Startia

3393 TSE Mothers

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Company Research and Analysis Report
FISCO Ltd.
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■Likely to increase earnings growth

Startia provides total Internet services to small and medium-sized companies. The company has grown by expanding into different businesses from which it extracted synergy. Its main business now is the rental and sale of network equipment, but it also sells communication terminals, such as traditional business telephones, and software for the production of electronic books (e-books).

In the first half of the fiscal year through March 2014, i.e., in H1 FY3/14, Startia reported a 19.2% year-on-year (y-o-y) rise in consolidated sales, but a 13.9% y-o-y decline in operating profit, a 14.6% fall in recurring profit, and a 13.4% drop in net profit. The profit declines had been projected by the company because it is investing heavily in future growth this fiscal year. For instance, it is expanding its operations in Asia, and it hired 87 recent college graduates this year. In fact, the sales reported for H1 FY3/14 exceeded the company’s forecast by 1.7%, while operating, recurring and net profits surpassed the company’s forecasts by 49.0%, 51.5%, and 83.1%, respectively, reflecting strong performance by the business solutions division and the network solutions division.

For FY3/14, the company retained its original forecasts, projecting a 22.9% y-o-y rise in consolidated sales to ¥8,160mn, a 22% rise in operating profit to ¥800mn, a 22.1% increase in recurring profit to ¥800mn, and a 2.3% upturn in net profit to ¥400mn. Given the company’s outperformance, relative to its forecasts in H1, its full-year forecast appear somewhat conservative.

In FY3/09, the company completely overhauled its business domains, allowing it to concentrate on forward-looking policies for growth. Since FY3/11, the company has achieved successive years of sales and profit growth. It is now building up a base of employees that will allow it to develop new businesses successfully, with the expectation that it will be able to offset its rising personnel costs and expand its business domain sequentially.

■Check Points

- Company exceeded its forecasts in H1 FY3/14 due to effective cost control
- Current investments expected to accelerate profit growth from FY3/17
- Company plans to increase its dividend to reflect profit growth and special occasions

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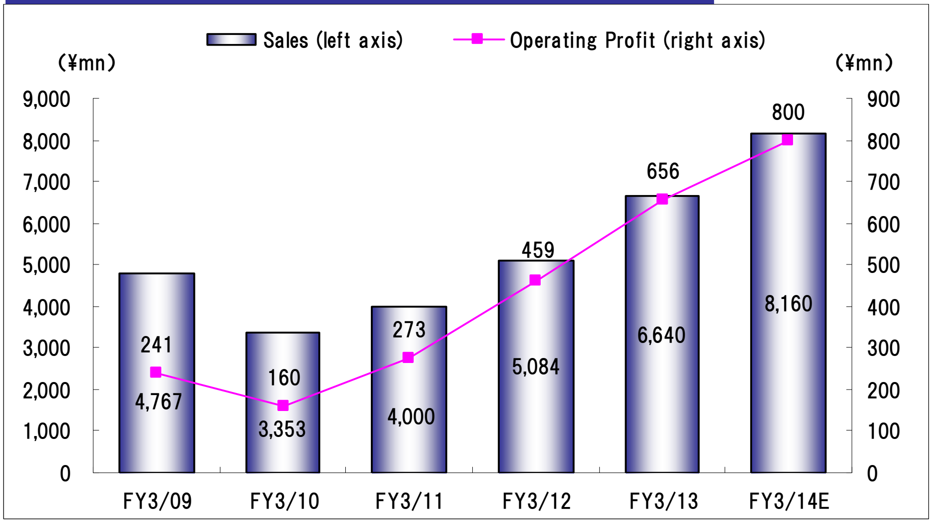
Consolidated Sales and Operating Profit (¥mn), FY3/09 - FY3/14E



