FUJI SOFT INCORPORATED

9749

Tokyo Stock Exchange First Section

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FISCO Ltd. Analyst

Yoshihiro Maeda

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

A major independent IT solutions vendor celebrating the fifty-year anniversary of its establishment in 1970
Is progressing a management strategy from a long-term perspective, focusing on "investment in human resources and work-style reforms"

1. Company outline and business description

FUJI SOFT INCORPORATED <9749> (hereafter, also "the Company") is a major, independent IT solutions vendor established in May 1970. It has its roots in FUJI SOFTWARE LABORATORY, Ltd., which was established in his home by Mr. Hiroshi Nozawa, the Company's current Chairman and Director, and two other employees. Today, nearly half a century after this establishment, the Group has grown to consist of more than 14,000 employees (as of December 31, 2019) in 28 consolidated subsidiaries, 2 equity-method non-consolidated subsidiaries, and 2 equity-method affiliates.

The Company has three reporting segments; the SI (systems integration) Business, the Facility Business, and Other Businesses. In the mainstay SI Business, it provides a diverse solutions menu, centered on the development of embedded / control software and operations software. The Facility Business entails rentals of office buildings, and Other Businesses includes a BPO (business process outsourcing) services business, a contact center business, and a regenerative medicine business.

2. Its core competencies are "technological capabilities + proposal capabilities"

The Company considers that the reasons why it is chosen by customers are its "high-level technological capabilities and proposal capabilities that continue to evolve every day." It is highly confident in its core competencies of its advanced technological expertise acquired through the development of embedded / control software that requires extremely high levels of precision, such as for vehicles and semiconductor manufacturing equipment; systems construction capabilities cultivated through the solutions it has provided to a wide range of industries; and "technological capabilities and proposal capabilities," that it demonstrates in aspects such as its ability to provide flexible proposals as an independent solutions provider.

3. While strengthening the financial structure, has renewed its record-high sales from their peak before the economic downturn precipitated by the Lehman Brothers bankruptcy for three consecutive periods

The Company's sales peaked before the economic downturn precipitated by the Lehman Brothers bankruptcy (FY3/06), but it set a new record high for sales in FY12/17 and then achieved double-digit sales growth in FY12/19 as well. So while it actually took more than 10 years to renew its peak sales, the Company can be highly evaluated on the point that during that time, it not only recovered flow profits, it also worked to strengthen its financial structure and growth potential.

Specifically, the Company achieved major improvements for the representative financial indicators, including that the equity ratio rose from 47.3% at the end of FY3/06 to 54.1% at the end of FY12/19, and the current ratio increased from 96.4% to 182.9%. On the other hand, due to the significant increase in the recruitment of new graduates from FY12/15 onwards, the number of consolidated employees increased by 1.5 times in the same period, from 9,415 people to 14,174 people. The percentage of certified technicians on a stand-alone basis (the percentage of certified specialists and certified project managers, based on the Company system, to the total number of employees) also had risen from 22.8% at the end of FY12/14 to 29.5% at the end of FY12/19. From this, it can be understood that growth potential as seen from the aspect of human resources has been enhanced both in terms of quantity and quality.

4. Results are strong currently, and in FY12/19, operating income was a record high for the first time in 13 periods

For FY12/19 consolidated results, the Company reported net sales of ¥231,074mn, up 13.1% YoY, operating income of ¥13,266mn, up 16.4%, ordinary income of ¥13,749mn, up 13.9%, and profit attributable to owners of parent of ¥7,836mn, up 20.3%. The sales and profits increased by double digits for three consecutive periods.

Looking at the achievement rates of these results for the initial Company forecasts announced in February 2019 (net sales of ¥210,500mn, operating income of ¥11,700mn, ordinary income of ¥12,200mn, and profit attributable to owners of parent ¥6,700mn), net sales achieved 109.8%, operating income 113.4%, ordinary income 112.7%, and profit attributable to owners of parent 117.0%. This is the fourth consecutive period in which the results have exceeded their initial forecasts.

The FY12/20 results forecasts announced by the Company in February 2020 are for net sales to increase 3.0% YoY to ¥238,000mn, operating income to rise 2.5% to ¥13,600mn, ordinary income to grow 0.7% to ¥13,850mn, and profit attributable to owners of parent to climb 2.1% to ¥8,000mn. Compared to the previous results of double-digit increases in sales and profits, there may be a tendency to think that these forecasts are for unsatisfactory results. However, since FY12/15, the Company has continuously followed a pattern of setting its initial forecasts by expecting net sales to increase by around 3% and assuming an operating margin of around the same level as in the previous fiscal year's results. It has stated that the current Company forecasts are simply targets to be achieved, and there is considered to be no particular reason to view them negatively.

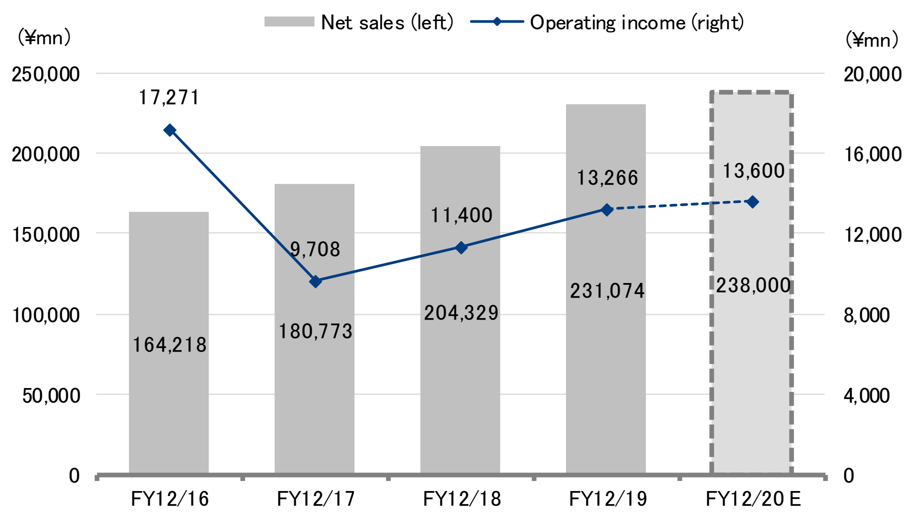
The dividend forecast is for an annual dividend of ¥51 per share (a dividend at the end of 2Q of ¥28 per share, which includes a commemorative dividend of ¥5 per share on the 50th anniversary of its establishment, and a period-end dividend of ¥23 per share). This is an increase of ¥9 per share on the FY12/19 annual dividend of ¥42 per share (¥20 per share at the end of 2Q, and ¥22 per share at the period end). If this increase is realized, it will be the fifth consecutive year of higher dividends. On looking in more detail at the current dividend policy, even after excluding the commemorative dividend, it can be said to be a forecast of a dividend increase that is unprecedented as a full-fiscal year dividend forecast for the next period that doubles the period-end dividend in the past 5 years up to FY12/19.

With regards to the effects of the novel coronavirus, in macro terms the situation is impossible to predict, but on looking at the demand side, it is undeniable that in the short term, supply-chain problems, centered on China, may keep down customers' IT investment. But on the other hand, on the supply side, the work-style reforms that the Company has been actively conducting, including for remote working, are proving successful, and it is thought that it will be able to avoid any major disruption at its work sites.

Key Points

- A major, independent IT solutions vendor established in 1970. Its active investment in human resources and a complementary M&A strategy are proving successful, and it has exceeded the ¥100bn barrier for net sales. At the end of December 2019, it had more than 14,000 consolidated employees.
- Its core competencies are "technological capabilities and proposal capabilities," as seen in its abundant track record and corporate philosophy. Results stagnated for a period after the economic downturn precipitated by the Lehman Brothers bankruptcy, but it has strengthened its financial structure and growth potential and is accelerating "Challenges and Creation" while aiming to be an innovative corporate group.
- In FY12/19, secured double-digit increases in sales and profits for the third consecutive period and achieved record-high operating income for the first time in 13 periods. For FY12/20, is forecasting a dividend increase for the fifth consecutive period, even while the forecast is for a slight increase in profits.
- It is impossible to predict the impact of the novel coronavirus, but the work-style reforms that the Company has been actively conducting are proving successful, and it should avoid any major disruption at its work sites.

Results trends



Source: Prepared by FISCO from the Company's financial results

Company overview

Based on its corporate motto of "Challenges and Creation," broke through the barrier of net sales of ¥100bnm, while remaining independent. Going forward, is focusing on the "AIS-CRM" strategy that it is tackling as a growth area.

The Company is a major, independent IT solutions vendor established in May 1970. It has its roots in FUJI SOFTWARE LABORATORY, Ltd., which was established in his home by Mr. Hiroshi Nozawa, the Company's current Chairman and Director, who at that time was a teacher in a computer vocational school and started a business focusing on the prospects for the computer industry with two other employees who he had previously been his students. Today, nearly half a century after this establishment, the Group has grown to consist of more than 14,000 employees in 28 consolidated subsidiaries (of which, 4 are listed companies), 2 equity-method non-consolidated subsidiaries, and 2 equity-method affiliates.

Even while achieving rapid development in terms of size, the Company, in accordance with its basic philosophy of "Being a corporate group that is more useful for society, makes customers more happy, and that is more considerate to the Earth, and that provides 'relaxed and worthwhile' work environments," has consistently conducted the enlightened management that its founder aimed for to contribute to society through business, and it aims to formulize the knowledge expressed by its corporate philosophy, such as through the Group's corporate charter and the systems to have executives and employees understand it.

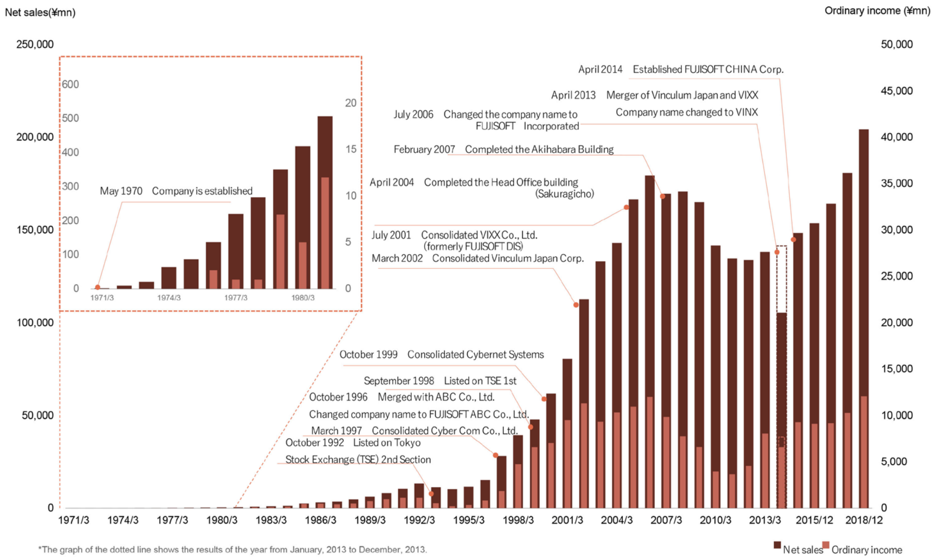
The Company has three reporting segments; the SI Business (systems construction and products and services), the Facility Business, and Other Businesses. In the mainstay SI Business, it provides a diverse solutions menu, centered on the development of embedded / control software and operations software. The Facility Business entails rentals of office buildings, and Other Businesses includes a BPO service business, a contact center business, and a regenerative medicine business. Although the entry into the regenerative medicine business appears at first glance to be an entry into an unrelated business area, it can be said to be a typical example of business creation based on its corporate philosophy.

Also, as a business strategy to be implemented across the reporting segments, the Company is advancing initiatives in the "AIS-CRM" area. This is its own acronym created from AI, IoT, Security, Cloud computing, Robot, Mobile & AutoMotive, and it covers areas that are expected to grow in the medium- to long-term. While it will not be easy to accumulate and refine technologies in these growth fields, if the Company can achieve this, it may be able to keep down the sudden changes to factors that affect the operating rate due to fluctuations in the economic cycle. The result of its efforts, particularly in the Cloud area, are becoming apparent in the Company, and we shall be paying attention to developments in the future.

At the time it was established, the Company's business was founded on the dispatch of computer operators. Subsequently, it entered-into the software development and systems construction businesses and achieved rapid development supported by the explosive expansion of the computer industry. But what should not be overlooked as a factor behind this growth is the conviction of the executive management, including founder Chairman Nozawa that the time of the computer society had arrived, and while bearing a considerable risk, the Company actively invested in recruiting and training engineers and pursued a complementary M&A strategy to incorporate into itself the technologies and customer bases it did not have.

Even as the computer society has become a reality and the domestic IT services market has expanded in scale to be worth more than ¥5 trillion, the major IT services companies with sales of more than ¥100bn are comprised almost entirely of manufacturers (such as Fujitsu Ltd. <6702>), user-related companies (such as NTT DATA Corporation <9613>), trading companies (such as SCSK Corporation <9719>), and overseas-related companies (such as IBM Japan, Ltd.) . Including the Company, there are only three so-called independent companies. It has become one of groups with over ¥100bn in net sales in FY3/02, but on looking at the number of employees to achieve this, of 4,002 people on a stand-alone basis and 6,353 on a consolidated basis, we can see that its business expansion has been supported by its active recruitment of human resources and training of engineers since its establishment. Also, in 1996, it merged with ABC Co., Ltd., which has strengths in finance-related operations systems, and subsequently also, it made consolidated subsidiaries of Cybernet Systems Co., Ltd., which has its origins in an overseas company in 1999, and MYCAL Systems Corp. (currently VINX Corp.), whose main business is distribution-related business systems, in 2002. In such ways, the Company has advanced an M&A strategy to incorporate into itself the technologies and customer bases to supplement its strengths in embedded /control software development. It is considered that it would not have been able to exceed net sales of ¥100bn solely from riding the favorable external wave, but that its bold decision making has also been vital to achieving this.

Since its establishment in May 1970, the Company's size has expanded dramatically



Source: From the Company's 2019 FACT BOOK

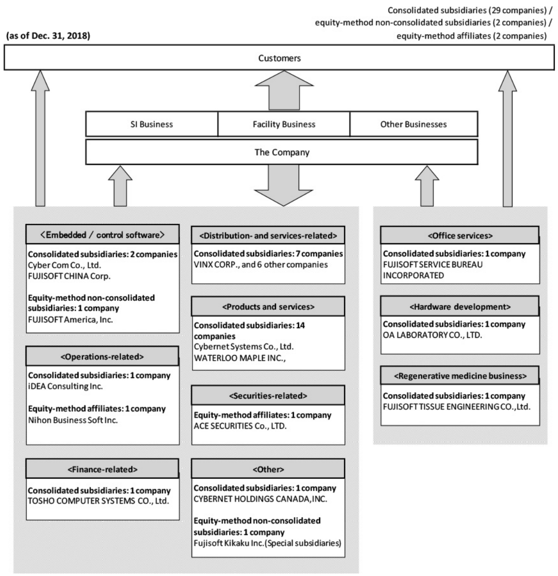
With "technological capabilities and proposal capabilities" as its core competencies, the Company is aiming to be a CSV-style innovative corporate group

The Company considers that the reasons why it is chosen by customers are its "high-level technological capabilities and proposal capabilities that continue to evolve every day." It is highly confident in its core competencies, of "technological capabilities and proposal capabilities," that it demonstrates in aspects such as its advanced technological expertise acquire through the development of embedded / control software that requires extremely high levels of precision, including for vehicles and semiconductor manufacturing equipment; its systems construction capabilities cultivated through the solutions it has provided to a wide range of industries; its ability to provide flexible proposals as an independent solutions provider; and its construction of a network of bases close to customers (42 bases in Japan + a global network) . Also, the Company believes that its important mission is for its various business activities to lead to the development of society, alongside sustainable growth and the creation of corporate value in the medium to long term. As its medium-term policy, it is aiming to be "an innovative corporate group that connects the development of ICT to the improvement of value for customers.

What can be read from the messages disseminated by the Company would seem to be "its conviction in the effectiveness and potential of utilizing ICT and its sense of mission to progress this," and having a "customer-oriented and CSV-type (a company that increases enterprise value through social contributions via its businesses) management policy." Of course, corporate activities will have CSV-type aspects to a greater or lesser extent, even if the company itself is unaware of this. But in the Company's case, the fact that the founder's strong intentions, based on the corporate motto of "Challenge and Creation," have been incorporated into its corporate culture, is worthy of note.

One of the Company's unique initiatives as a CSV-type company is the All Japan Robot-Sumo Tournament, which it has held continuously since 1990 and which has grown to become Japan's largest robot competition. It started with the aim of providing a place to experience the enjoyment of building things and to improve technologies through building robots. But it is currently recognized to be an excellent example of support for developing human resources through manufacturing; for example, since a section for high school students established in 1993, the National Association of Principals of Technical Senior High Schools has joined the operation, and the organizations including the Ministry of Education, Culture, Sports, Science and Technology, and METI are also known as the sponsors as well.

Business structural diagram



Source: From the Company's securities report

Business overview

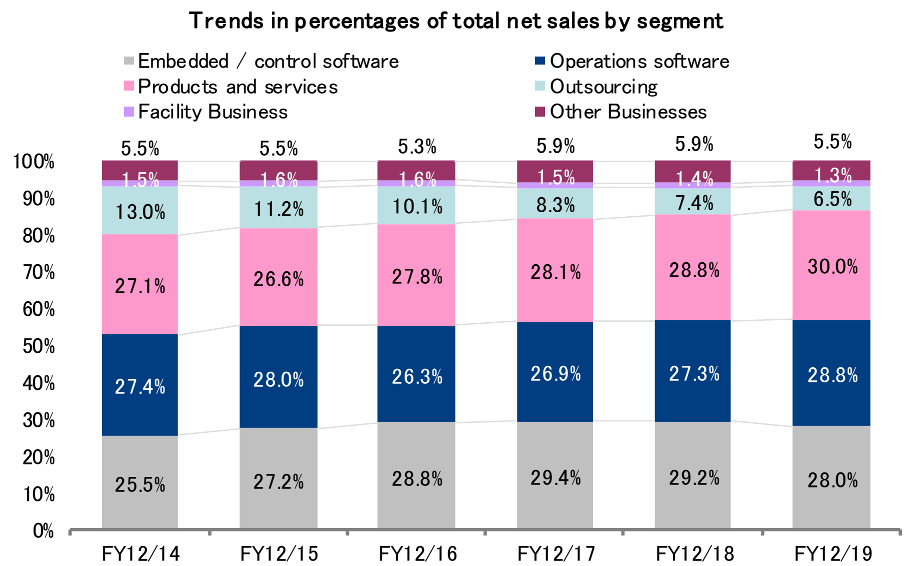
Offering varied and unique ICT services and products

The Company has three reporting segments; the SI Business, the Facility Business, and the Other Businesses. The mainstay SI Business is broadly divided into systems construction, and products and services. Further, systems construction is subdivided into embedded / control software and operations software, while products and services are subdivided into narrowly defined products and services, and outsourcing. Also, the Facility Business entails rentals of office building, while Other Businesses includes the BPO service business, a contact center business, and a regenerative medicine business.

Segment breakdown

Segment name				Breakdown
SI Business				
	Systems construction			
		Embedded / control software		
			Machine control systems	Embedded / control software such as FA, OA, digital home appliances
			Automotive-related	Automotive-related embedded / control software
			Mobile-related	Embedded / control software for mobile devices, etc.
			Social infrastructure-related	Embedded / control software for communication control (switches, routers, etc.), base stations, aerospace and defense, etc.,
		Operations software		
			Financial industry	Operations software for financial companies (life insurance, credit cards, securities companies, banks, etc.)
			Distribution and services	Operations software for distribution-related companies (retail, wholesale, trading companies, real estate, construction industry, etc.)
			Manufacturing industry	Operations software for manufacturing
			Other operations-related	Operations software that does not correspond to the above fields
	Products and services			
		Products and services		Products and services of the FUJISOFT Group and of other companies based on strategic partnerships
		Outsourcing		Data center business, systems maintenance operations, etc.
Facility Business				Sales related to the real estate rentals business
Other Businesses				Office services, hardware development, regenerative medicine business

Source: From the Company's results briefing material



Source: Prepared by FISCO from the Company's results briefing material

1. Mainstay embedded/control software

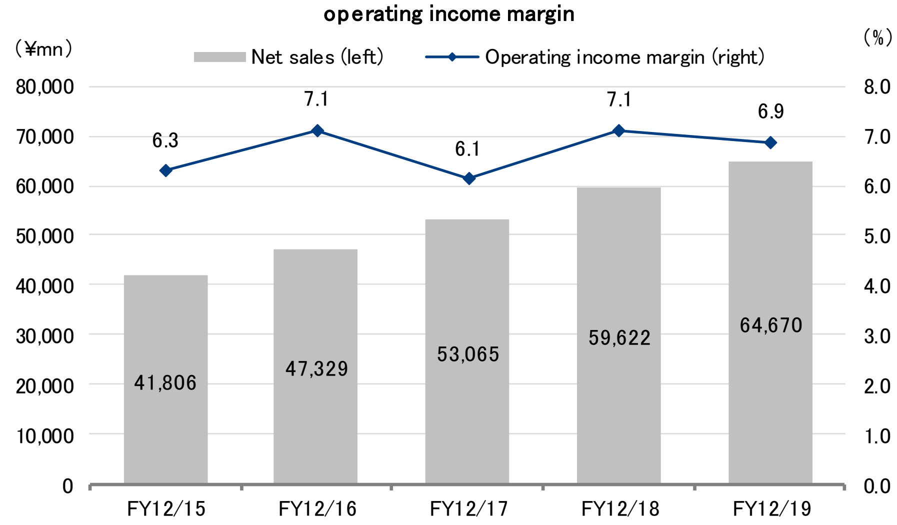
Embedded / control software, which belongs to the systems construction category in the SI Business, accounted for 28.0% of Company-wide sales (FY12/19) and 33.5% of operating income, and its segment profit margin was also the highest within the SI Business.

Embedded / control software is software that runs on a microcomputer or other device, embedded into the device to provide specific functions. The Company's technologies are used in a variety of products and devices, including vehicles and mobile phones, home appliances such as TVs and air conditioners, office automation (OA) equipment including printers, robots and semiconductor manufacturing device production equipment, infrastructure equipment such as traffic lights, and medical equipment like CT and MRI.

The Company has accumulated top-class results in Japan in this area, and it has strengths in FA and other machine control systems and automotive-related. If limited to vehicles installations, in practical terms it delivers products to all vehicle manufactures in Japan, and it has the top share of the domestic market.

The developments in the productivity revolution through CASE (Connected, Autonomous, Shared/Service, Electric), AI and robots in the automotive industry are currently proving advantageous for the Company. In FY12/19, it secured a sales increase of 8.5% YoY and a profit increase of 4.8%, while the backlog of orders at the end of the period had steadily increased, up 10.8% the end of the previous fiscal period. While the segment profit margin fell slightly, from 7.1% in FY12/18 to 6.9%, it seems that the impact of factors like the recruitment of new graduates is being absorbed and that the engineer turnover rate is being maintained, so it is not necessary to view this as a problem.

Trends in embedded / control software net sales and operating income margin



Source: Prepared by FISCO from the Company's results briefing material

2. Operations software achieved double-digit increases in sales and profits for the third consecutive period

Operations software, part of the system construction category in the SI Business, is a major pillar of earnings, contributing 28.8% of Company-wide net sales (FY12/19) and 24.1% of operating income. Results stopped growing temporarily in FY12/16, but subsequently achieved double-digit increases in sales and profits for third consecutive period. In FY12/19, the sales-increase rate further accelerated to 19.4% (12.3% in FY12/17 →14.8% in FY12/18) and the profit-increase rate was 17.0%, while the backlog of orders at the end of the period also trended favorably, up 11.8% the end of the previous fiscal period. In addition, a segment profit margin of 4.8%, which is about the same level as in the previous fiscal period (4.9%), was secured.

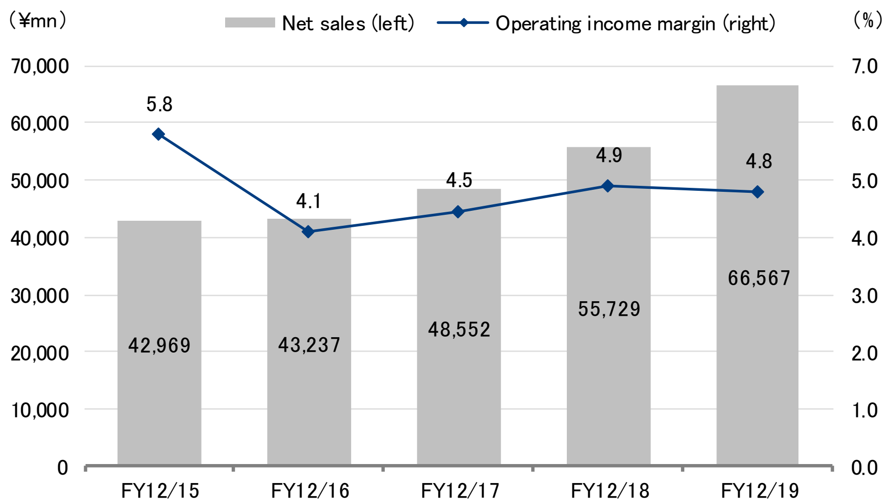
In this area, in addition to organic business growth, the complementary M&A strategy is proving successful, and the Company has established a system that is able to provide a one-stop service, from consulting through to development, systems construction, and support, for various solutions, such as for backbone systems like store and ordering systems and production, sales, inventory, and accounting systems, and also information systems and online services. It provides these solutions to a wide range of industries, including distribution, financial, services, manufacturing, online businesses, social infrastructure, education, medicine, and public institutions.

In the operations software area, which is positioned as the main battlefield in the domestic IT services market, there have been structural changes in the market that could prove to be disadvantageous to the existing players, including 1) the shift from on-premises (operating IT systems, such as servers, through equipment installed within a company) to the use of cloud services, and 2), the evolution from "defensive IT (mainly to improve work efficiency) to offensive IT (mainly to create businesses) ." Within this situation, the Company, based on a spirit of seeing "changes as opportunities," has clearly set out and is implementing an approach of strengthening the development of outsourcing through actively investing in human resources. It undoubtedly makes management decisions in accordance with the Company motto, of "Challenge and Creation."

On this point, the strong performance of operations software can be said to be the result of the Company accurately providing services in response to the changes to the times and to the market structure; namely, the shift to e-commerce in the distribution and services fields and the increase in demand in the digital content field, the acceleration of responses to the various digital transformations (DX) in fields centered on systems infrastructure, and the promotion of the utilization of ICT on the theme of work-style reforms. In addition, its series of initiatives have also been highly evaluated by its business partners. Specifically, it achievements in 2019 included that it won the Modern Device Award in "Microsoft Japan Partner of the Year 2019"; that it was the first company in Japan to acquire certification of "Government Agency Competency" and "IoT Competency" from Amazon Web Services (AWS), which is the largest provider of IT cloud services in the world; and that it is the only company in Asia to be certified as "VMware Master Service Competency" by VMware, which has a globally leading share of the IT virtualization market.

Also, in January 2020, the Company established a new business department and it is working to further strengthen initiatives in the online business field. This is one part of its business strategy that directly addresses an issue that is facing existing players, which is the "inconvenient truth" of "the Amazon Effect" (a phenomena that includes the disruption of and reforms to various markets alongside the rapid growth of Amazon.com), and we shall be paying attention to developments in the future.

Trends in operations software net sales and operating income margin



Source: Prepared by FISCO from the Company's financial results

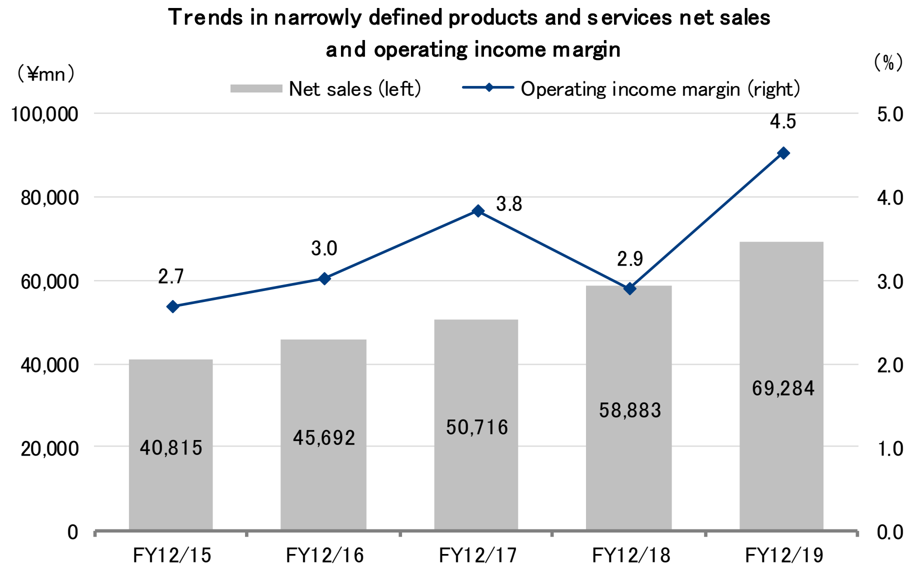
3. The profitability of narrowly defined products and services has greatly improved

Products and services in the SI Business are divided into narrowly defined products and services and outsourcing. Narrowly defined products and services provided 30.0% of net sales and 23.7% of operating income in FY12/19. In FY12/19, net sales increased 17.7% and operating income grew 84.5%, while the backlog of orders at the end of the period also rose significantly, up 58.7% on the end of the previous fiscal period. It would also seem to have made a steady start to FY12/20.

While the percentage of total net sales has risen in each of the last four years, the overall segment profit margin was below the Company-wide level. This is because the majority of the segment's net sales are from product sales and others whose profit margins are low (Practically all of remaining sales come equally from Company products and the license business.) That said, due mainly to the success of the upfront investment conducted in FY12/18 to enhance quality and also the improved profitability of the subsidiary Cybernet Systems, in FY12/19, the segment profit margin improved to 4.5%, which is its highest level in the last 5 years.

Narrowly defined products and services are comprised of 1) the Company's own products (including moreNOTE, a paperless system; Mirai School Station, a comprehensive education solution for the information society; smartBYOD, a tool for utilizing employees' personal smartphones and other devices for a company's operations; and PALRO, a communication robot) ; 2) the license business (Microsoft products, AWS, VMware, etc.) ; 3) product sales, etc. (PCs, servers, etc.) Looking at the YoY percentage increase in sales in 12/19, sales of the Company's own products increased 13% (versus 7% in FY12/18), while license business sales were up 28% (versus 26%) and product sales, etc. grew 15% (versus 17%), so the license business showed particular strength. While special demand in advance of the ending of support for Windows 7 (on January 14, 2020) helped to push up sales in the license business, generally speaking it is possible that stability in the business has increased thanks to the growing shift to a subscription model for ICT products—a business model in which fees are collected based on length of use, rather than via one-time software sales—including Office 365 and various cloud services. Note that sales of support for deployment of licensed products is recorded in the Company's own products, apparently enabling it to secure high profit margins.

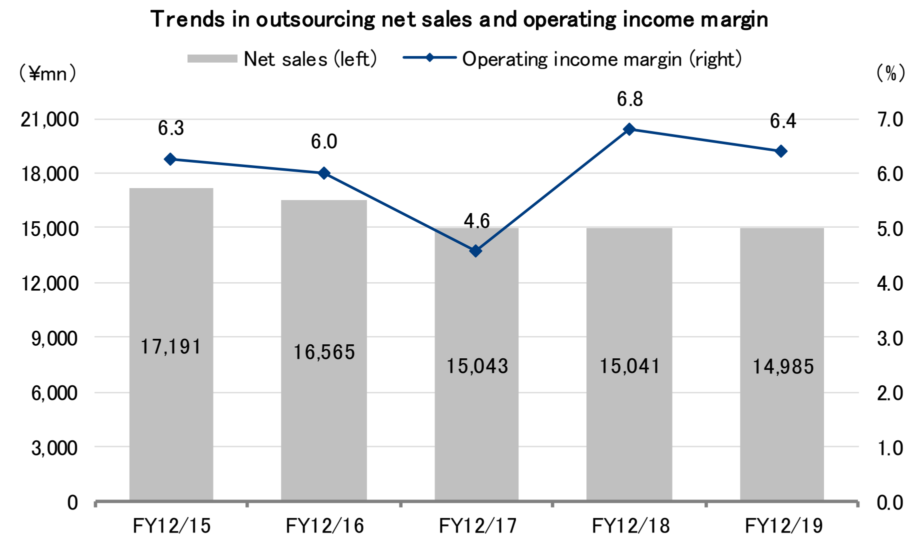
One of the Company's strengths is that, as an independent SIer, it is able to construct systems flexibly without being tied to specific hardware, but launching proprietary products, including hardware such as the communication robot PALRO, seems to pose unique challenges. The strategy of working to create new added value through the Company's own products that are infused with its core competencies, of "technological capabilities and proposal capabilities," acts in accordance with its corporate motto, of "Challenge and Creation." But we shall be paying close attention to the high profitability the Company is seeking for after the upfront investment phase.



Source: Prepared by FISCO from the Company's results briefing material

4. Outsourcing is searching for the bottom

Outsourcing provides services including data centers and systems operations and maintenance, and in FY12/19 it contributed 6.5% of total net sales and 7.2% of operating income, and it had a segment profit margin of 6.4%. The downward trend in sales in recent years has largely been due to the decrease in ongoing projects for distribution and services, and in FY12/19 as well, sales declined 0.4% YoY and profits decreased 6.2%. At the end of FY12/19, the order backlog had recovered, up 7.2% on the end of the previous fiscal period. This recovery was led by systems operations and maintenance, and it is considered that the data center business, in which competition with the cloud services of other companies is severe, is still searching for the bottom for results.



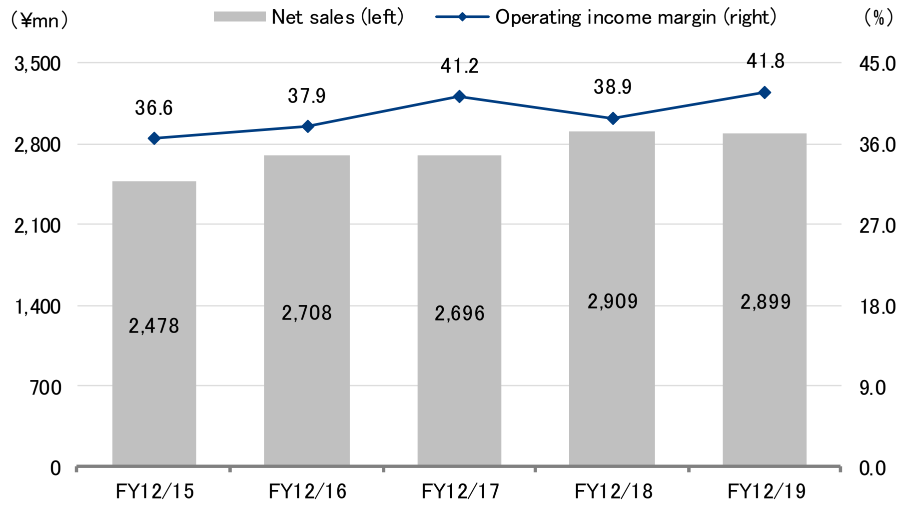
Source: Prepared by FISCO from the Company's results briefing material

5. The Facility Business has high earnings

The Facility Business, which obtains rental income from the office buildings the Company owns, provides 1.3% of total net sales (FY12/19) and 9.1% of operating income, with a high segment profit margin of 41.8%. While sales fell 0.3% in FY12/19, profits rose 7.1%, providing stable support for the Company's profit level. The segment profit margin rose 2.9 percentage points (pp) compared to FY12/18, to realize its highest level in the last 5 years.

According to the Company's securities report, there are four properties; the Yokohama Head Office (land-acquisition year: 2000, land and property book value: ¥11,399mn), the Akihabara Office (2005, ¥32,635mn), the Kinshicho Office (2000, ¥6,065mn) and the Monzen Nakacho Office (2003, ¥1,760mn) .

Trends in the Facility Business net sales and operating income margin



Source: Prepared by FISCO from the Company's results briefing material

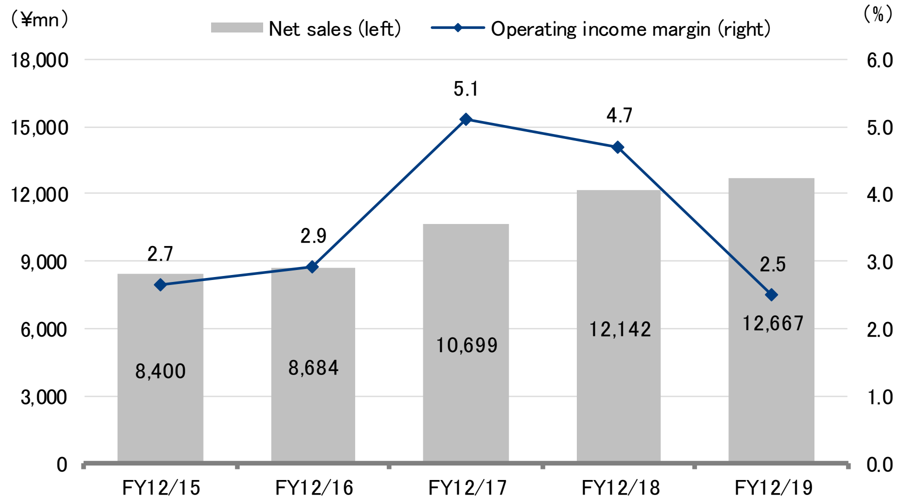
6. In Other Businesses, results of FUJI SOFT SERVICE BUREAU have rapidly slowed down

Other Businesses provides 5.5% of total net sales (FY12/19) and 2.4% of operating income. Results in FY12/19 changed direction from the excellent performance up to that time, to sales increasing 4.3% YoY and profits decreasing 44.6%, which compares to sales increasing 13.5% and profits increasing 4.8% in the previous fiscal year, and the segment profit margin fell by 2.2pp YoY to 2.5%. In recent years, the higher sales and profits have been driven by the strong performances of the BPO (business processing outsourcing) services business conducted by subsidiary FUJI SOFT SERVICE BUREAU<6188> and the contact center business, and the main reason for the worsened performance is that the temporary suspension of eligibility to participate in competitive tenders for the projects of the Japan Pension Service (from April 8, 2019, to January 7, 2020) has applied the brakes to this.

The regenerative medicine business began the "the cartilage and bone regenerative medicine donation course" at the University of Tokyo Hospital in November 2002, and in 2007, it was commissioned by the Japan Science and Technology Agency (since April 2015, it has been commissioned by the Japan Agency for Medical Research and Development) . At first glance, the entry into this business would appear to be unconnected to the rest of the businesses, but it is also a "Challenge and Creation" business that focuses on the effectiveness of utilizing ICT in the medical field.

The Company received a technology transfer from the University of Tokyo and succeeded in researching and developing the world's first "implant-type regenerated cartilage" using autologous cells. In 2015, it conducted company trials to evaluate its efficacy and safety for patients with cleft lips and palates toward improving appearance and functions. Then in September 2018, it acquired a certificate of success for implant-type regenerative cartilage, and it is aiming to realize a production and sales business in 2020.

Trends in the Other Businesses net sales and operating income margin

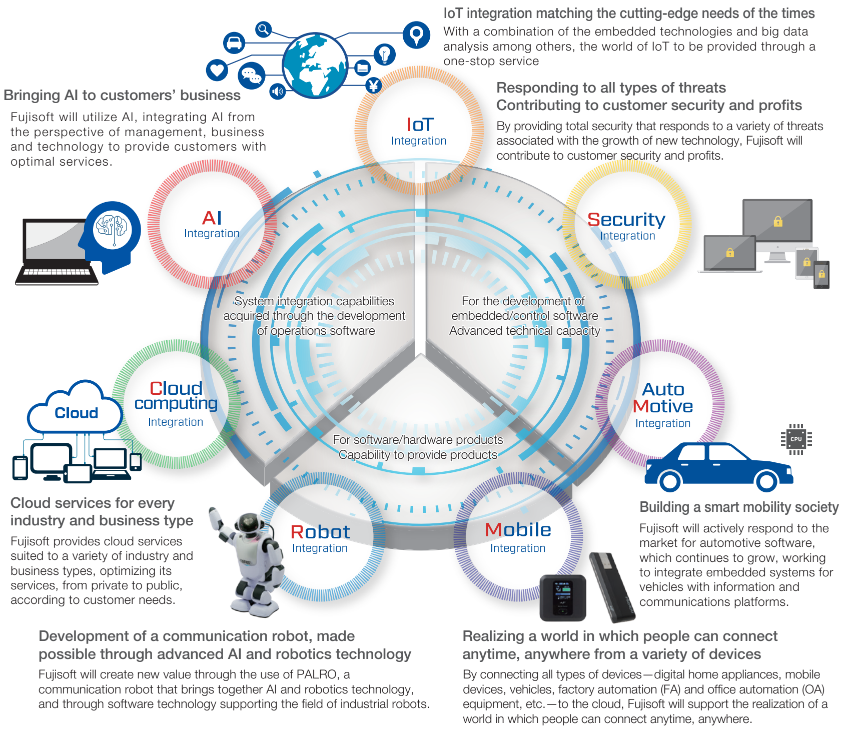


Source: Prepared by FISCO from the Company's results briefing material

7. In the business strategy for initiatives in the "AIS-CRM" area, is taking on the challenge of creating new products and businesses

As previously stated, the Company has positioned "AIS-CRM" as an important-technology field, and it is focusing on creating the seeds of new products and businesses and improving the added-value of existing businesses. At first glance, this might look like it is merely espousing buzzwords, but the superordinate concept of the "AIS-CRM" strategy is included in the Company's core competencies, and the results of these initiatives are steadily being realized. Results are especially strong in the Cloud area, and they provide the majority of the Company's stand-alone net sales in the "AIS-CRM" area as a whole.

Summary of AIS-CRM



Source: From the 2019 CSR Report

Results trends

Both strengthened the financial structure and conducted upfront investment, and in FY12/19, operating income was a record high for the first time in 13 periods

In the FY12/19 consolidated results, net sales increased 13.1% YoY to ¥231,074mn, operating income rose 16.4% to ¥13,266mn, ordinary income grew 13.9% to ¥13,749mn, and profit attributable to owners of parent climbed 20.3% to ¥7,836mn, for the third consecutive period of double-digit increases in sales and profits. As a result, the Company achieved record high operating income for the first time in 13 fiscal periods, since before the Lehman's crash (¥12,078mn in FY3/06; it had already set new record high net sales in FY12/17).

Looking at the achievement rates of these results for the initial Company forecasts announced in February 2019 (net sales of ¥210,500mn, operating income of ¥11,700mn, ordinary income of ¥12,200mn, and profit attributable to owners of parent ¥6,700mn) net sales achieved 109.8%, operating income 113.4%, ordinary income 112.7%, and profit attributable to owners of parent 117.0%. This is the fourth consecutive period in which the results have exceeded their initial forecasts.

In this way, in FY12/19 the Company completed the updating of its record high results. But it can also be highly evaluated on the point that during this time, it not only recovered flow profits, it also worked to strength the financial structure and bolster growth potential.

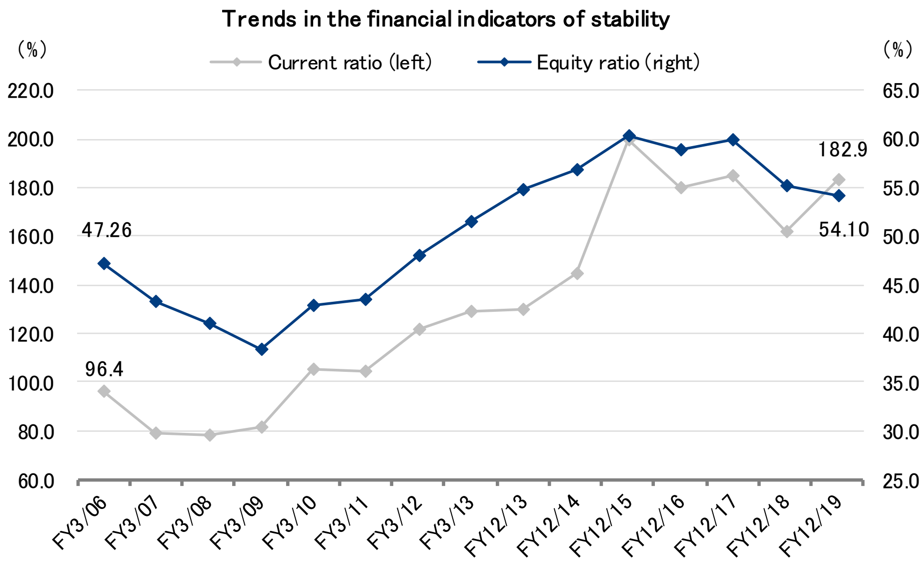
First, looking at the trends in the representative indicators showing the stability of the financial structure, the equity ratio rose trended from 47.3% at the end of FY3/06, 60.3% at the end of FY12/15, and 54.1% at the end of FY12/19, the current ratio trended from 96.4%, 199.7%, and 182.9%, respectively, and net interest bearing debt (interest bearing debt – cash and cash equivalents) trended from ¥21,295mn, excess cash of ¥3,000mn in FY12/16, and excess cash of ¥7,498mn, respectively, and every indicator is improving significantly.

Also, due to the large-scale recruitment since FY12/15, the number of employees has increased by 1.5 times, from 9,415 people the end of FY3/06 to 14,174 people the end of FY12/19. On the other hand, looking at the percentage of certified technicians on a stand-alone basis (the percentage of certified specialists and certified product managers, based on the Company system, to the total number of employees), it had risen from 22.8% at the end of FY12/14 to 29.5% the end of FY12/19. So the Company has realized both large-scale recruitment and the early training and development of new and young human resources.

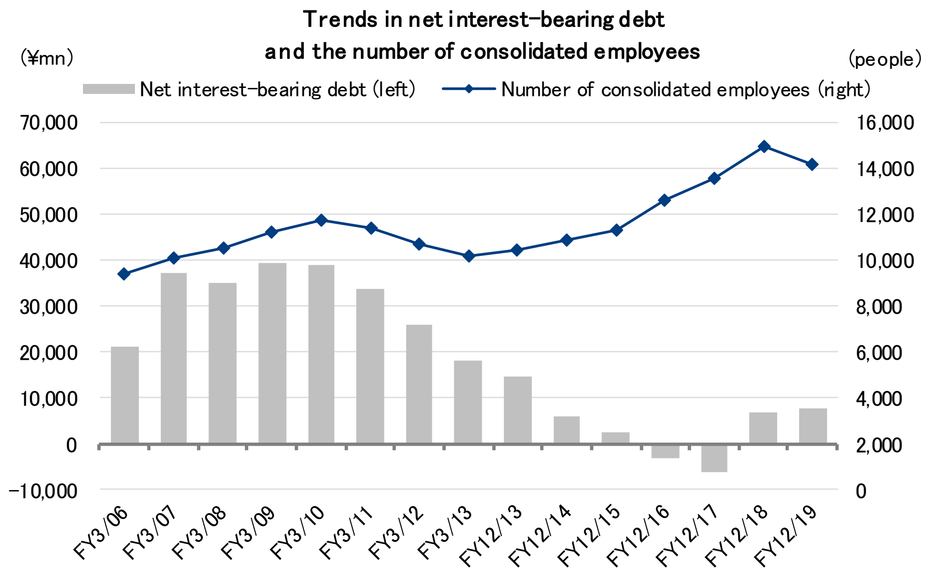
In addition, the capital investment amount increased from ¥3,028mn in F12/14 to ¥22,608mn in FY12/18, while R&D expenses also rose from ¥488mn in FY12/13 to ¥1,011mn in FY12/17. So the Company has been expanding upfront investment, which together with its investment in human resources, indicates its intention to strengthen growth potential toward “Challenge and Creation.”

Looking here at the relationship between the financial indicators and the management strategy, in FY12/15, which is when the Company embarked on the large-scale recruitment and increased upfront investment, the equity ratio was around the 60% level, the current ratio had improved to nearly 200%, and net interest bearing debt had been reduced to a level of excess cash in FY12/16 and FY12/17. This indicates that FY12/15 was when the Company realized a strong financial structure.

It can be said that the Company’s strengths include its ability to make and implement management decisions quickly through strong leadership, including that of its founder. It did not hesitate to change to “offensive management (actively conducting upfront investment)” precisely because it had progressed “defensive management (strengthening the financial structure)” during a phase of slumping results. So the Company can be highly evaluated for taking dispassionate management decisions that accurately reflect the changes to its business environment.



Source: Prepared by FISCO from the Company's securities report and financial results



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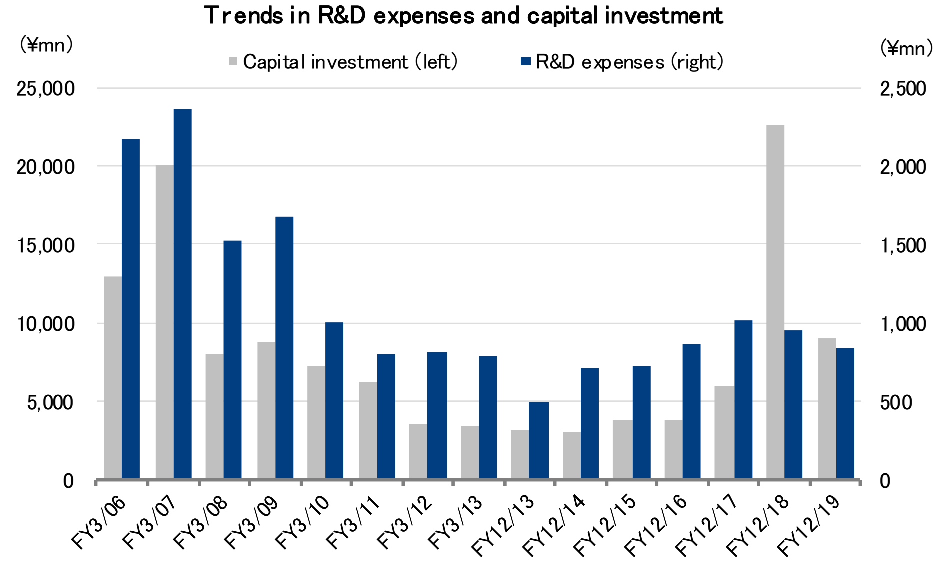


Source: Prepared by FISCO from the Company's securities report and results briefing material

Simplified income statements

(¥mn)

	FY12/16	FY12/17	FY12/18	FY12/19	FY12/19 (E)
Net sales	164,218	180,773	204,329	231,074	238,000
YoY	6.9%	10.1%	13.0%	13.1%	3.0%
Cost of sales	126,024	138,706	156,808	178,337	-
YoY	7.2%	10.1%	13.0%	13.7%	-
Gross profit	38,193	42,066	47,520	52,736	-
YoY	5.8%	10.1%	13.0%	11.0%	-
Gross profit margin	23.3%	23.3%	23.3%	22.8%	-
SG&A expenses	29,394	32,359	36,119	39,470	-
YoY	6.2%	10.1%	11.6%	9.3%	-
SG&A expenses ratio	17.9%	17.9%	17.7%	17.1%	-
Operating income	8,798	9,708	11,400	13,266	13,600
YoY	4.5%	4.5%	17.4%	16.4%	2.5%
Operating income margin	5.4%	5.4%	5.6%	5.7%	5.7%
Ordinary income	9,166	10,260	12,071	13,749	13,850
YoY	0.8%	11.9%	17.7%	13.9%	0.7%
Profit attributable to owners of parent	5,042	5,797	6,516	7,836	8,000
YoY	2.4%	15.0%	12.4%	20.3%	2.1%

Source: Prepared by FISCO from the Company's financial results

Simplified balance sheets

(¥mn)

	End-FY12/16	End-FY12/17	End-FY12/18	End-FY12/19	Change
Current assets	67,350	72,457	77,315	88,009	10,694
Cash and deposits	19,134	18,851	22,554	22,278	-276
Notes and accounts receivable - trade	36,727	40,288	44,456	49,570	5,114
Non-current assets	96,513	102,110	115,310	119,609	4,299
Property, plant and equipment	65,796	65,220	82,356	86,334	3,978
Intangible assets	5,949	6,821	4,738	4,043	-695
Investments and other assets	24,766	30,068	28,214	29,231	1,017
Total assets	163,863	174,568	192,625	207,618	14,993
Current liabilities	37,461	39,197	49,428	48,106	-1,322
Notes and accounts payable - trade	9,444	9,977	9,526	13,361	3,835
Short-term borrowing and CP	9,410	8,464	16,207	7,158	-9,049
Non-current liabilities	17,400	16,959	23,526	32,691	9,165
Long-term loans payable	6,723	4,182	13,319	22,618	9,299
Total liabilities	54,861	56,156	72,955	80,797	7,842
(Interest-bearing debt)	16,134	12,647	29,526	29,776	250
Total net assets	109,001	118,411	119,670	126,820	7,150

Source: Prepared by FISCO from the Company's financial results

Simplifies cash flow statements

(¥mn)

	FY12/16	FY12/17	FY12/18	FY12/19
Net cash from operating activities (a)	9,530	9,244	11,192	12,584
Net cash from investing activities (b)	-4,337	-4,524	-23,424	-9,442
Net cash from financing activities	1,076	-4,462	14,766	-1,451
Free cashflow (a) + (b)	5,192	4,720	-12,232	3,142
Cash and cash equivalents at end of period	21,790	22,157	24,587	26,158

Source: Prepared by FISCO from the Company's financial results

Outlook

Is steadily conducting active investment and work-style reforms, and focus could be placed on its "further steps" that will lead to improved productivity in the future.

1. The Company's FY12/20 results forecasts are simply targets to be achieved

The FY12/20 results forecasts announced by the Company in February 2020 are for net sales to increase 3.0% YoY to ¥238,000mn, operating income to rise 2.5% to ¥13,600mn, ordinary income to grow 0.7% to ¥13,850mn, and profit attributable to owners of parent to climb 2.1% to ¥8,000mn. Compared to the previous results of double-digit increases in sales and profits, there may be a tendency to think these forecasts are for unsatisfactory results. However, since FY12/15, the Company has continuously followed a pattern of setting its initial forecasts by expecting net sales to increase by around 3% and assuming an operating margin of around the same level as in the previous fiscal year's results. It has stated that the current forecasts are simply targets to be achieved, and there is considered to be no particular reason to view them negatively.

The dividend forecast is for an annual dividend of ¥51 per share (a dividend at the end of 2Q of ¥28 per share, which includes a commemorative dividend of ¥5 per share on the 50th anniversary of its establishment, and a period-end dividend of ¥23 per share). This is an increase of ¥9 per share on the FY12/19 annual dividend of ¥42 per share (¥20 per share at the end of 2Q, and ¥22 per share at the period end). If this increase is realized, it will be the fifth consecutive year of higher dividends. Taking a more detailed look at the current dividend policy, even after excluding the commemorative dividend, the dividend is more than the period-end dividend in the past 5 years up to FY12/19 that doubles the previous period-end dividend, making it unprecedented as a full-fiscal year dividend forecast.

The Company has stated that its "basic policy is to return profits to shareholders through realizing stable and continuous dividend payments based on a comprehensive consideration of factors including strategic growth investment and the need to respond to sudden changes in the economic environment and to various unforeseen business risks." From the forecasts of unprecedented dividend increases that have continued since the announcement of a higher interim dividend in 2019, we can sense the Company's intention to raise its degree of freedom for its dividend policy, while avoiding dividend increases that are weighed more heavily on the period-end dividend.

With regards to the impact of the novel coronavirus, in macro terms the situation is impossible to predict, also for the Company, on looking at the demand side, it is undeniable that in the short term, supply chain problems centered on China may keep down customers' IT investment. That said, investment in the CASE area in automotive-related, responses to IoT in FA-related, and investment to utilize AI can be said to be strategic investments for its customers that relate to their very survival, and their desire to invest in the "AIS-CRM" area, which the Company is focusing on, can be expected to trend comparatively steadily. In addition, on the supply side, the work-style reforms that the Company has been actively conducting, including for remote working, are proving successful, and it is thought that it will be able to avoid any major disruption at its work sites.

Results forecast

(¥mn, %)

	Net sales		Operating income		Ordinary income		Profit attributable to owners of parent		Net income per share (¥)
	Amount	% change	Amount	% change	Amount	% change	Amount	% change	
FY12/18	204,329	13.0	11,400	17.4	12,071	17.7	6,516	12.4	208.22
FY12/19	231,074	13.1	13,266	16.4	13,749	13.9	7,836	20.3	250.40
FY12/20 (E)	238,000	3.0	13,600	2.5	13,850	0.7	8,000	2.1	255.64

Source: Prepared by FISCO from the Company's financial results and results briefing material

2. Productivity is improving from the focus on upfront investment and work-style reforms

On the one hand, the Company is focusing on investing in human resources, centered on the large-scale recruitment of new graduates, while on the other hand, it is assiduously implementing work-style reforms that are tailored to a variety of lifestyles, and providing support for these reforms, toward realizing "relaxed and worthwhile" working environments.

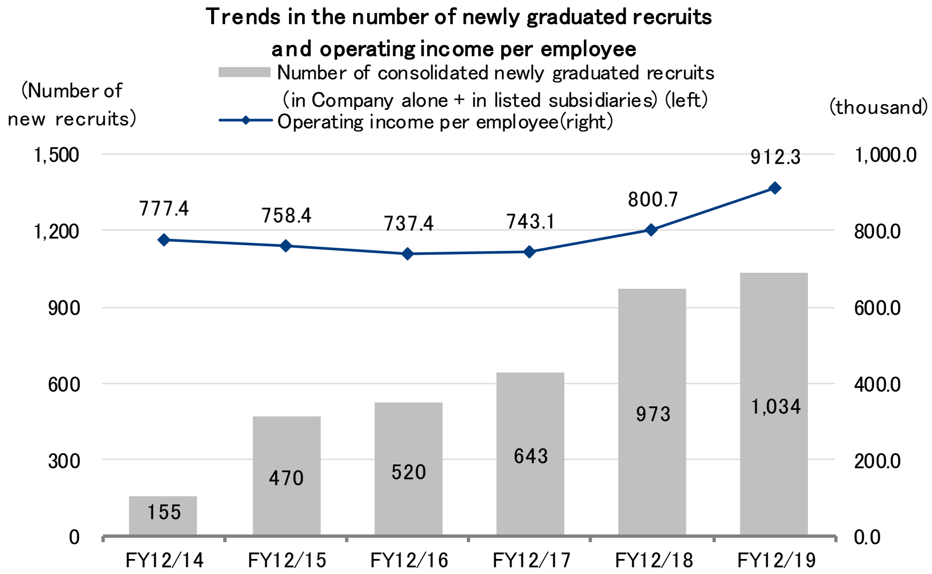
Specifically, based on the upgraded version of the Super Flex System, introduced in 1990 that had no core working hours, the Company introduced the Ultra Flex system (the Super Flex system + a system enabling acquisition of paid-leave on units of 30 minutes without fixing the time period, and 'refresh time' of 10 minutes)," and working to establish a working environment for remote locations and also on the fully fledged management of a teleworking system for which all employees are eligible. As a result of these efforts, in 2018 (the totaling period was April to March), it achieved the following results; 1) paid-leave acquisition rate: 72.9% (private-sector average, 51.1%; government target, 70% by 2020), 2) number of employees using the teleworking system: 5,930 in total, 3) number of employees taking child-care leave: 165, and 4) number of people working more than 80 hours of overtime a month: 0. The Company achieved some excellent results in 2019 as well, including that the number of employees using the teleworking system approached 8,000 people for the eleven-month period. These excellent results are also being highly evaluated and recognized by external organizations, including being awarded the Platinum Kurumin Certification based on the Act on Advancement of Measures to Support Raising Next-Generation Children (Ministery of Health, Labour and Welfare) and the highest rank of the Eruboshi Certification based on the Act on Promotion of Women's Participation and Advancement in the Workplace (Ministery of Health, Labour and Welfare). Moreover, it has been included in the Top Hundred Telework Pioneers (Ministry of Internal Affairs and Communications), the Certified Health & Productivity Management Outstanding Organizations Recognition Program (Ministry of Economy, Trade and Industry), and the Kanagawa businesses that promote the support of children and child raising (Kanagawa Prefecture).

In addition, when considering the attitude of management, of attempting to convert the crises facing the Company into opportunities, it can be thought highly likely that, in response to the novel coronavirus pandemic, it will promote work-style reforms even further. So we shall be paying attention to the further steps taken by the Company, which is realizing productivity improvements through work-style reforms even while still providing labor-intensive IT services.

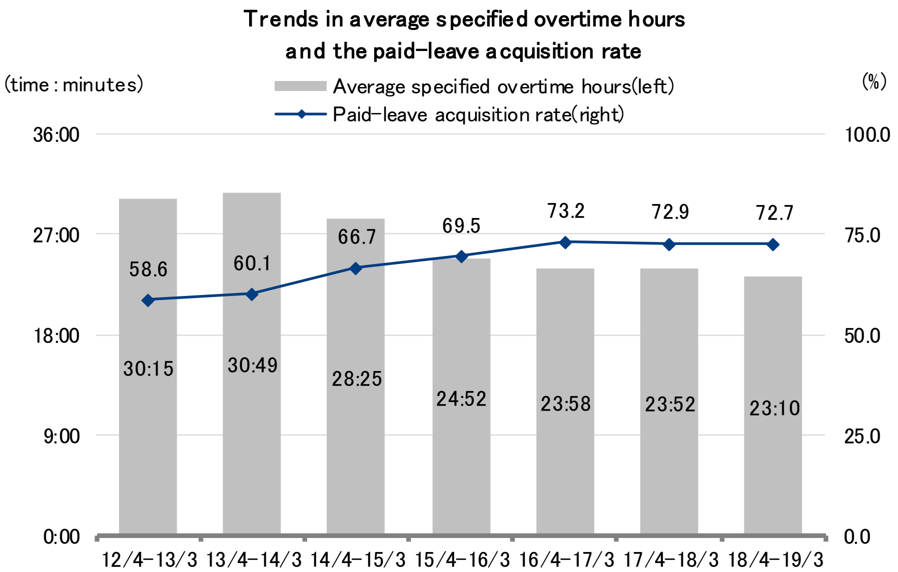
Work-style reforms, which will cause a reduction in the working hours of existing employees, and the large-scale recruitment of new graduates will lead directly to a dilution in the fighting strength of employees and an increase in upfront costs. So in many cases, in the short-term these are factors keeping down the productivity indicator of operating income per employee (operating income / the average number of employees at the end of the period). In the case of the Company, in the two years after FY12/15, when it began the large-scale recruitment of new graduates while producing positive effects from work-style reforms, operating income per employee decreased but since FY12/17, it changed direction and has been increasing.

Specifically, when simply calculating the new graduate inclusion rate (the number of recruited new graduates in the Company alone + in listed subsidiaries / the number of employees at the end of the previous year on a consolidated basis), it rose each year, from 1.5% in FY12/14, to 4.3% in FY12/15, 4.6% in FY12/16, 5.1% in FY12/17, and 7.2% in FY12/18, and the high rate was maintained in FY12/19 as well, at 6.9%. In this situation, it also made progress in reducing overtime hours and increasing the number of employees taking paid-leave. On the other hand, in FY12/19, in which the Company realized record high operating income, operating income per employee increased 17.3% compared to FY12/14 to more than ¥910,000. So it would seem that, through implementing measures to utilize ICT and continuously reviewing work forms and the work environment, the improvements to the work framework and the creation of workplaces that are "relaxing and worthwhile" is leading to improved productivity.

Going forward, there remains room to further reduce overtime and increase the number of people taking paid-leave, while the new graduate inclusion rate is expected to peak-out. Therefore, the positive effects from improving hourly productivity will become easier to realize. We can have high expectations for the future of the Company, which is aiming to further improve profitability in the long term.



Source: Prepared by FISCO from the Company's securities report and results briefing material



Source: Prepared by FISCO from the Company's CSR report

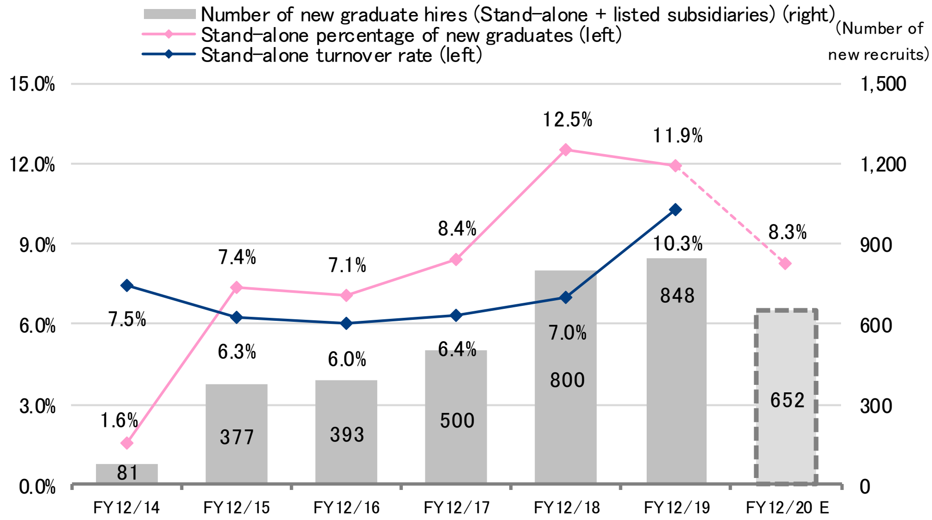
3. Has entered a cruising stage for investment in human resources, and is expected to realize productivity-improvement effects

Looked at on a stand-alone basis, which offers more detailed disclosure of the Company's human resource investment trends, signs of a shift can be seen in what had been a relatively stable turnover rate (the annual number of retirees/ the number of employees at previous year's end), even as the percentage of new college graduates (the number of recruited new graduates/the number of employees at the end of the previous year) in the Company's workforce jumped from 1.6% in FY12/14 to the 7% range in FY12/15 and beyond. Specifically, the turnover rate for FY12/18 was 7.0%, an increase of 0.6 points YoY, while the Company was forced to experience a 3.3 points YoY rise to 10.3% in turnover rate for FY12/19. One reason that might be pointed out is that the percentage of new college graduates rose suddenly in FY12/18, to 12.5% (a 4.1 points increase YoY, and remained high in FY12/19 at 11.9%.

While the absolute turnover rate is itself not at a level that requires excessive concern, it is difficult to conceive that the Company is viewing the situation idly given its emphasis on human resource investment. In fact, the Company's per-graduate spending on recruitment training (recruitment training costs on a consolidated basis/ the number of new graduates hired by the Company alone plus its listed subsidiaries), which had been on a downward trend (from ¥1.94mn in 1H FY12/14 to ¥0.76mn in 1H FY12/18) even as it increased the number of new graduate hires, swung back in 1H FY12/19, to ¥0.91mn (a 18.6% increase YoY). It also feels like it is keeping down the new graduate inclusion rate (stand-alone basis) (FY12/18, 12.5%, FY12/19, 11.9%, and FY12/20 forecast, 8.3%), and it seems that the Company has started to review the balance between quantity and quality for its investment in human resources. In other words, up to the present time, it has been in an accelerating phase for its investment in human resources, but it can now be considered to be progressing to a cruising stage to solidify footholds.

Generally speaking, once a company's human resource investments enter this cruising stage, the effect of increased productivity in boosting results can more easily come to the surface. FY12/20 is not only the final year for the three-year results forecast indicated by the Company in February 2018, it is also the milestone of the 50th anniversary of its establishment. Given that it will leverage the novel coronavirus pandemic to strengthen work-style reforms that will lead to productivity improvements in the future, in its next three-year results forecasts, we can expect it to send a message of setting its sights even higher than up to the present time.

Number of new graduate hires (Stand-alone + listed subsidiaries) and turnover rate



Source: Prepared by FISCO from the Company's results briefing material

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■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp