adding to ongoing 28nm "*All Programmable"* FPGA (*1).

(*1) "*All Programmable*" is a concept of system development platform that Xilinx offers in order to realize high system levels and sophisticated integrity.

In this process, development of equipment and systems are to be increasingly sophisticated and complicated, and comprehensive technological capabilities and proposals offered by FPGA vendors should be needed. In this aspect, PALTEK is highly versatile in extending its businesses into M2M/IoT markets, as it has rich accumulation of technologies and know-how in FPGAs. It also has "Second Pillar" semiconductor products to support FPGA business, tie-ups with leading vendors for sensors and GPS systems, and its own smart energy solutions.

PALTEK has been working hard on growing markets for FPGAs, such as broadcasting and medical equipment, 5G wireless solutions, and ADAS. From now on, the Company will focus also on broader range of M2M/IoT systems. It hopes to offer complete product lines covering from sensor terminals to datacenters, integration software developed mainly by Explorer for all-in-one systems as well.

In 2016, the Company has enhanced initiatives for fulfilling product line-up to get into M2M/IoT markets through new tie-ups with Oki Electric Industry Co., Ltd. (TSE1, hereinafter "OKI") and Guangzhou Robustel Technologies Co., Ltd (China-based). The related products are 920MHz band multi-hop wireless devices and cellular gateways, respectively.

Launching Sales of 920MHz Band Multi-Hop Wireless Device "*SmartHop*®"

Accelerating M2M/IoT market expansion is expected also in Japan as in overseas markets. This trend seems backed by the governmental policy for opening up Platinum Band, or 700-900 MHz frequency band, triggered by the "Frequency Reallocation Action Plan" promoted by the Ministry of Internal Affairs and Communications. The band has been available since July 2012 for use in wireless telecom services including mobile phone networks, as it became vacant after television broadcasting shifted to terrestrial digital broadcasting. In addition, the adjacent 920MHz band was liberalized to open up full operations of short distance wireless communications.

The 920MHz band is expected to extend its usage to new applications, as it has advantages over 2.4GHz conventionally used in terms of signal propagation and obstruction circumvention. The Ministry of Internal Affairs and Communications, for example, is working on technological

researches for implementing smart meters and others based on 920MHz band multi-hop sensor network technologies.

（*2）”Multi-Hop Senor Network” refers to a telecom communication method of sensor data transmissions involving many other adjacent wireless devices by a "*bucket brigade*" process. It enables wide area communications as many wireless equipment collaborate one another even though each has limited signal propagation, and is also superior in power saving as transmission power of each wireless equipment can be low.

OKI’s 920MHz band multi-hop wireless *SmartHop*® launched this time by PALTEK offers “920MHz band wireless telecom modules” and “920MHz band multi-hop wireless units” with capabilities for multi-hop connections of 100 sub-units per base unit proved so far. Installation period and costs are also significantly restrained as these devices are equipped with initially installed application software which communicate on the standard interface without needs for device vendors to develop software from scratch. This feature handily realizes connections of many devices offered by multiple vendors, enabling to significantly reduce total costs including development, system build-up and operations. Likewise, device vendors can construct various wireless M2M/IoT systems in short period of time at low costs.

PALTEK, having prepared product line-up to build low-cost wireless networks at this early stage of 920MHz band M2M/IoT application market, plans to offer solutions not only to current telecom and industrial equipment clients, but to a wide variety of business fields including public infrastructure, facility industry and agriculture.

● OKI’s Multi-Hop Wireless Products Enabling Sensor Networks

20MHz band wireless telecom module

920MHz band multi-hop wireless unit

Source: PALTEK’s release date February 4, 2016

Launching Sale of High Quality IoT Gateway at Low Cost

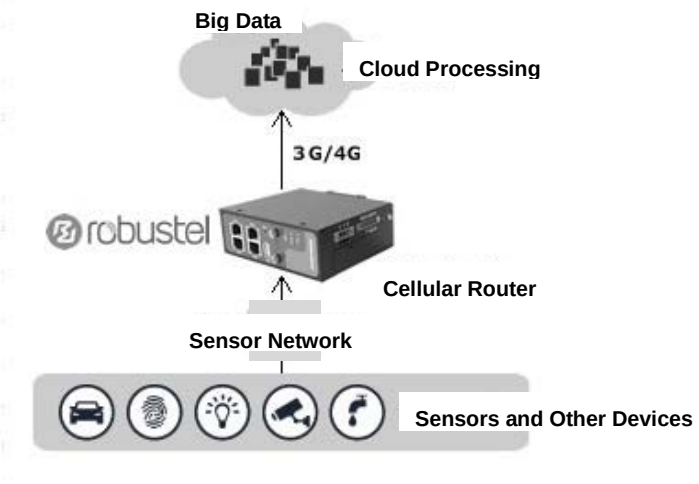
When sending data collected from various terminals including sensors and other devices to cloud environment, exchange of information is done through gateways and routers connected to mobile networks. Robustel, though an emerging company founded in 2010, has a strong development power and offers M2M/IoT-enabled gateways, cellular routers and modems, and has already been

certified by more than 20 mobile carriers in Japan, the U.S., Europe and Southeast Asia.

It has operated in Europe and Australia and has track records in M2M/IoT markets in remote monitoring and control business fields, including managing express way electronic message boards, power monitoring and traffic monitoring/controlling for public transportation.

PALTEK plans to help domestic client manufacturers in quick development of products and services for M2M/IoT markets by supporting Robustel products through applying them to wider varieties of equipment and systems. In addition, the tie-up with the Chinese company may pave the way for PALTEK to expand overseas with its proprietary solutions.

● Robustel Product Bridging Sensor Networks and Cloud Environments



Source: PALTEK's release date February 4, 2016

References

Consolidated Key Financial Data

No. of Shares Issued	FY12/15 end	11,849,899
No. of Treasury Shares	FY12/15 end	895,577
Market Value (¥million)	24-Mar-16	7,228
BPS (¥)	FY12/15 end	826
ROE (%)	FY12/15 end	7.6%
ROA (%)	FY12/15 end	4.2%
PER (times)	FY12/16 Fcst.	9.5
PCFR (times)	FY12/15	9.8
PBR (times)	FY12/15 end	0.7
Share Price (¥)	24-Mar-16	610
Unit Share (shs)	24-Mar-16	100
Average Daily Volume (shs)	24-Mar-16	51,019

Total Assets (¥million)	FY12/15 end	15,977
Shareholders' Equity (¥million)	FY12/15 end	9,048
Interest-Bearing Debt (¥million)	FY12/15 end	4,130
Equity Ratio (%)	FY12/15 end	56.6
Ratio of Interest-Bearing Debt (%	FY12/15 end	45.6
Free Cash Flows (¥million)	FY12/15	(3,804)

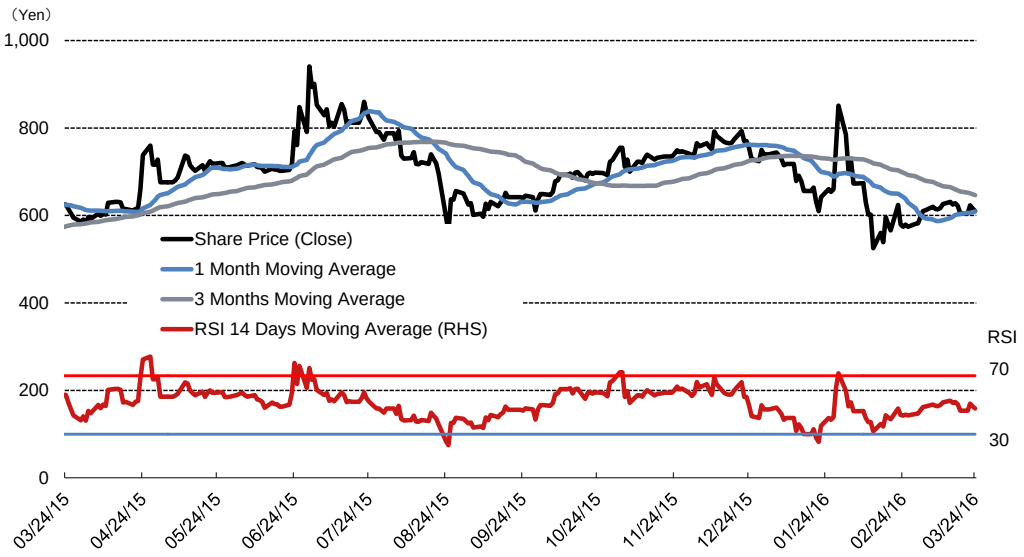
ROE=Current Net Income÷Averaged Shareholders' Equity
ROA=Current Net Income÷Total Assets
PCFR=Maket Value÷(Current Net Income+Depreciation)
Ave. Daily Volume=ADV for the period from Mar-24-15 to Mar-24
Interest-Bearing Debts Ratio = I.B.D. ÷ Shareholders' Equity
Free Cash Flows=Operating CF+Investment CF

Consolidated Financial Results

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS(¥)	DPS(¥)
FY12/11	13,231	(317)	(185)	(106)	(9.33)	5.00
FY12/12	17,611	772	782	443	38.86	8.00
FY12/13	23,155	1,008	1,052	563	49.31	8.00
FY12/14	28,841	1,361	1,144	674	61.16	15.00
1H FY12/16 Forecasts	14,600	520	470	300	27.39	-
FY12/16 Forecasts	30,000	1,200	1,100	700	63.90	13.00

Note: FY12/16 forecasts announced on Feburuary 9, 2016.

Share Prices and RSI (March 24, 2015～March 24, 2016)



Source: Prepared by Trias Corp. with Bloomberg data.
Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices. In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.
RSI=averaged share price appreciation for N days÷(averaged share price appreciation for N days +averaged share price decline for N days) x100