Company Description

Three divisions provide total IT environment for Internet services

○ Business Summary

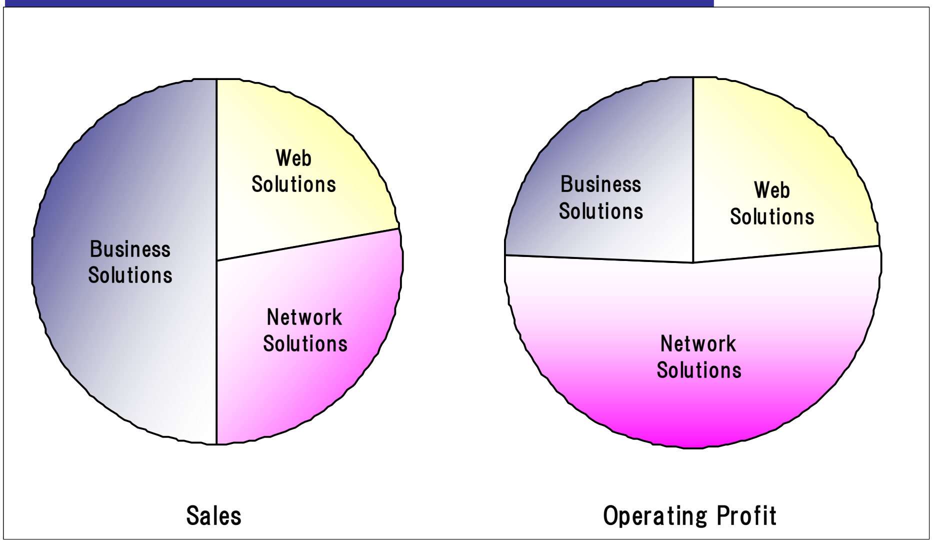
Startia's mission is to eliminate the information gap, or digital divide, among companies, thereby helping them to become dynamic organizations. Toward this end, it provides total IT environments to smaller companies, those with fewer than 300 employees.

In FY3/09, Startia reorganized its businesses into three divisions. The business solutions division provides equipment and services for Internet terminals. The network solutions division provides equipment and services for Internet use. The web solutions division supplies software and services for Internet use.

Originally, Startia provided only business solutions. Thus, even in FY3/13, the business solutions division supplied 50% of the company's total sales, while the network solutions business accounted for 28% and the web solutions division for 22%. However, the network solutions division contributed 52% of the company's total operating profit that year.

■Company Description

Divisional Contributions to Total Sales and Operating Profit in FY3/13



○ Company History

In 1996, current company president Hideyuki Hongo established the limited company Telecomnet in Tokorozawa City, Saitama Prefecture, to sell business telephones. Subsequently, the company expanded into Internet businesses, such as hosting service (renting servers). In 2004, the company changed its name to Startia, and in 2005, the company listed its shares on the Mothers market of the Tokyo Stock Exchange. In 2009, Startia sold its staffing company and reorganized its remaining businesses. Since then, the company has concentrated on developing software for the production of e-books and on other new services. The company increased its sales and profits in FY3/11 - FY3/13 and foresees further growth of both in FY3/14, the final year of its current medium-term plan.

Company History

February	1996	Limited company Telecomnet established in Tokorozawa City, Saitama Prefecture
October	1996	Company’ s name is changed to ND Telecom Inc.
January	2000	Company starts operating the Digit@Link Rental Server hosting service
February	2004	Company's name is changed to Startia, Inc.
December	2005	Company’ s shares are listed on the Mothers market of the Tokyo Stock Exchange
July	2007	Company starts offering the Managed Gate network equipment rental service
October	2007	Company acquires multi-function printer (MFP) and print counter businesses from Arest, Inc.
April	2009	Company establishes consolidated subsidiary Startia Lab, Inc. to create websites and to develop software to create e-books.
June	2009	Company underwrites an allocation of shares from MAC Office, Inc., which becomes an equity method affiliate.
October	2011	Company establishes STARTIASOFT INC. as a joint venture with Xi’ an Shiwei Software Co., Ltd. (China) and as an equity method affiliate.
January	2012	Company underwrites an allocation of shares from Urban Plan Co., Ltd., which becomes an equity method affiliate.
January	2013	Company establishes subsidiary Startia Shanghai Inc.
June	2013	Company takes an equity stake in Horma Service Co., Ltd., of Taiwan.

■Description of Divisions

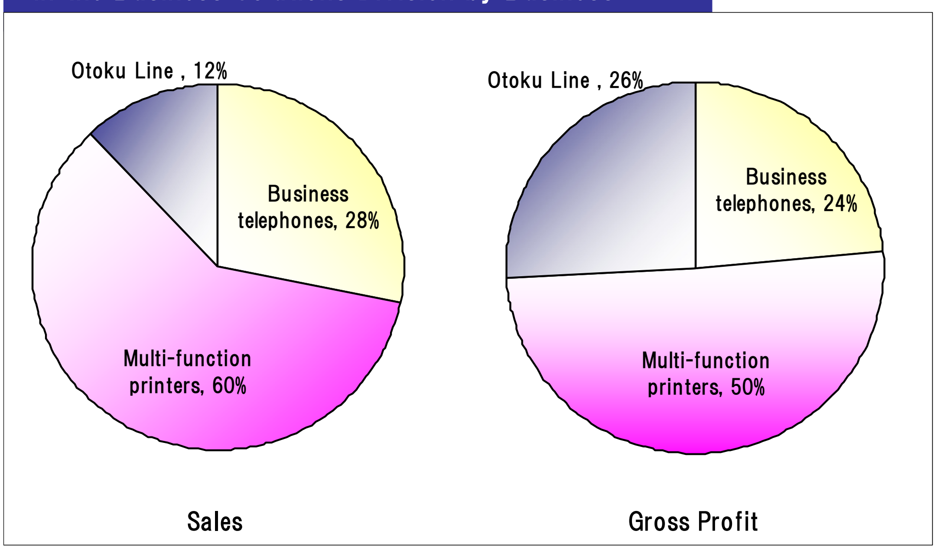
Multi-function printers and Otoku Line telephone service underpin profit

(1) Business Solutions

The business solutions division, the company's original operation, engages in three businesses: the sale of business telephones, the sale of multi-function printers (MFPs), and the sale of the Otoku Line telephone service offered through copper circuits by Softbank Corp. (9984). In H1 FY3/14, business telephones provided 28% of total sales in the division, multi-function printers supplied 60%, and the Otoku Line telephone service accounted for 13%.

In H1 FY3/14, the business solutions division earned a gross profit margin of 45.5%. Business telephones provided 28% of the division's gross profit, multi-function printers provided 50%, and the Otoku Line telephone service supplied 26%. Obviously, sales of the Otoku Line telephone service afford a higher gross profit margin than the other two businesses. However, after deducting selling and administrative costs, the operating profit margins for these three businesses are probably similar.

Breakdown of H1 FY3/14 Sales and Gross Profit in the Business Solutions Division by Business



The Japanese market for business telephones is mature, and many competing suppliers of these telephones have withdrawn from the business, allowing Startia to reap a "profit of remaining players". Business telephones are rather routine products, but they are vital for business activity. Furthermore, as many former suppliers of business telephones have left the industry, Startia is able to provide telephone maintenance service for a growing number of companies.

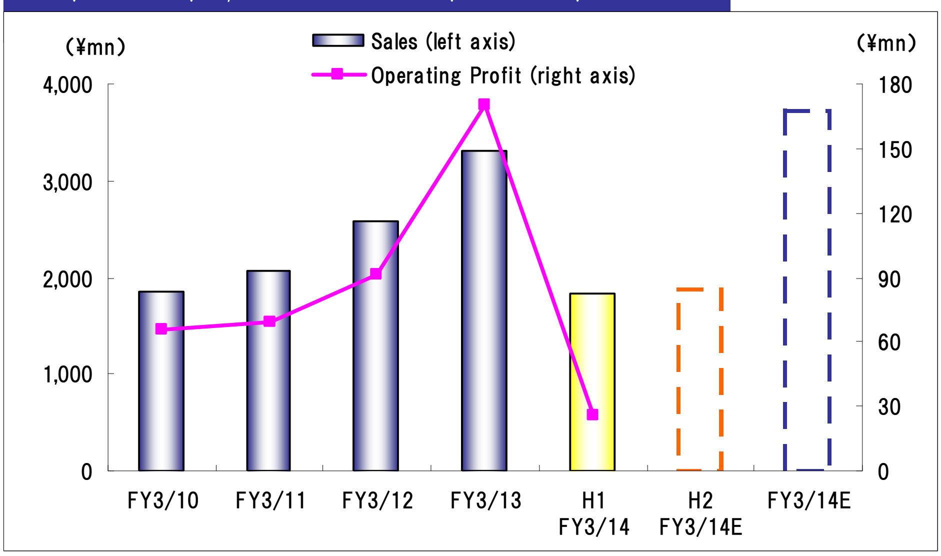
■Description of Divisions

Multi-function printers enable the printing of documents produced on personal computers, the copying of printed material, and the transmission and receipt of facsimile messages. Thus, they are also indispensable for most offices and need to be replaced at regular intervals. Startia receives revenue when it sells a multi-function printer and it receives a charge for each print made, the number of prints being recorded by a counter device. In return for the print charge, the company supplies toner and repair service without charge.

Startia is a sales agent for Softbank’s Otoku Line, which is a metal circuit service. Metal telephone circuits are being replaced by fiber-optic glass circuits, but metal circuits are cheaper, so they are still in demand. In addition, the sale of this service gives the company an opportunity to sell other services to its customers. Startia considers cross-selling one of its strengths. Startia receives the fees paid for this service and incorporates the billing for this service into its single Slim Billing format, which benefits both the company and the customer.

Although the businesses pursued in the business solutions division are not flashy, they provide steady increases in sales and profit. Thus, this division is to the company as a veteran number seven batter is to a baseball team. Although the batter may be past his prime, he has a high batting average and can still run fairly fast, so he can contribute to victory.

Sales and Operating Profit (¥mn) in the Business Solutions Division, FY3/10-H1 FY3/14, Forecasts for H2 FY3/14 and FY3/14



■Description of Divisions

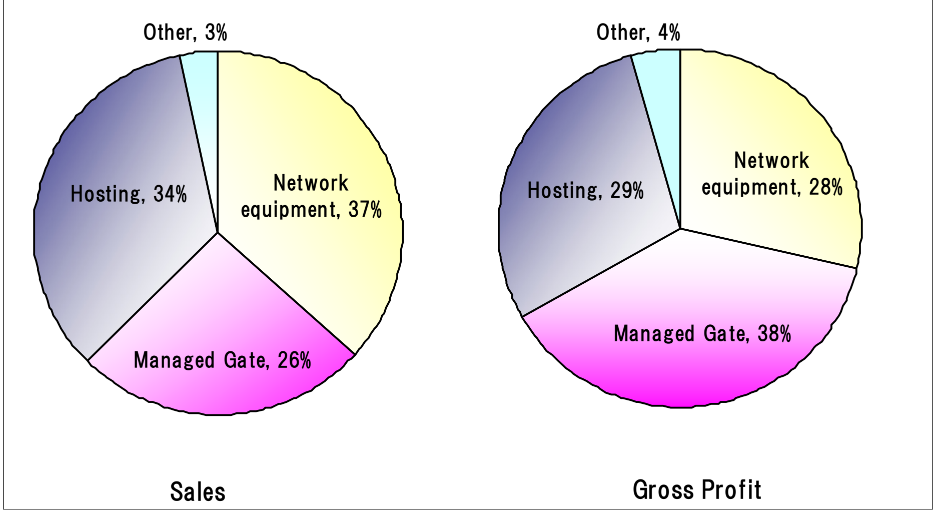
Management Gate network equipment rental service is growing

(2) Network Solutions

The network solutions division engages in four businesses: the sale of network equipment, the Managed Gate network equipment rental service, hosting service, and other services. In H1 FY3/14, the sale of network equipment provided 37% of total division sales, the Managed Gate network equipment rental service provided 26%, the hosting service supplied 34%, and other services accounted for 3%.

In H1 FY3/14, the network solutions division earned a gross profit margin of 46%. Network equipment sales provided 29% of total gross profit, the Managed Gate network equipment rental service provided 38%, the hosting service supplied 29%, and other services accounted for 4%. Thus, the Managed Gate network equipment rental service was slightly more profitable than the other businesses, but in general, the profit distribution mirrors the sales distribution.

Breakdown of H1 FY3/14 Sales and Gross Profit in the Network Solutions Division by Business



The network equipment sales business sells such equipment as routers and firewalls to corporate customers. As mentioned above, this business now provides the largest proportion of sales among the businesses in the division. However, demand is growing faster for the Managed Gate network equipment rental service.

The Managed Gate network equipment rental service also provides maintenance service for the equipment it rents. Thus, customers can use the network equipment with confidence and without a large initial cost. Startia receives rental revenue and profit on a regular monthly basis, helping to smooth out the seasonality of other business revenues and profit.

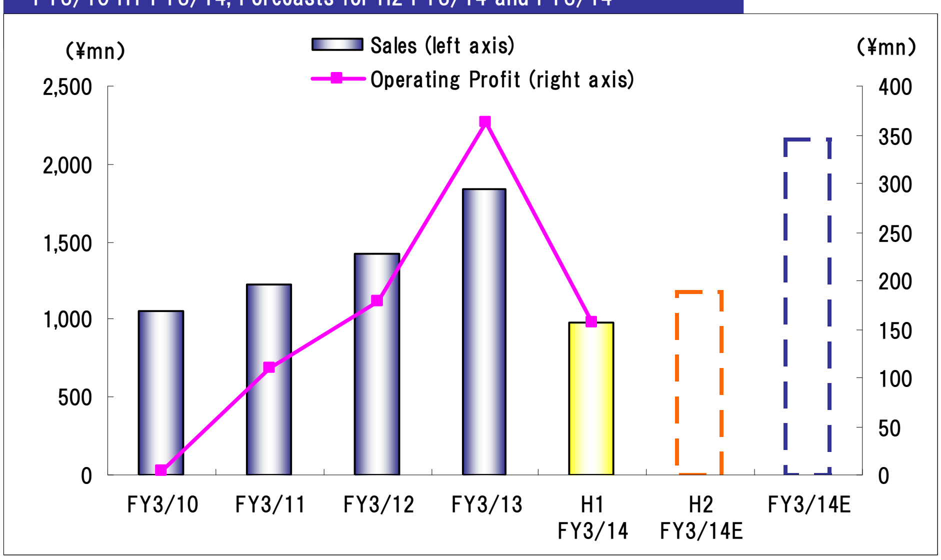
■Description of Divisions

Hosting service is renting servers. The company provides a wide range of hosting services, but the Secure SAMBA service is now in great demand. This is a cloud computing file server that allows users to drag and drop files into their desktop personal computers, then stores files in an Internet server. Company employees can jointly use files just like they could using an in-house server. The Secure SAMBA hosting service is a software-as-a-service (SaaS) service based on software developed by Startia. Thus, it offers a convenient balance between cost and capacity. The service is very secure and stable, so it helps companies to plan for business continuity in the event of an emergency.

Among other services, the Netless Q service providing support during Internet emergencies is expected to grow rapidly. This service is priced at only ¥4,000-5,000 per month, so it does not contribute significantly to sales and profit, but it has two advantages. First, it is easy to bundle with the company's other goods and services. For example, when a Startia employee goes to a client's office to repair a piece of equipment, the employee can offer the Netless Q service as part of the solution. Second, providing the Netless Q service helps to educate Startia employees. To repair communications equipment requires advanced knowledge and capability in all aspects of information technology, including hardware, software, and network structure. When Startia sells a piece of network equipment, it promotes its Netless Q service. In the near future, this service may become a powerful sales support tool.

The goods and services provided by the network solutions division are very necessary for smaller companies with fewer than 300 employees, yet they may be the slowest to be acquired by these companies. Although smaller companies need these products as much a large companies, they lack the personnel and the budgets to buy them. Thus, they must rely on companies such as Startia to provide them. The network solutions division is already Startia's main source of profit, and many of the services provided by this division supply steady revenue and profit, offsetting the seasonality of revenue and profit in the other divisions.

Sales and Operating Profit (¥mn) in the Network Solutions Division, FY3/10-H1 FY3/14, Forecasts for H2 FY3/14 and FY3/14



■Description of Divisions

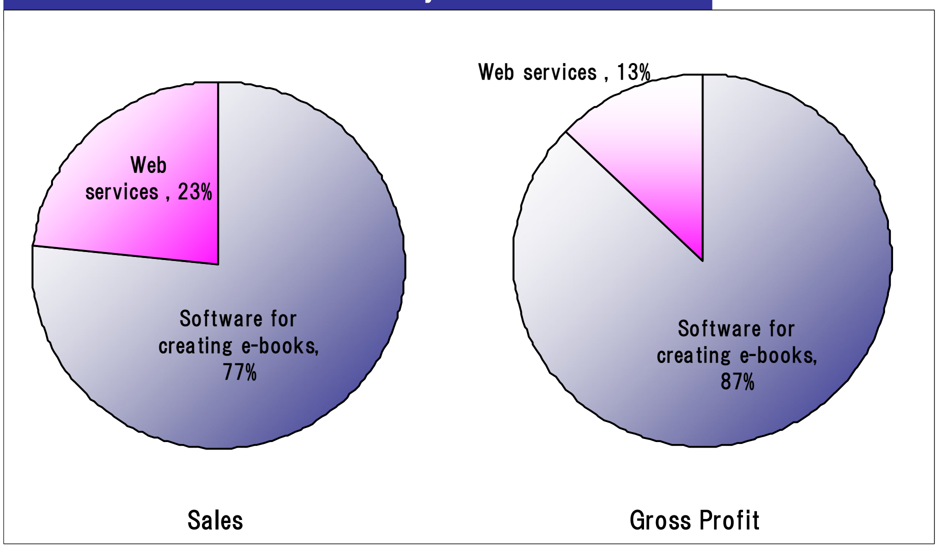
Gross profit ratio is 63.1%, the highest division ratio by far

(3) Web Solutions

The Web solutions division engages in two main businesses: the development of software to create e-books, and Web services. In H1 FY3/14, software to create e-books supplied 77% of the division's total sales, while Web services provided 23%.

In H1 FY3/14, the Web solutions division earned a gross profit ratio of 63.1%, higher than the gross profit ratios in the other two divisions. Software to create e-books contributed 87% of the division's gross profit, while Web services supplied 13%. Obviously, software to create e-books is very profitable.

Breakdown of H1 FY3/14 Sales and Gross Profit in the Web Solutions Division by Business



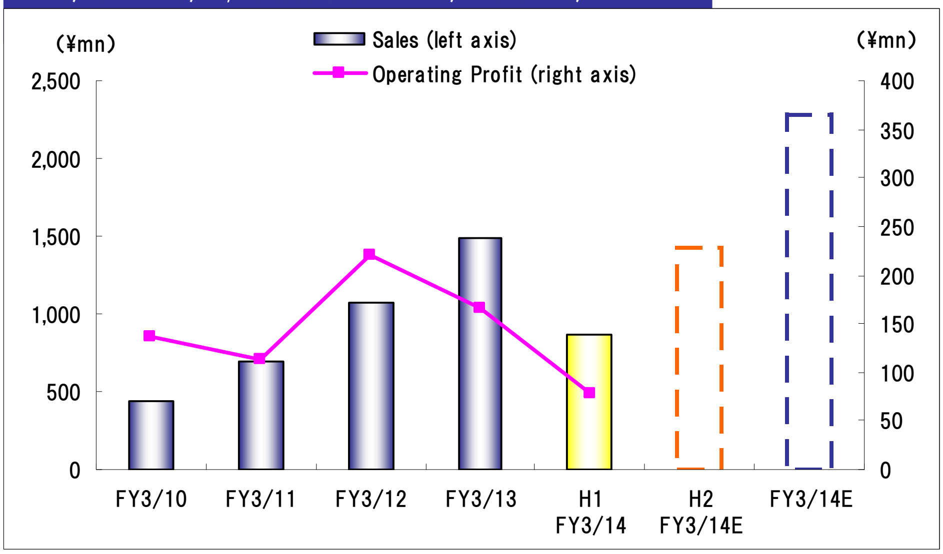
Startia started developing software to create e-books in 2005 by establishing the Internet media content group for this purpose. In August 2006, this group released its ActiBook software program, which sold well. In 2009, Startia spun off its Internet media content group to form subsidiary Startia Lab, Inc., which continued the business (see section below on Startia's Strengths for further detail on the development of software to create e-books).

The Web services business offers a wide range of services. For example, it produces and operates websites, plans and develops web applications, provides consultancy on ways to increase the number of accesses to the web, and offers log analysis, search engine optimization (SEO) and social media optimization (SMO) services to ActiBook users.

■Description of Divisions

The Web solutions division differs from the other two divisions in two important respects: 1) it registers attractive new products, and 2) it has operations overseas. It has recently registered its COCOAR service, which uses augmented reality (AR) technology but is low priced. The division now has two operations in China and one in Taiwan. Its first operation, STARTIASOFT INC., was established in 2011 as a joint venture Xi' an Shiwei Software Co., Ltd. (China). Startia holds a 30% stake in STARTIASOFT INC. The second operation, fully owned subsidiary Startia Shanghai Inc., was set up in January 2013, and in June 2013, Startia invested in Horma Service Co., Ltd., of Taiwan. Startia Shanghai sells network equipment and builds communication network infrastructure in Shanghai and sells the high-speed, highly secure Global Gateway in China and Japan. Startia invested in Horma Service Co. to promote sales of the ActiBook software program in Taiwan. Clearly, Startia has decided to expand its operations aggressively in Asia.

Sales and Operating Profit (¥mn) in the Web Solutions Division, FY3/10-H1 FY3/14, Forecasts for H2 FY3/14 and FY3/14



■Startia' s Strengths

Well Thought-out Sales Strategy Supports Pattern of Success

(1) Sales Strategy

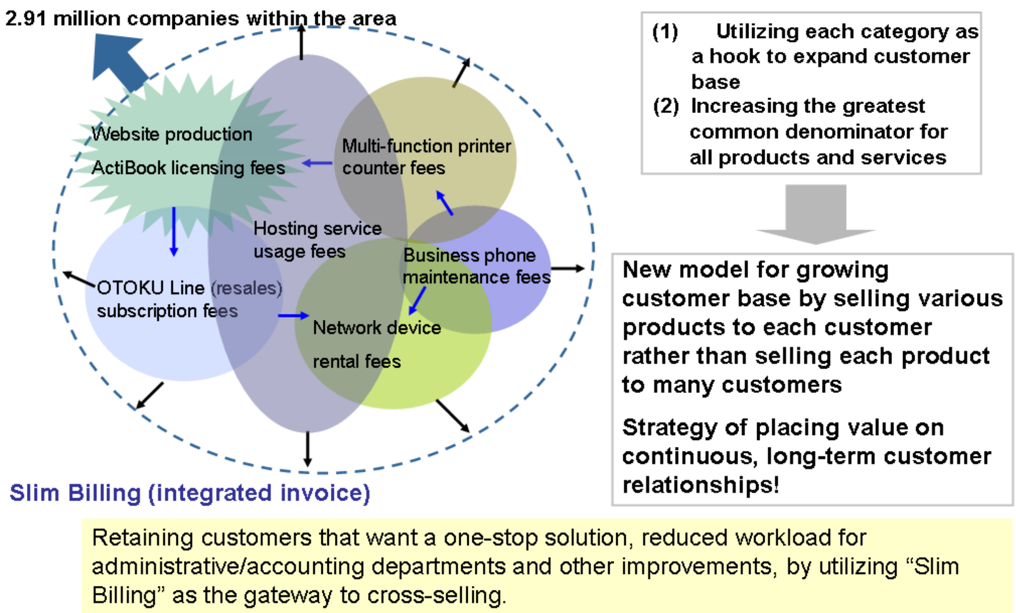
○ Cross Selling

Startia' s sales force is adept at cross-selling, i.e., at bundling goods and services onto a product which a customer has already bought. Its success in cross-selling reflects three factors. First, Startia' s product lines are conducive to such selling, in that all products are related to the Internet or to office networks. Second, cross-selling supports the company' s development of new goods and services that are easy to use, such as the Secure SAMBA hosting service and the Netless Q service. Third, Startia offers attractive services, such as its Slim Billing service, which encourages clients to purchase more than one good or service.

■Startia’ s Strengths

The Slim Billing service is also the avenue for customers to contact Startia. Few small companies have a large accounting department, and the accounting department of most small companies is near the office of the president. If Startia sales people convince the accounting department of a client company to buy a new good or service, the president of the client company is influenced to approve the purchase.

The Gateway to Cross-Selling



Source : Company

○ Limited Geographical Areas of Service

Startia only serves companies that can be reached within 1 - 1.5 hours of travel from one of its offices. This allows it to satisfy its clients. To try to serve companies further afield would risk losing customers to competitors. On the other hand, Startia could displace competitors serving dissatisfied customers within the company’ s areas of operation.

According to the Ministry of Internal Affairs and Communications, there are 5.43 million companies in Japan with fewer than 300 employees each. Startia currently limits its service to the 1.35 million small companies in Greater Tokyo, the 500,000 such companies in Greater Nagoya, the 740,000 such companies in Greater Osaka, and the 330,000 such companies in Greater Fukuoka. As the company hires and trains more employees, it plans to serve other urban areas in Japan.

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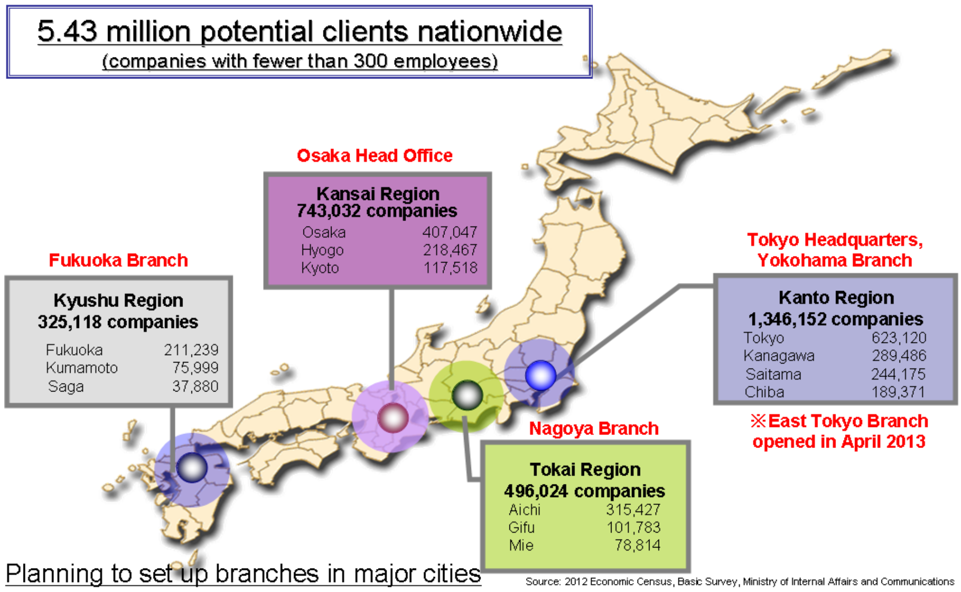
■Startia’ s Strengths

Locations and Targeting Business Sites



Source : Company

Possesses goods and services that support medium-term growth

(2) Promising goods and services

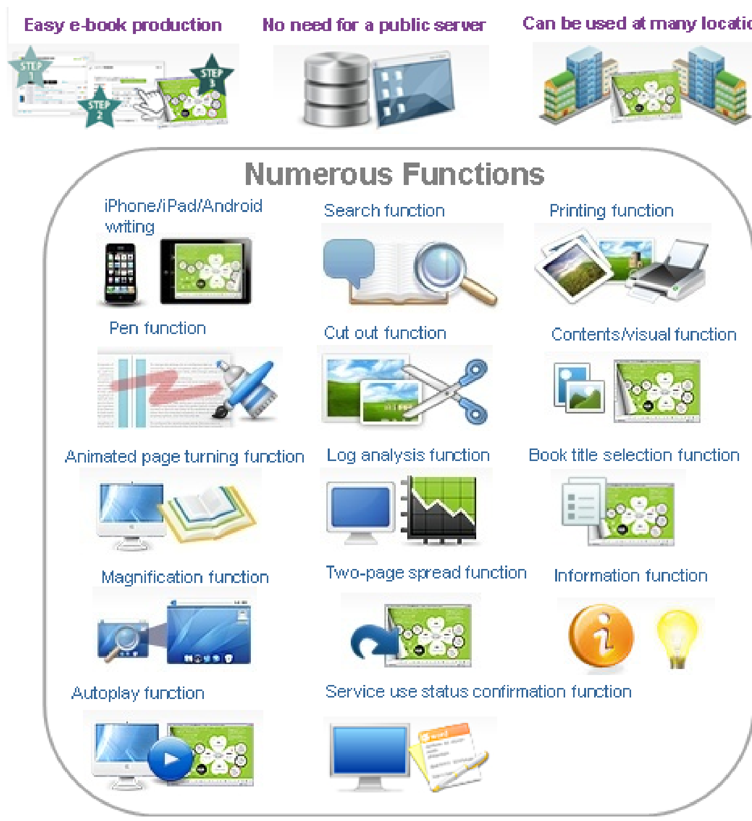
○ Software for the creation of e-books

The ActiBook software program for creating e-books that the company commercialized in 2006 has sold so well that it has become the industry standard for such programs. Recently, the number of users of smartphones or dedicated terminals to create novels and comic books has increased. However, the ActiBook program is not used to create novels and comic books. Instead, it is used to create corporate pamphlets, catalogs, and investor relations materials, such as periodic financial statements. In other words, the ActiBook program is targeted to companies, and the corporate market for the program is huge.

PDF files compete with the files created using the ActiBook program, but the ActiBook program is superior to PDF files in several respects. Probably the greatest advantage of the ActiBook program over PDF files is the ability of the program to provide log analysis. This capability records and analyzes information such as the page numbers of an electronic catalog read by customers and the length of time spent on each page. The issuer of the catalog can then rearrange the page order of the catalog to make it more effective and target customers more efficiently. Log analysis enables the analysis of sales presentations and the attendance at such presentations. It also facilitates the creation of automatic sales reports, supporting the efficient use of a sales person’ s time. PDF files do not provide this capability. Many schools now use electronic textbooks. They will probably also be interested in the ActiBook program, given its log analysis capability.

■Startia’ s Strengths

SaaS e-Book Production Tool



Source：Company

Startia estimates that at least 1,000 Japanese companies use its ActiBook program. Unlike the company’ s other products, the ActiBook program has been sold mainly to large companies in the printing, publishing and other industries. This customer base has made the program the industry standard. Priced at ¥3mn, the ActiBook is too expensive for many small companies. Therefore, Startia has begun to lease the program instruction about the effective use of the program. This option is appealing to more small companies.

Companies using ActiBook as of September 30, 2013

Publisher	Newspaper	Free paper	Printing
Nikkei Publishing Inc., Shogakukan Inc., Kadokawa Group Publishing Co., Ltd., Starts Publishing Corp., Hakusensha, Inc, Toyo Keizai, Inc., Shueisha Inc., