COMPANY RESEARCH AND ANALYSIS REPORT

CAC Holdings

4725

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Index

Summary

An IT and healthcare group that is progressing globalization. Aiming for business growth and improved capital efficiency through strengthening governance and prompt decision making

1. Company outline and business description

CAC Holdings <4725> (hereafter, also "the Company") was established in Japan in August 1966 and started in business as a pioneering, independent, specialist software company. It expanded its business domain through an active M&A strategy, and today, it has become an IT and healthcare group that is aiming to take a dramatic leap forward in its overseas business (it conducts business through 20 consolidated subsidiaries and 1 equity method affiliate under the holding company).

It has three reportable segment; the domestic IT business (including systems development and integration services, systems operation and management services, and human resource (HR) BPO, in the domestic subsidiaries), the overseas IT business (such as systems development and integration services, systems operation and management services, and maintenance services, in the overseas subsidiaries), and the CRO business (outsourcing and agency services for clinical trial operations at the time of drug development by a pharmaceutical company and operations after the drug's manufacture and sale). Also, in 2019, in order to realize prompt decision making and the mobile implementation of business, the existing businesses were divided into four domains and one new business domain was added, establishing a total of five business domains.

2. Financial stability has further improved, while the FY12/19 full year results forecasts have been revised, as progress in the CRO business and the overseas IT business was behind schedule

In FY12/18, which was the first fiscal year of the medium-term strategy currently being implemented, net sales decreased 6.3% year-on-year (YoY) to ¥49,906mn and operating income increased 104.3% to ¥1,426mn. The initial forecasts, of net sales of ¥54,000mn (up 1.4% YoY) and operating income of ¥1,600mn (up 129.1%), were not achieved, but the Company still realized a major increase in profits based on a decrease in sales from measures to eliminate unprofitable projects and to optimize costs. Also, looking at the trends in the leading indicators on the stability of the financial structure, all indicators further improved, including the equity ratio from 58.6% at the end of FY12/17 to 59.7% at the end of FY12/18, the current ratio from 216.6% at the end of FY12/17 to 222.7% at the end of FY12/18, and net cash (cash and deposits – interest-bearing debt; positive figure indicates cash in excess) from ¥3,611mn at the end of FY12/17 to ¥5,337mn at the end of FY12/18.

In the FY12/19 1H consolidated results, net sales increased 3.2% YoY to ¥26,251mn and operating income rose 56.6% to ¥837mn. Also, in the 3Q consolidated results announced on November 8th, net sales increased 1.2% to ¥37,827mn and operating income grew 17.9% to ¥1,039mn. While the results steadily grew YoY, compared to the initial results forecasts (net sales of ¥52,000mn and operating income ¥2,000mn), the progress made by the CRO business and overseas IT business for the sales forecasts was behind schedule. So the Company has revised the FY12/19 full year results forecasts to net sales to decline 1.0% to ¥51,500mn and operating income to fall 25.0% to ¥1,500mn in comparison to the previous forecasts.

3. Greatest strength is its “transformational power”

The Company’s greatest strength is considered to be its “transformational power (corporate reforms),” of being able to transform itself in response to societal needs and issues that change with the times.

It is not content with growing as an independent, specialist software company, and recently it has evolved to become an IT and healthcare services company, while interweaving “business structural reforms through selection and concentration” with “business expansion through M&A.” The aspects supporting this “transformational power” are “a corporate culture of positively taking on challenges (management’s intention),” “an excellent customer base as the core of business expansion,” and “a solid financial structure that makes possible a flexible financial strategy.”

4. In the revised medium-term strategy, the focus is on the basic policies, the first of which is strengthening governance

Following in-depth discussions in the Board of Directors, the Company revised the medium-term strategy Determination 21, which has FY12/18 as its first fiscal year, and it re-published it in February 2019.

As a result of a review following changes to the management environment and a clarification of strategy, the Company has set four basic policies in the revised medium-term strategy;1) Strengthening governance by separating management and execution, 2) Mobile implementation of business with prompt decision-making, 3) Improvement of capital efficiency and strengthening of return to shareholders, and 4) Promotion of value sharing with shareholders. Also, it left unchanged the numerical targets for the final fiscal year (FY12/21), of net sales of ¥70bn and operating income of ¥4bn, but it has newly added ROE of 8% as an indicator toward improving capital efficiency.

5. The idea of improving non-financial value can be read from its support of Boccia

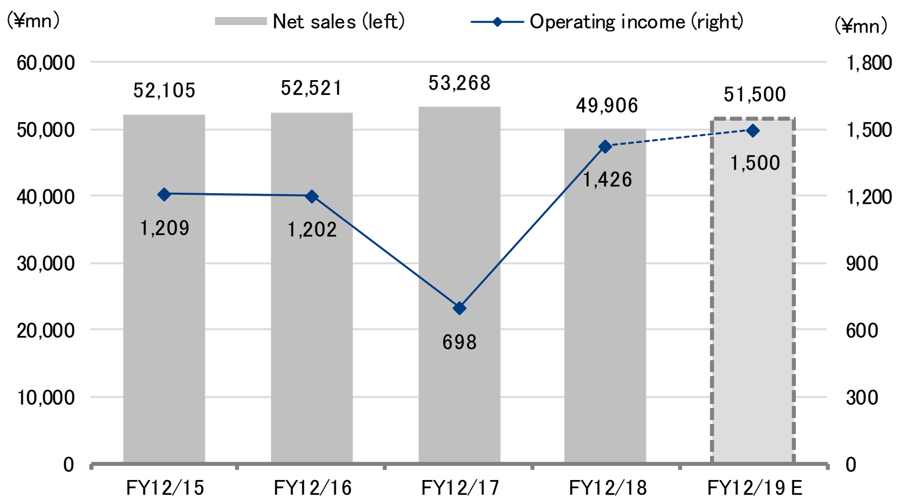
The Company, whose main business pillars are IT and healthcare, is a typical CSV (Creating Shared Value; social contribution through its business) corporate group that solves the problems facing society through its main businesses. Since 2016, it has been continuously conducting activities to spread participation in and to support Boccia, which is a sport for people with disabilities, from which can be read its idea of sincerely working to improve non-financial value.

It started these activities from the opportunity provided by the 50th anniversary of its foundation, but currently practically every employee in the Group has experienced Boccia, and by continuously communicating the appeal of Boccia both inside and outside of the Group based on their actual experience the exchanges with people with disabilities, a project that is still small at the present time has the potential to grow into something much larger. Therefore, it is considered that the reason why the Company selected Boccia as a measure for the 50th anniversary of the foundation was its idea of improving non-financial value, which it calls “invisible assets.”

Key Points

- An independent, pioneering SIer with a history of more than 50 years since its establishment. Currently, it is evolving to become an IT and healthcare services company conducting a domestic IT business, an overseas IT business, and a CRO business. In 2019, it divided the existing businesses into four domains and added one new business domain, establishing a total of five business domains.
- Its greatest strength is its "transformational power," which is supported by "a corporate culture that is positive about taking on challenges," "an excellent customer base," and "a solid financial structure."
- In the revised medium-term strategy, it has formulated four basic policies, the first of which is strengthening governance. Also, it left the earnings targets for the final fiscal year (net sales of ¥70bn and operating income of ¥4bn in FY12/21) unchanged, but it has newly added ROE of 8% as an indicator toward improving capital efficiency
- The Company, which is a CSV-type corporate group, is continuously supporting Boccia, from which can be read its idea of sincerely working to improve non-financial value.

Results trends



Note: The FY12/19 forecasts are the revised full fiscal year results forecasts announced on November 8, 2019
Source: Prepared by FISCO from the Company's financial results

Company profile

An independent SIer pioneer that continues to change and evolve. Is taking on the challenge of fully-fledged overseas business development after the IT business expansion period and the CRO business development period

The Company was founded in August 1966 as Computer Applications Co., Ltd. (CAC) as a pioneering, independent, specialist software company in Japan. Its founding philosophy was "to construct user-oriented information systems from a neutral standpoint independent of hardware manufacturers," and this philosophy, of "creating new value based on advancing ICT from the field to the world," has been handed down as its current corporate philosophy.

Looking back on the Company's history of more than half a century, we see that it has sensitively ascertained and responded to the changes of the times and continued to take on the challenge of creating new value, while also developing and cherishing its core competencies.

1. As an independent SIer pioneer, went through an expansion period for its IT business, for which it has built an excellent customer base

Soon after its foundation in 1966, CAC expanded its business to become a systems integrator (SIer) that undertakes various operations, including planning, construction and support for systems development and integration. In 1988, it acquired certification from the Ministry of International Trade and Industry (currently, the Ministry of Economy, Trade and Industry) in the Systems Integrator Registration and Certification System at the same time as this system was launched. It has continued to expand its business domain as a group. This includes that in 1971, it invested in Nippon System Service Co., Ltd. (SSK), from the idea that "specialist companies should operate and manage information systems in order to support customers' businesses," as the first company in Japan specializing in outsourcing services, and then in 1973, it established System Utility Co., Ltd. (SUC), whose main operations were information processing and filing services.

In 1994, the above three companies (CAC, SSK, and SUC) merged to become CAC Co., Ltd., putting in place a system that in name and reality was able to provide all services, from planning and development and integration through to management, and it entered a period of IT business expansion. During this IT business expansion period, in addition to organic growth, the Company actively expanded the business even further through M&A, which it has conducted since it was listed (public share offering as over-the-counter shares in 1999, then listed on the 1st Section of the Tokyo Stock Exchange in 2000). Specifically, it made subsidiaries of ARK Systems Co., Ltd., in 2000; YUASA KNOWLEDGE INDUSTRY Co., Ltd., in 2002 (currently CAC Knowledge Co., Ltd.); and ORBIS CORPORATION (currently CAC ORBIS CORPORATION) and MARUHA SYSTEMS CORPORATION (currently CAC MARUHA NICHIRO SYSTEMS CORPORATION) in 2003. These companies are IT subsidiaries with leading companies as their customers, and they can be said to be good examples in terms of showing the Company's position as seen from customers.

The Company has strongly focused on providing services optimized for various industries from its position as the prime contractor. In a prime contractor agreement, the Company is responsible for product liability, so the risk is greater compared to a delegation-type contract or a second-receiver contract. However, it makes it possible for it to accurately and directly ascertain the needs of end customers (as a result, if it meets customer needs, it can obtain higher profits), and this type of agreement is consistent with its founding philosophy of being customer oriented. These good relations with its customers as the prime contractor led to the expansion of the outsourcing business through M&A and it entering-into the CRO (pharmaceutical BTO) domain.

2. Utilizing an M&A strategy in the CRO business development period from 2006 to 2016

Within its domestic IT business, the Company's CRO business has a long history, having acquired major pharmaceutical companies as its leading customers. The Company started input operations for clinical trial data in the 1970s, and then in 1990, at which time the business term "CRO" did not yet exist, it began data management, which is one CRO operation. Therefore CAC Croit Corporation, which is responsible for the CRO business in the Company's Group, is proud to be "in actual terms, Japan's first CRO."

The Company is also expanding the CRO business by utilizing an M&A strategy. Looking at the CRO-related M&A results since 2006, we see that the one company after another has been incorporated into the Group, and that it has expanded its service lineup for drug development support. Starting with Arm Systex Co., Ltd., in 2006, these include Medical Ecology Co., Ltd., in 2007; clinical trust Co., Ltd., in 2009; and the CRO business of Moss Institute Co., Ltd., in 2010. After an appropriate period of organizational consolidation and restructuring, in 2016 it founded CAC Croit as a pioneering company that combines CRO and IT, which brings its history up to the present day.

3. Acquisition of an Indian company opened the curtain on a period of the fully-fledged development of the overseas IT business, and has restarted the M&A strategy after the business reconstruction

The Company's overseas business development passed through a few stages, of 1) entering-into the U.S. in 1989 and Europe in 1990 in response to the overseas business development of customer companies, and 2) entering-into the Asia region (China in 2000 and India in 2010) with the aim of reducing development costs. In 2014, it entered a new stage, of taking on the challenge of the fully-fledged development of its overseas business through an M&A strategy. Specifically, to strengthen its overseas support capabilities, in 2014 it invested more than ¥1.5bn in Accel Frontline Limited (hereafter AFL; company name changed to Inspirisys Solutions Limited in 2018), an Indian IT company which has bases in the U.S., the U.K., the Middle East, and elsewhere, and made it a subsidiary. Then in 2015, it made a subsidiary of Sierra Solutions Pte. Ltd. (hereafter, Sierra), which is a Singapore IT company that conducts a business for medical institutions in the Asia region.

Subsequently, as results could not be obtained as initially anticipated, in 2017 it transferred all of its shares in a Singapore company (Accel Systems & Technologies Pte. Ltd.), whose main business is building the cyber-security systems owned by AFL, and in Sierra, and it progressed the reconstruction of the overseas business throughout 2018. However, in September 2019, it acquired all of the shares and made a consolidated subsidiary of Mitrais Pte. Ltd. (hereafter, Mitrais) of Singapore (execution date; October 18, 2019), whose main base is in Indonesia, and it restarted its M&A strategy.

Company history

Date	Event
1966	Computer Applications Co., Ltd. (CAC) was established as an independent, specialist software company.
1971	Invested in Nippon System Service Co., Ltd., (SSK) and started a business as a company specializing in outsourcing services (the first in Japan).
1973	CAC established System Utility Co., Ltd. (SUC), a company specializing in systems operations and management and software development, as its wholly owned subsidiary.
1976	Completed the construction of the CAC FM Center (the Iidabashi Shogaku Building), a specialist computer building. Made a subsidiary of SSK with an investment ratio of 56%.
1977	Opened the Kansai Sales Office.
1986	Fully fledged start of systems consulting services.
1988	Became a certified company on the launch by MITI of the Systems Integrator Registration and Certification System.
1989	Established CAC America in New York City, U.S.
1990	Established CAC Europe in London City, U.K.
1991	In order to enhance systems development and integration services in the Kyushu area, conducted a capital participation in SCI Co., Ltd., and made it an affiliate.
1993	Started a desktop services business to support information systems management. Launched an information technology education services business.
1994	Entered into a business alliance with SAP Japan, an ERP package (Enterprise Resource Planning integrated business package) sales company. CAC, SSK, and SUC merged and CAC Co., Ltd., was established.
1995	Was once again certified as a systems integrator company by MITI, as CAC Co., Ltd. Was certified as a "special systems operating company, etc.," by MITI.
1996	Entered into a business alliance with SHL Japan, a subsidiary of SHL of Canada, whose strength is in distributed systems outsourcing, and started a distributed systems operations and management services business.
1998	Opened the Data Center in Shinkawa, Chuo Ward, Tokyo.
1999	Offered shares to the public as over-the-counter shares.

Date	Event
2000	Acquired all of the shares of ARK Systems Co., Ltd., a systems operation and management services company, and made it a subsidiary. Established the subsidiary CAC PACIFIC CORPORATION in San Jose City, USA. Established Web Progressive Co., Ltd., to conduct a multimedia business that utilizes the Internet as a joint venture between SHOGAKUKAN Inc., NEC Corporation <1670>, and the Company. Established CAC Shanghai Corporation in Shanghai City, China, through a 100% investment by CAC Pacific. Established NetAdvance Inc., to provide digital content services as a joint venture between SHOGAKUKAN Inc., FUJITSU LIMITED <6702>, and the Company. Listed on the 1st section of the TSE.
2001	Acquired all of the shares of AVANT-GARDE COMPLEX OF DESIGN ASSOCIATES INC., a provider of web hosting services.
2002	Acquired the shares of GoldenTech Computer Technology (Suzhou) Co., Ltd., and made it a subsidiary. Established CEN Solutions Co., Ltd., as an affiliate through a joint venture with NEC Corporation and Kumagai Gumi Co., Ltd. <1861> Acquired the shares of YUASA KNOWLEDGE INDUSTRY Co., Ltd., and made it a subsidiary, and changed its company name to CAC Knowledge Co., Ltd. Starting providing PRASMA, a service to comprehensively support new drug research and development. Made a subsidiary of IXI Co., Ltd., which conducts business-model construction and support, and systems-consulting operations
2003	Acquired the shares of ORBIS CORPORATION (currently, CAC ORBIS CORPORATION) and made it a subsidiary. Acquired the shares of MARUHA SYSTEMS CORPORATION (currently, CAC MARUHA NICHIRO SYSTEMS CORPORATION) and made it a subsidiary.
2005	Established Catient Inc., to conduct surveys, analysis, and consulting to create value utilizing IT. Transferred shares held in CAC Information Services Co., Ltd. Established CrossForce Co., Ltd., as a joint venture with Fuji Xerox Co., Ltd., to conduct an outsourcing services management business Transferred shares held in IXI Co., Ltd., and AVANT-GARDE COMPLEX OF DESIGN ASSOCIATES INC. Relocated the head office to Nihonbashi-Hakozaki-cho, Chuo Ward, Tokyo.
2006	Established CDI Solutions, Inc., as a joint venture between Corporate Directions, Inc., the Company, and others in order to conduct IT-ROI consulting (management strategy x IT). Acquired the shares of Arm Systex Co., Ltd., which conducts a CRO business, and Arm Co., Ltd. made them subsidiaries of the Company.
2007	Established kizasi Company, Inc., to conduct an Internet-related business. Acquired all of the shares of Medical Ecology Co., Ltd., which conducts CRO operations (subsequently, its company name was changed to CAC ClinIT Co., Ltd.) and made it a subsidiary.
2009	Made an equity method affiliate of MIC Medical Corp., which conducts CRO operations (monitoring). Acquired the shares of clinical trust Co., Ltd., which conducts CRO operations, and made it a subsidiary.
2010	Merger of CAC ClinIT Co., Ltd., Arm Systex Co., Ltd., and Arm Co., Ltd. Made an equity method affiliate of Sogo Rinsho Holdings Co., Ltd., which conducts SMO operations (clinical trial facility support organization). Acquired the CRO business of Moss Institute Co., Ltd., and strengthened clinical DM and statistical analysis. Established CAC India in Mumbai City, India.
2012	Established CAC EXICARE Corporation, which conducts CRO operations, through a company split. Transferred the shares held in MIC Medical Corp. Transferred some of the shares held in Sogo Rinsho Holdings Co., Ltd.
2013	Dissolved CAC Pacific.
2014	Acquired the shares of Accel Frontline Limited (listed on the Bombay Stock Exchange and National Stock Exchange) and made it a subsidiary.
2015	Acquired the shares of Sierra Solutions Pte. Ltd., a Singapore IT company, and made it a subsidiary.
2016	Invested in Affectiva, Inc., a leading US company in the emotion recognition AI market, and signed the first distributor agreement in Japan.
2017	Transferred all of the shares of Accel Systems & Technologies Pte. Ltd., held by Accel Frontline Limited. Transferred all of the shares of Sierra Solutions Pte. Ltd.
2018	Composed a CVC fund for domestic companies as part of its measures to create new businesses (total amount, ¥3bn). CAC Croit decided to start a compounds library-sharing (QualityLead) business. Accel Frontline Limited updated its in-company structure and changed its corporate name to Inspirisys Solutions Limited.
2019	Decided to dissolve and liquidate the consolidated subsidiary kizasi Company, Inc. (liquidation scheduled to be completed in December 2019) Acquired all of the shares and made a consolidated subsidiary of Mitrais Pte. Ltd., a Singapore company whose main base is in Indonesia.

Source: Prepared by FISCO from the securities report and the Company materials

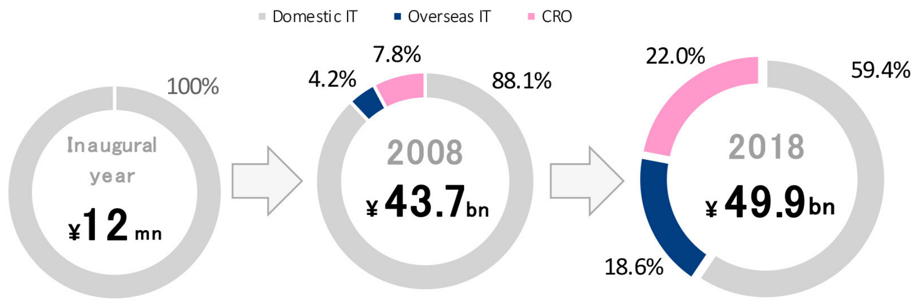
Business description

Conducts the domestic IT business, the overseas IT business, and the CRO business

In the situation of the Company changing its business portfolio to reflect the needs of the times, in 2018 it changed its reportable segments, from the previous segments of "systems development and integration services, systems operation and management services, and BPO/BTO services" to the new segments of "the domestic IT business, the overseas IT business, and the CRO business." It has also been conducting an M&A strategy since 2014, and a direct reason for the review of the reportable segments was the fact that net sales from the overseas IT business had reached 20% of total net sales.

Also, in 2019, in order to realize prompt decision making and the mobile execution of business, it divided the existing businesses into four domains (Core ICT Domain, China Domain, India Domain, and Healthcare Domain), and added one new business domain (Future Domain), establishing a total of five business domains.

Trend in the percentages of total net sales by the reportable segments



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

1. The domestic IT business has a prime contractor rate of 90%

The domestic IT business, which provides 59% of Company-wide net sales (FY12/18), is the Company's mainstay business, and through its domestic subsidiaries, it conducts operations that include systems development and integration services, systems operation and management services, and HR BPO services.

As the prime contractor and from the neutral standpoint of an independent SIer, the Company focuses on accurately and directly ascertaining user needs and strengthening its provision of optimal services to customers. In fact, CAC Corporation, which is responsible for the core of the domestic IT business, has around 300 customer companies, and in this situation, it is keeping the prime contractor rate at around 90% and securing a gross margin at the time of ordering of 25%.

(1) Strength is in systems development and integration services for banks and trusts

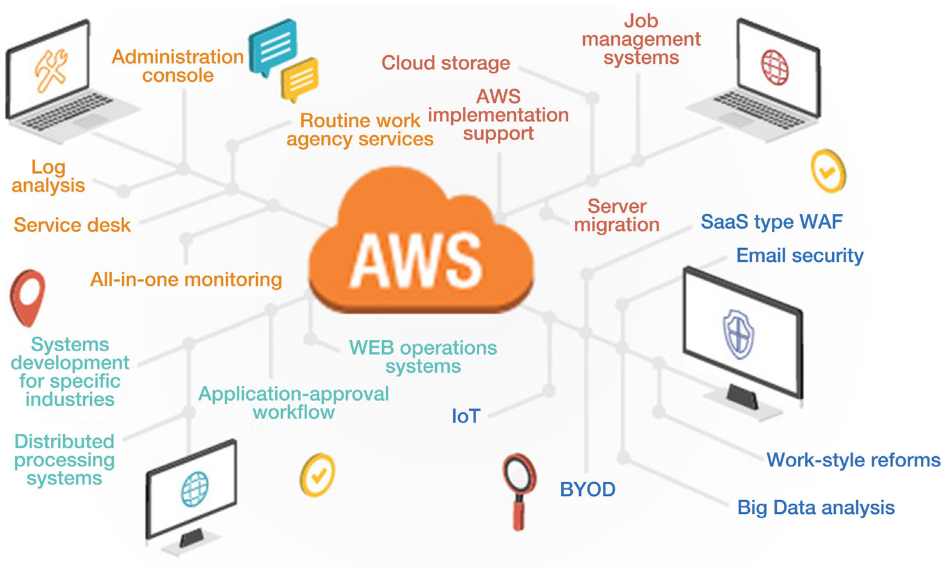
In systems development and integration services, the Company totally develops and integrates companies' information systems, from the planning of information systems through to their design, development, testing, introduction, and maintenance. Among its top-ranking customers in terms of net sales are several financial institutions and major trust banks. As a prime contractor for over half a century, the Company has accumulated highly specialized operational knowledge and experience. As a result, it has strengths in market- and overseas-related systems for megabanks and in pension-related systems for trust banks.

(2) Advancing Cloud support for systems operation and management services

The origins of the systems operation and management services can be found in the investment in the specialist outsourcing services company (SSK) in 1971. The Company provides total services for the necessary functions for systems management, and currently these include operations process management, operations management, user support, client equipment management, application management, and infrastructure management. The Company's strengths include the management expertise it has accumulated through providing comprehensive services to major pharmaceutical companies and that through M&A, it directly meets the needs of various industries (manufacturing industry, trading companies, fishery and foods).

Also, for AWS (Amazon Web Services), it is focusing on aspects such as systems integration and applications development and has accumulated many achievements as a result of this focus, such as being certified as an "APN advanced consulting partner." The Company has also been strengthening its Cloud support at a rapid pace since 2012. As a result, it is supporting more than 30 companies, including major financial institutions and pharmaceutical companies. The acceleration of the migration to the cloud has the aspect of leading to a contraction of the existing businesses of IT vendors, but the negative impact of this on the Company is small.

Overall image of Cloud services using AWS

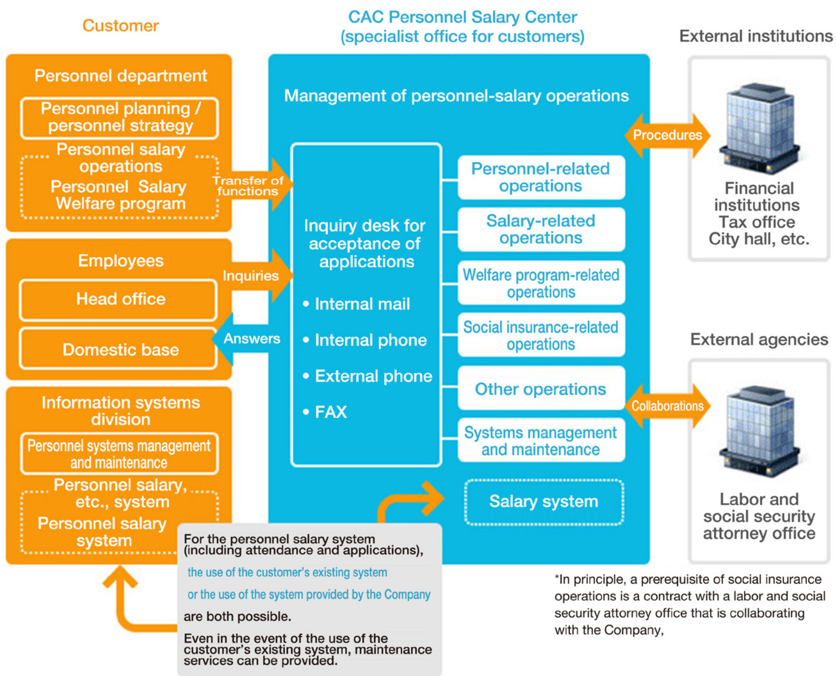


Source: Company website

(3) Human resource BPO services

Human resource (HR) BPO services utilize IT to conduct human resource operations and other business processes on behalf of the responsible managers in companies. One feature of these services is that the outsourced operations are not limited to work such as general payroll calculations, but also include personnel system management and labor management, welfare management, and other HR operations in general. In July 2019, the Company opened the Nagasaki BPO Center in Nagasaki City, aiming for business expansion. Not limited to HR operations in general, in the future it has in view conducting general affairs, accounting, and other operations, and it will comprehensively conduct consigned back-office operations.

Overall image of HR BPO services



Source: Company website

(4) Measures for digital transformation

The Company's awareness about digital transformation (hereafter, DX), that transforms society as a whole through the rapid evolution of ICT technology, is that for existing SIers, it offers both opportunities and threats. DX is transforming not only the creation of new businesses, but also the designs of existing businesses. In other words, "in a new world in which the virtual world and the physical world are integrated, it demands the migration to a digital business that is able to bring about the mutual interactions of people, objects, money, and businesses."

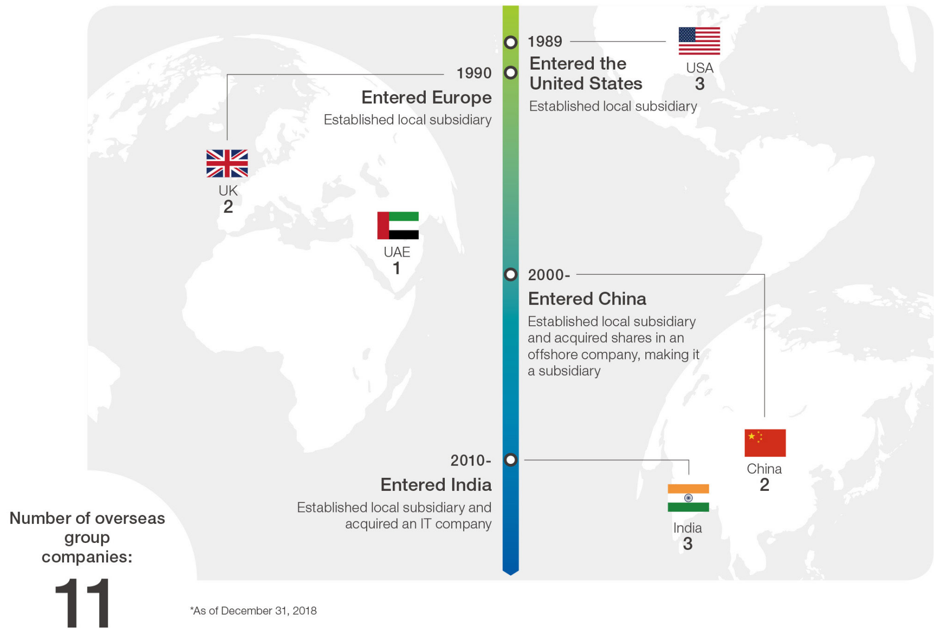
In order to support the advancement of DX by its customers, the Company has already prepared a menu of services that utilize the latest ICT technologies, of AI, blockchain, and IoT. The Company is focusing on increasing the factors that differentiate itself in the responses to DX by migrating to a digital business and by constantly anticipating future technological trends.

2. Is rebuilding under a new system of responsibilities and accelerating the development of the overseas IT business

The Company conducts overseas IT business through its 12 overseas Group companies (as of October 31, 2019) and provides system-building services, system management services, and maintenance services. The Company ascertained that the overseas market was a growth frontier from the beginning, such as by entering into overseas markets in the 1970s in advance of other companies. It has also actively conducted M&A and by 2017, the percentage of total net sales from overseas had grown to 22% (of which, 74% was from Asia).

On the other hand, in a situation of seeking a rapid expansion of scale, greater-than-expected losses occurred in the acquired companies, and due to the impact of the business reconstruction conducted in 2017, the percentage of total net sales from overseas fell to 19% in 2018. But in September 2019, it made Mitrais of Singapore a wholly owned subsidiary (execution date; October 18th) and restarted the M&A strategy. Mitrais is a software company with a track record of results in Indonesia and Australia, and its strengths include its agile development approach that is effective for system development in short periods, as required in the DX age. It seems that this M&A was discussed at great length in the Board of Directors and elsewhere in the Company, indicating that it is determined to learn from the lessons of the past.

Global network

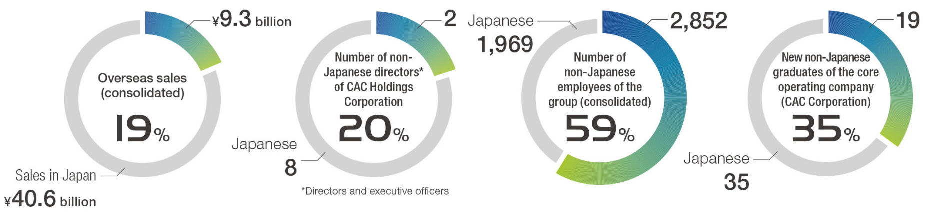


Note: Excludes Mitrais, which was made a subsidiary in October 2019
Source: Company's annual report 2019

The Company's overseas IT business has been advancing from the stage of focusing on global support for its customers of Japanese companies and the offshore utilization of the overseas Group companies, to the stage of focusing more on the huge local market themselves, of India and China. In fact, in 2019 it divided the overseas IT business into three business domains; the Core ICT Domain (Europe and the US), which mainly conducts global support for Japanese companies, the China Domain, and the India Domain, and it is migrating to a system of pursuing business growth in each domain in which the executive officers in charge are responsible for their respective domain. Of these officers, two foreign employees are responsible for the China Domain and the India Domain and the percentage of foreign employees in the Group is high at 59%, so the organizational and personnel aspects are in place in order to respond to globalization.

In this situation, the company that is being particularly focused on is Inspirisys Solutions Limited (listed on the Stock Exchange of India, formerly AFL), which was made a subsidiary in 2014. This is because Inspirisys Solutions Limited has excellent customers, including manufacturing companies and financial institutions, not only in its home country of India, but also in various other regions, including in the United States, the United Kingdom, and the Middle East. Moreover, it can be highly evaluated for its role of building bridges to open up local markets overseas. Furthermore, Inspirisys Solutions Limited has a track record of sales of hundreds of millions of yen in Japan and other countries in the growth field of ADAS (Advanced Driver-Assistance System), which is extremely significant in terms of establishing a foothold for and incorporating into the Group business for the automotive industry, which despite being an enormous industry, the Group had conducted little business for so far. In addition, in the ADAS field, the scope of application of the emotion recognition AI technology of Affectiva of the US, with which the Company has invested in and concluded an agency agreement, is wide, and developments can be expected in the future.

Percentages of net sales and personnel from overseas

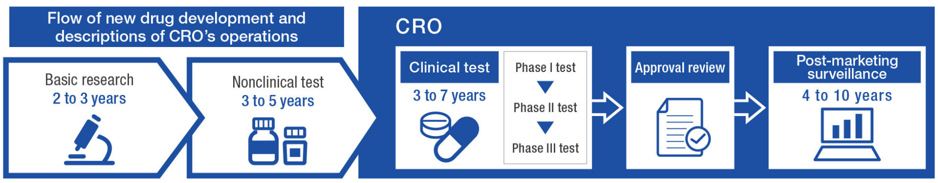


Source: Company's annual report

3. The CRO business will be the second pillar of the CSV-type businesses

The CRO (Contract Research Organization) business entails conducting clinical trial operations at the time of drug development by the pharmaceutical company and outsourcing and agency services after the drug's manufacture and sale. In FY12/18, its percentage of total net sales was 22%, while in terms of profits also, it has grown to be second in scale to the domestic IT business. But on entering 2019, the earnings environment was approaching an adjustment phase and it will be necessary to pay attention to developments in the future.

The position of CRO operations in new drug development



Source: Company's annual report

(1) The slogan of "All You Need is CRO x IT"

The direct operations in the CRO business are undertaken by CAC Croit (hereafter, Croit). With the pioneering, independent SIer as the parent body and under the slogan of "All You Need is CRO x IT," it provides comprehensive services from the three directions of "operations support, IT, and consulting." The "CRO x IT" approach is expressed in the skill sets of Croit's employees. On the one hand, it employs many specialists such as doctors, pharmacists, and labor and social security attorneys as well as specialist with the skill sets required for CRO operations, including pharmacovigilance, DM and statistical analysis, clinical development, and applications. But on the other hand, approximately 30% of all employees are ICT personnel.

Croit provides support to its 160 customer companies in a range of operational fields; specifically, it conducts pharmacovigilance services (percentage of total net sales in FY12/18, 49.8%), clinical trial operations (22.8%), operations after the drug's manufacture and sale (8.9%), application-related operations (6.0%), and other operations (4.6%). Within them, it has acquired the leading track record in Japan in terms of results for its mainstay pharmacovigilance services (accumulation of information on the side effects of pharmaceuticals and applications to the authorities) and application-related operations.

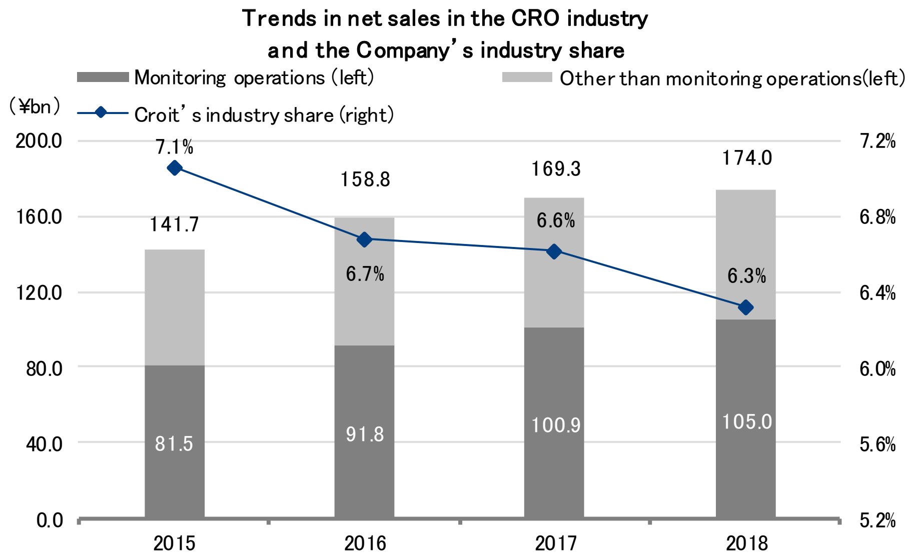
(2) Continues to work to improve productivity

On considering the data that the Japan CRO Association publishes on its members, we can note the following three points for Croit's industry position; 1) although the Company maintains industry share of 6%, it is on a downward trend, 2) its net sales per capita is below the industry average, and 3) the increase rate of its net sales per capita (labor productivity) is higher than the industry average.

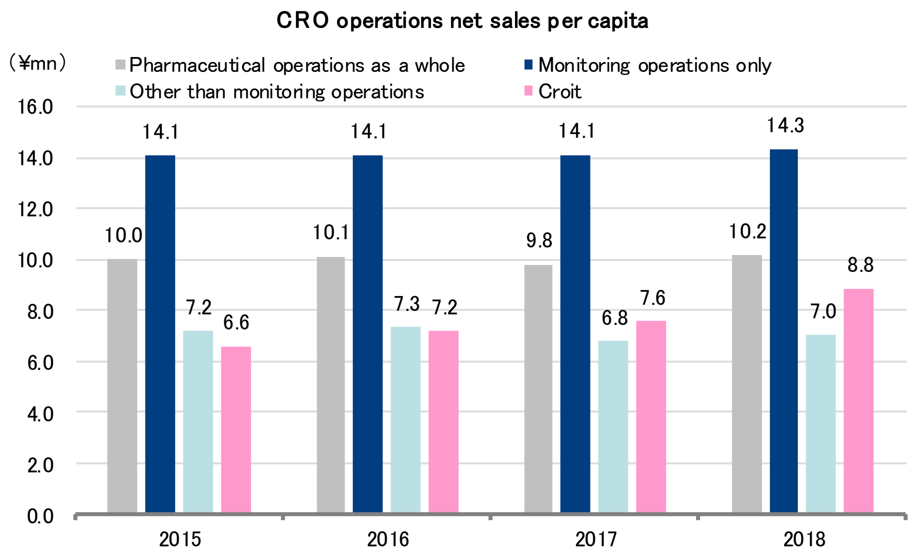
The point to be aware of here is that the Croit's portion from monitoring operations is small. In monitoring operations, the CRA (Clinical Research Associate) is responsible for a range of work, including visiting the medical institution that is participating in the clinical trial and talking directly with the doctors in charge, explaining the contents of the protocol (the trial implementation plan), confirming the progress made in the trial, and requesting entries into the trial tables and collecting and checking them. Therefore, a feature of it is that on the one hand the value-added per capita is large, but on the other hand it strongly has the aspect of being labor-intensive work. The annual growth rate of net sales from monitoring operations (the whole members) in the last three years was 8.8%, which was above the rate for the industry as a whole of 7.1%, and they provided 60% of total net sales. The differences in the operations-composition ratios would seem to be the main reason for the low industry share and the small net sales per capita.

Conversely, even on taking into consideration the differences in the operations-composition ratios, Croit's labor productivity improvement rate appears to be high. Croit's labor productivity improved by slightly less than 9% in 2016, when the company was established and continued to improve in 2017 by slightly more than 5%, and also in 2018 by slightly less than 17%. In contrast to this, the labor productivity of the industry as a whole for monitoring operations was unchanged in 2016 and 2017, then improved by slightly less than 2% in 2018, while for operations other than monitoring operations, it improved by slightly less than 2% in 2016, worsened by slightly less than 8% in 2017, and improved about 4% in 2018. Generally, Croit's upward trend has been noticeable, but keep in mind that the improvement in productivity in 2018 was largely a result of the reduction in the number of employees.

The factors behind the improvement in Croit's labor productivity would seem to include that 1) it actively utilizes nearshore bases in the IT business because in the mainstay pharmacovigilance services, the ratio of operations that can be responded to within each business office is high, and 2) it leverages to the greatest possible extent the fact that it has an independent SIer as its parent body and is making progress in improving efficiency and precision through utilizing ICT, such as RPA (Robotic Process Automation). With regards to the effective use of nearshore bases, we should not overlook the fact that as of the start of 2019, within the total number of employees of 1,243 people, 505 were mate employees (employees of cooperating companies).



Source: prepared by FISCO from the Japan CRO Association's Annual Report and CAC Croit's Fact Book



Source: prepared by FISCO from the Japan CRO Association's Annual Report and CAC Croit's Fact Book

(3) QualityLead can be highly evaluated as a model CSV-type business

Croit is aiming to connect the excess capacity it has created in its CRO operations through utilizing ICT to grow a business peripheral to CRO. Specifically, it is working on and achieving results for the business in which Croit consolidates, manages, and creates a database of the drug discovery and research compounds and information that the pharmaceutical companies individually own and manage (compound and solutions management operation, compound library-sharing program; below QualityLead). On entering 2019, Mitsubishi Tanabe Pharma Corporation <4508> (January) and Shionogi & Co., Ltd. <4507> (February) announced their participation. Moreover, it seems its use by several other companies has also been decided, so it can be expected to contribute annual sales in the range of ¥0.3bn to ¥0.5bn in the future.

A feature of QualityLead we should pay attention to is the fact that it is a typical example of CSV (Creating Shared Value; social contribution through its business), which the Company's Group emphasizes. The effects expected from sharing the use of the database with organizations like pharmaceutical companies, academia, and bio-ventures are greatly reducing the time period and costs for new drug development and increasing drug discovery opportunities. With the arrival of the aging society in Japan, it can be said that improving the efficiency of drug development, which will contribute directly to keeping down the rising medical expenses, is precisely a CSV type of business.

Croit has also started working on utilizing real world data. Real world data refers to data as a whole that is based on actual medical practices. It includes medical fee receipts data and DPC data (various types of data related to medical expenses in hospital wards), electronic medical records data, and medical examination data. If real world data can be prepared and utilized as a database, it will clarify aspects such as the efficacy and safety of pharmaceuticals in actual medical treatment and costs versus benefits, which will make it possible to improve the quality and efficiency of medical-treatment services. The launch of a business relating to real world data can naturally be said to be a model ICT-utilization and CSV-type business, and we shall be paying attention to developments in the future from measures typical of Croit.

Results trends

In addition to improving the domestic IT business, is taking on the challenge of securing the profitability of the overseas IT business

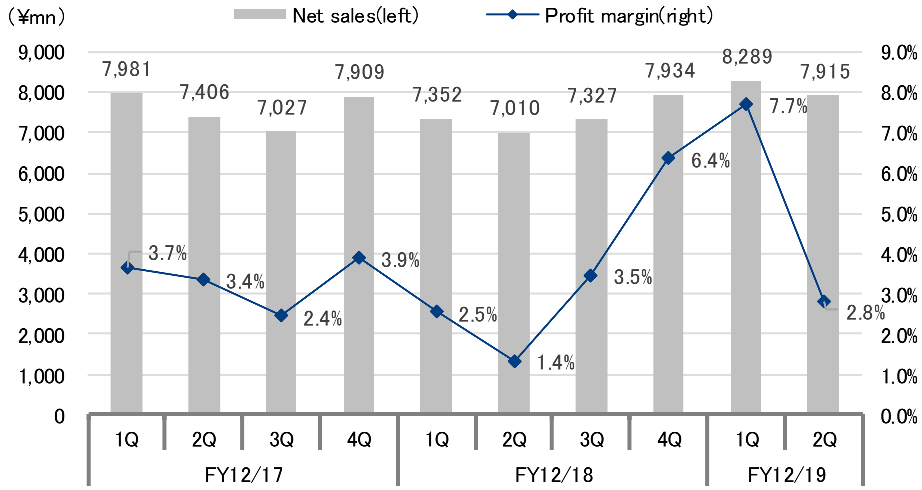
1. Continues to take on challenges of improving the domestic IT business and securing the profitability of the overseas IT business

In FY12/18, which was the first fiscal year of the medium-term strategy currently being implemented, net sales decreased 6.3% year-on-year (YoY) to ¥49,906mn and operating income increased 104.3% ¥1,426mn. The initial forecasts, of net sales of ¥54,000mn (up 1.4% YoY) and operating income of ¥1,600mn (up 129.1%), were not achieved, but the Company still realized a major increase in profits despite lower sales from measures to eliminate unprofitable projects and to optimize costs.

From the quarterly trends by segment, such as in net sales and the profit margin, it can be read that each business is experiencing differing fortunes; namely, that 1) the domestic IT business is recovering, 2) it is the moment of truth for the overseas IT business, and 3) the CRO business is in an adjustment phase.

From FY2018 1H to FY2019 1H, the domestic IT business realized higher sales and profits YoYfor four consecutive quarters. Even the decline from 1Q to 1H of FY2019 was mainly due to seasonal factors and does not need to be viewed as a problem. In fact, at the end of the FY2019 1H, the order balance had steadily accumulated, rising 8.6% YoY, and it is considered to be in a recovery phase as it is benefiting from the strong IT demand from existing customers. In order to adjust each quarter for seasonal factors, looking at the trends in segment profit margin by the quarterly moving average (4qMA), we see that the low profitability, which had been a problem, is improving. Specifically, the segment profit margin from FY2018 1H to FY2019 1H (4qMA) continuously improved, from 2.6%→2.9%→3.5%→4.9%, and while it is not yet at a satisfactory level, the Company can be said to be steadily securing a foothold.

Trends in net sales and the profit margin in the Domestic IT business

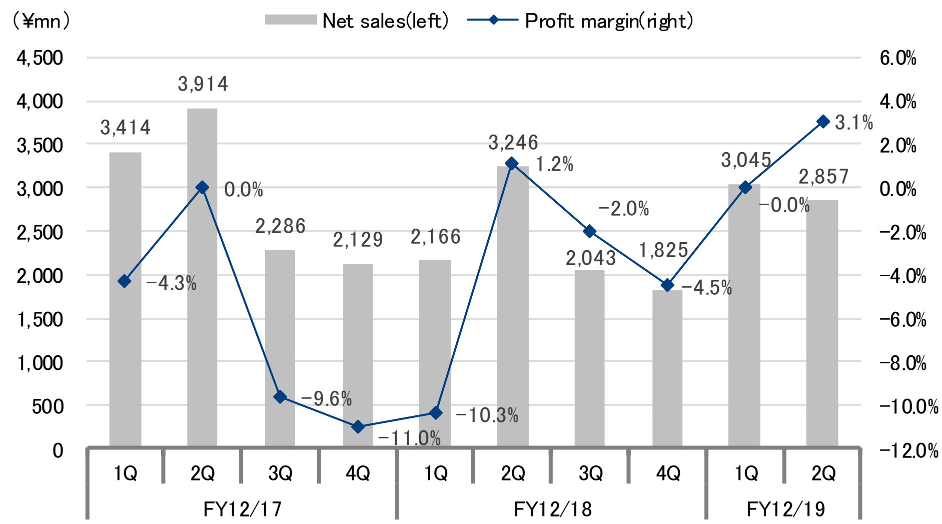


Source: Prepared by FISCO from the securities report and the Company's financial results

In the overseas IT business, net sales were pushed-up by the effects of the series of acquisitions. But due to the recording of structural reforms costs for the business of Inspirisys Solutions Limited (formerly AFL) and Sierra's large-scale unprofitable projects, segment profit up to FY2018 1Q trended basically unchanged. However, in December 2017, the current phase of the reconstruction of the overseas IT business was completed, including by transferring all the shares held in Sierra, and since FY2018 1Q, which is when it became possible to calculate YoY comparisons, we see that although sales have declined YoY, mainly due to the effects of the company transfer, segment profit has continuously improved compared to in the previous fiscal year.

As a result, in FY2019 1H, the business was profitable for the first time in 4 quarters, and the segment profit margin also improved to 3.1%, But on looking back on the past 10 quarters, we see that the overseas IT business has not been profitable for 2 consecutive quarters. From FY2019 4Q, the effects of the acquisition of Mitrais in terms of pushing-up earnings (Mitrais' FY12/18 net sales were 22,461,000 Singapore dollars, net income was 2,931,000 Singapore dollars, and amortization of goodwill is unknown) can be expected to contribute to results, although it will be very small.

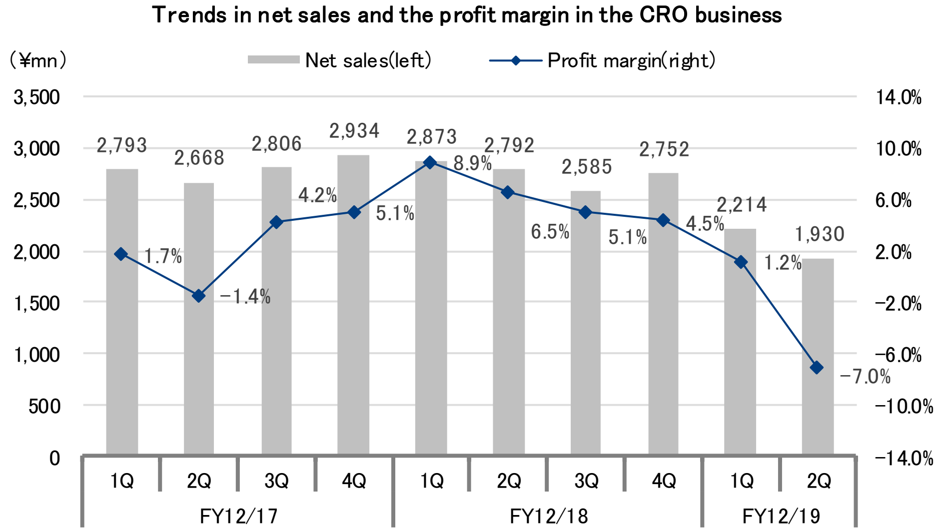
Trends in net sales and the profit margin of the Overseas IT business



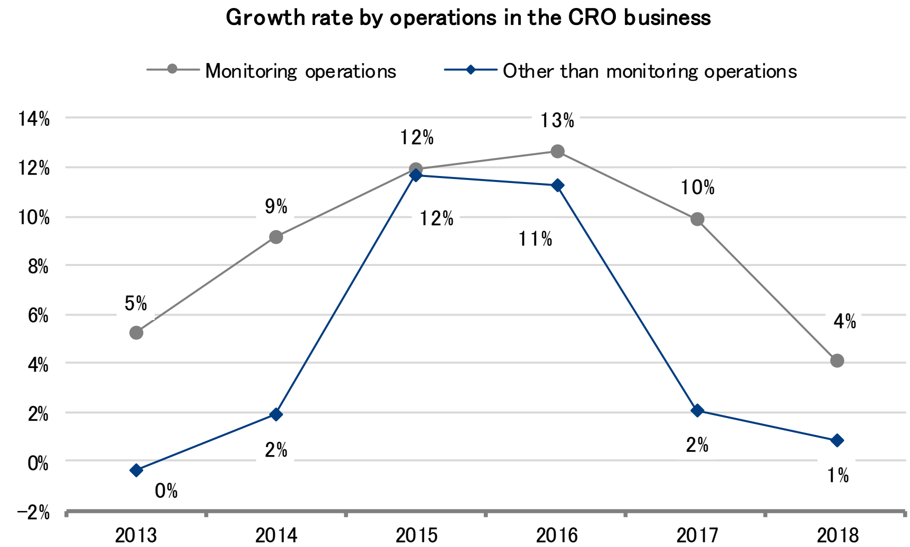
Source: Prepared by FISCO from the securities report and the Company's financial results

The CRO business has also realized a steady increase in scale, even while experiencing some temporary stoppages. But with the change in business environment by the offensive strategies of foreign companies that are highly responsive to global CRO operations, sales changed direction and have been trending downward YoY since FY12/18 3Q. Looking at segment profit also, since FY2018 4Q, profits have continued to decline YoY and in FY12/19 1H, the Company was forced to record a loss for the first time in eight quarters.

In addition to the changes in the business environment, it seems necessary to be aware that the main operations in the Company's CRO business are pharmacovigilance operations (the collection and accumulation of information on pharmaceuticals' side effects and their applications). When estimated based on the member data announced by the Japan CRO Association, it can be confirmed that the growth rate of monitoring operations (all members), for which the Company's percentage is low, is higher than the growth rate of operations other than monitoring operations (same), which includes pharmacovigilance operations. Also, even when limited only to operations other than monitoring operations, Croit's industry share is trending downward based on the calculations, and the current situation would seem to be an unpredictable one. In order to keep down volatility and improve productivity in the CRO business, the Company has reviewed the forms of contracts with pharmaceutical companies and worked to actively utilize ICT. But based on the current situation, it seems that improving profitability will require drastic cost reductions and other measures, and we await management's decisions on such drastic measures



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



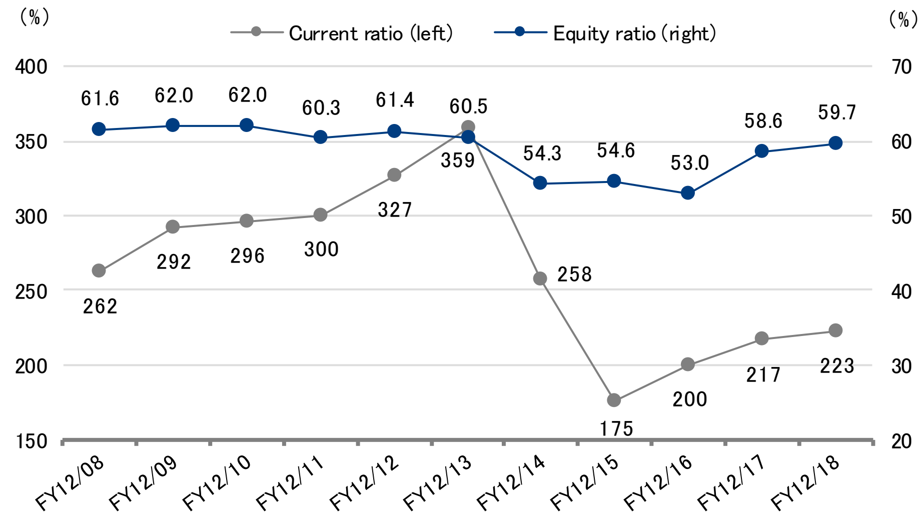
* Based on the sales of pharmaceutical development-related operations of all members
Source: Prepared by FISCO from the Japan CRO Association's Annual Report

2. Steered to a financial strategy that prioritizes capital efficiency through enhancing the financial base

Looking at the trends in the representative indicators of the stability of the financial structure, we see that each indicator improved further. Specifically, the equity ratio improved from 58.6% at the end of FY12/17 to 59.7% at the end of FY12/18, the current ratio improved from 216.6% at the end of FY12/17 to 222.7% at the end of FY12/18, and net cash (cash and deposits minus interest-bearing debt, plus shows cash in excess) improved from ¥3,611mn at the end of FY12/17 to ¥5,337mn at the end of FY12/18.

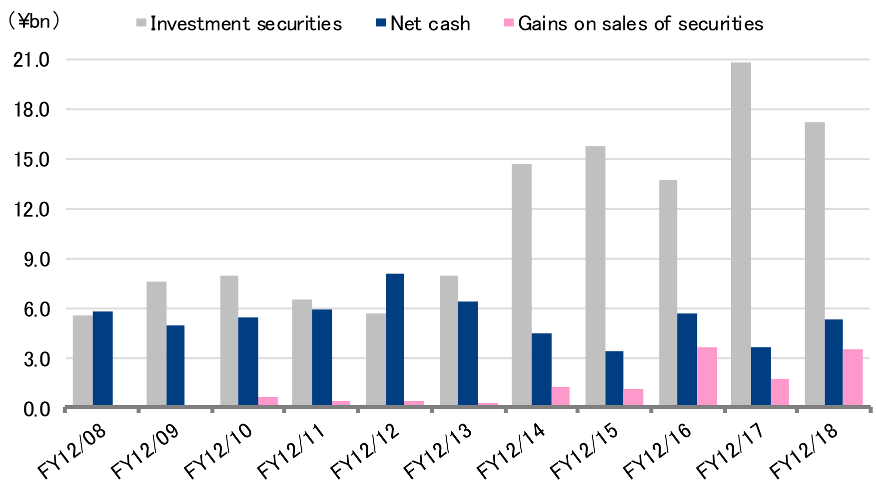
In the last few years, the Company has continuously sold its shares in Recruit Holdings Co., Ltd. (hereafter, Recruit), which has a low acquisition book value, and while enhancing its financial base, it has conducted M&A and business structural reforms. Even so, the Company still held 3,869,000 shares of Recruit (at the end of FY12/18, valuation, ¥10,301mn). But then in September 2019, from the viewpoint of improving capital efficiency, it decided to sell all at once 2,000,000 Recruit shares (total amount, ¥5,970mn; gain on sale, ¥5,291mn). It has set improving capital efficiency as the central pillar of the revised medium-term strategy, so in this situation, we can expect it to effectively utilize the enormous funds from this sale.

Trends in the indicators of financial stability



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

Changes in investment securities and net cash



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

Results trends

Simplified consolidated statements of income

(¥mn)

	FY12/15	FY12/16	FY12/17	FY12/18	FY12/19 E
Net sales	52,105	52,521	53,268	49,906	51,500
YoY	4.1%	0.8%	1.4%	-6.3%	3.2%
Cost of sales	42,315	42,041	42,996	39,425	-
YoY	5.9%	-0.6%	2.3%	-8.3%	-
Gross profit	9,790	10,479	10,272	10,481	-
YoY	-2.8%	7.0%	-2.0%	2.0%	-
SG&A expenses	8,581	9,277	9,573	9,054	-
YoY	24.8%	8.1%	3.2%	-5.4%	-
Operating income	1,209	1,202	698	1,426	1,500
YoY	-62.1%	-0.6%	-41.9%	104.3%	5.1%
Ordinary profit	1,080	937	717	1,368	1,400
YoY	-64.0%	-13.2%	-23.4%	90.6%	2.3%
Profit attributable to owners of parent	-142	2,039	1,100	1,319	1,700
YoY	-	-	-46.0%	19.9%	28.8%

Note: The FY12/19 forecasts are the revised results forecasts announced on November 8, 2019
Source: Prepared by FISCO from the securities report and the Company's financial results

Simplified consolidated balance sheet

(¥mn)

	FY12/15	FY12/16	FY12/17	FY12/18	Change
Current assets	25,300	26,468	24,084	23,963	-121
Cash and deposits	8,983	11,428	8,551	9,387	836
Notes and accounts receivable - trade	12,081	10,318	10,440	8,605	-1,835
Non-current assets	26,483	23,876	30,041	23,005	-7,036
Property, plant and equipment	1,883	1,731	1,392	1,228	-164
Intangible assets	5,315	4,736	3,871	1,577	-2,294
Investments and other assets	19,284	17,408	24,777	20,199	-4,578
Total assets	51,783	50,344	54,125	46,968	-7,157
Current liabilities	14,434	13,218	11,120	10,760	-360
Notes and accounts payable - trade	3,907	3,324	3,431	2,928	-503
Short-term loans payable, bonds payable	5,070	3,382	2,856	2,034	-822
Non-current liabilities	8,055	9,442	10,576	7,350	-3,226
Bonds payable, convertible bonds	0	0	0	0	0
Long-term loans payable	463	2,373	2,084	2,016	-68
Total liabilities	51,783	50,344	54,125	18,111	-36,014
(Interest-bearing debt)	5,533	5,755	4,940	4,050	-890
Total net assets	29,293	27,683	32,429	28,857	-3,572

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

3. Downwardly revised the FY12/19 results forecasts with the recording of business structural reforms costs, and aiming to improve profitability from the next fiscal period onwards

In the FY12/19 3Q consolidated results (hereafter, 3Q results), net sales increased 1.2% YoY to ¥37,827mn, operating income rose 17.9% to ¥1,039mn, and ordinary income grew 19.1% to ¥966mn. Also, profit attributable to owners of parent increased 744.6% to ¥3,954mn due to the recording of gain on sale of Recruit shares of ¥5,291mn in extraordinary income. At the same time as it announced the 3Q results, the Company downwardly revised some of the full fiscal year results forecasts from the initial forecasts (net sales of ¥52,000mn→¥51,500mn, operating income of ¥2,000mn→¥1,500mn, and profit attributable to owners of parent of ¥1,350mn→¥1,700mn). The main reasons for the downward revisions were the slump in the CRO business, the changes in the Indian subsidiary in the overseas IT business, and the recording of M&A-related costs. It also expects to record business structural reforms costs (approximately ¥2.7bn) in 4Q as an extraordinary loss. In terms of the specific measures aimed at improving profitability from the next fiscal period onwards, the outlook is that it will implement measures including the disposal of unprofitable businesses in the domestic IT business and the CRO business and a review some assets held. For the period-end dividend, it has left unchanged the initial forecast of ¥25 per share and plans to increase the dividend for the second consecutive period to an annual dividend, including the interim dividend, of ¥50 per share (FY12/17: ¥36 per share→FY12/18: ¥38 per share).

Looking at the indicators of financial stability at the end of September 2019, the equity ratio was 58.6% and the current ratio was 241.1%, and both are being maintained at sound levels.

Financial results forecast

(¥mn)

	Net sales		Operating income		Ordinary income		Profit attributable to owners of parent		EPS
		YoY		YoY		YoY		YoY	
FY12/18	49,906	-6.3%	1,426	104.3%	1,368	90.6%	1,319	19.9%	71.57
FY12/19 E	51,500	3.2%	1,500	5.1%	1,400	2.3%	1,700	28.8%	95.96
FY12/19 1H	37,827	1.2%	1,039	17.9%	966	19.1%	3,954	744.6%	221.16

Note: The FY12/19 forecasts are the revised results forecasts announced on November 8, 2019
Source: Prepared by FISCO from the Company's financial results

Strengths and issues

Greatest strength is its “transformational power”

1. Strengths are its “corporate culture,” “customer base,” and “financial structure” that support its “transformational power”

What is apparent on considering the Company's history, business description, and results trends, is that its greatest strength is its "transformational power," which is its ability to transform itself (corporate reforms) according to societal needs and issues that change with the times.

It is not content with growing as an independent, specialist software company, and recently it has evolved to become an IT and healthcare services company, while interweaving “business structural reforms through selection and concentration” with “business expansion through M&A.” The aspects supporting this “transformational power” are “a corporate culture of positively taking on challenges (management’s intention),” “an excellent customer base as the core of business expansion,” and “a solid financial structure that makes possible a flexible financial strategy.”

Naturally, “taking on challenges” is a method, and we estimate that it is precisely because the Company has a clear mission and purpose (a management philosophy), of being “customer oriented and emphasizing CSV,” that a corporate culture has taken root within it that is based on “taking on challenges” that is necessary to achieve its goals. Also, the fact that the Company launched an overseas IT business in advance of its industry peers and developed the CRO business to be one of its two pillars of earnings can be said to be a benefit of the good relations with its “excellent customer base” that it has built as Japan’s first independent SIer. In other words, its “excellent customer base” creates the seeds for “taking on challenges.”

It is the Company’s “solid financial structure” that supports its M&A strategy, rapid business structural reforms, and stable returns to shareholders. The reason why it has held a large amount of Recruit shares up to the present time is likely because Recruit is an important business partner, but the Company also has a track record of selling its Recruit shares as necessary. On this point also, the Company benefits from its good relationships with customers.

2. An issue is how to improve profitability

When it initially formulated the medium-term strategy Determination 21, the issues facing the Company were 1) continuously creating business profits, 2) strengthening Group governance, and 3) responding to DX. Also, in 2018, Mr. Tokihiko Mori, who has been appointed as the Company’s outside director, stated that “I think that greater preparations are necessary for discussing M&A and business investment projects,” “I think increasing the operating margin is the important first step toward enhancing corporate value,” and “I would like to encourage reforms that increase the motivation to enhance shareholder value through offensive governance.” In this context, we shall be paying attention to the progress made for the basic policies in the revised medium-term strategy, the first of which is strengthening governance.

Business outlook

Expectations for the results of the revised medium-term strategy

Following in-depth discussions in the Board of Directors, the Company revised the medium-term strategy Determination 21, which has FY12/18 as its first fiscal year, and it re-published it in February 2019. It had already begun implementing several of its measures prior to its publication, which suggests how serious the Company is about this strategy.

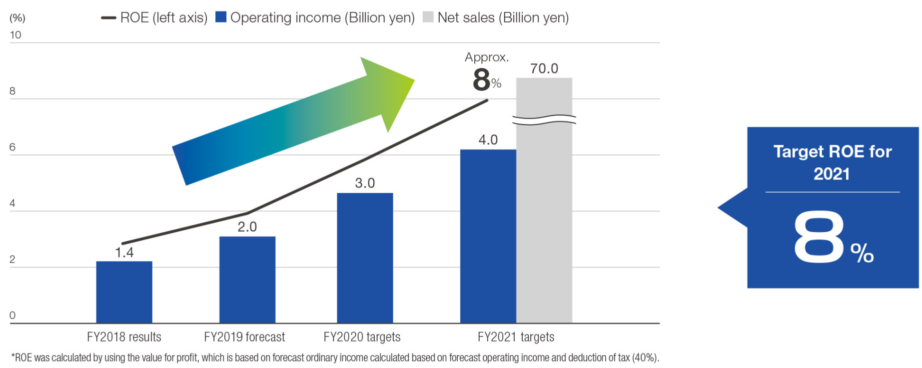
As a result of a review alongside the changes to the management environment and the clarification of strategy, the basic polices in the revised medium-term strategy are 1) Strengthening governance by separating management and execution, 2) Mobile implementation of business with prompt decision-making, 3) Improvement of capital efficiency and strengthening of return to shareholders, and 4) Promotion of value sharing with shareholders. Also, while it has left unchanged the numerical targets for the final fiscal year (FY12/21), of net sales of ¥70bn and operating income of ¥4bn, it has newly added ROE of 8% as an indicator toward capital efficiency.

The Company is already implementing a number of measures in accordance with the four basic policies. First, for 1), in FY2019 it reduced the number of directors from eight (of who, three were outside directors) to five (unchanged), thereby changing to a Board of Directors' system in which the outside directors are in the majority for the monitoring of decision making for policies and strategy and for the execution of operations. At the same time, it appointed five executive officers to focus on the execution of operations in accordance with the Board of Directors' policies. For 2), from the start of FY2019, 5 executive officers have been working on the mobile execution of business in the five business domains (Core ICT Domain, China Domain, India Domain, Healthcare Domain, and Future Domain) for which they are respectively responsible.

Also, for 3), while aiming for sustainable profit growth, the Company is increasing the dividend (FY12/18 result, ¥38 per share→FY12/19 forecast, ¥50 per share) and strengthening its acquisition of treasury shares (the upper limit for acquisitions up to December 2019 is 3 million shares or ¥3bn, and by September 30, it had already acquired 931,600 shares with a value of more than ¥1.4bn). For 4), it has introduced a transfer-restricted share-based remuneration plan and is more actively conducting IR activities.

Then in September 2019, the Company made the major decisions of restarting overseas M&A through the acquisition of Mitrais and selling a large volume of Recruit shares. The Board of Directors, while monitoring multiple KPI (Key Performance Indicators), will make decisions and conduct supervision, and also hold in-depth discussions. We shall be paying close attention to whether or not the expectation is met, that decision-making and the implementation of operations based on the new system will lead to improved profitability.

Numerical targets under its medium-term strategy



Source: Company's annual report

ESG

The idea of improving non-financial value can be read from its support of Boccia

The Company, whose main business pillars are IT and healthcare, is a typical CSV (Creating Shared Value; social contribution through its business) corporate group that solves the problems facing society through its main businesses. Since 2016, it has been continuously conducting activities to spread participation in and to support Boccia, which is a sport for people with disabilities. In our interview with the Company, we became aware that its passion for Bocca is greater than we had anticipated.

The Company started these activities from the opportunity provided by the 50th anniversary of its foundation, but why did it choose Boccia? In advance of the Tokyo Olympics and Paralympics in 2020, there seems no doubt that the Company's support for Boccia reflects the voices heard in society and that its aim is to improve its name recognition. However, it does not simply provide financial support, as it also advocates activities with the emphasis on its own employees conducting the planning and implementation.

Boccia, which was proposed for people with disabilities, is spreading throughout the world (it was officially adopted into the Paralympics in 1988), and it is a sport requiring strategy that can be enjoyed by all, regardless of whether with or without a disability, young or old, men or women, and in the East or West. From this feature, the Company has not only adopted an in-house Boccia curriculum for new employee training and Company-wide training, it made it possible to provide employee's families and others with opportunities to experience Boccia. Today, practically every Group employee has experienced Boccia, and in tournaments and other events, from 20 to 40 employees will rush to provide management support, while 9 of its employees are included in the list of names of registered judges of the Japan Boccia Association, which is not a simple qualification to acquire.

The Company's measures for Boccia go beyond the framework of spreading participation and support, and they are contributing to communication between Group employees and to improving their awareness about social contribution. In advance of the Tokyo Olympics and Paralympics in 2020, it is natural that the Company's support for Boccia reflects the voices in society, by continuously communicating the appeal of Boccia both inside and outside of the Group the appeal of Boccia that has a rich presence based on their actual experience from the exchanges with people with disabilities initiated on its own volition, a project that is still small at the present time has the potential to grow to be something more larger. Therefore, it is considered that the reason the Company selected Boccia as a measure for the 50th anniversary of its foundation is its idea of improving non-financial value, which it calls "invisible assets."

The Third CAC Cup, a Boccia Interchanges Student Tournament

Source: Company's news letter

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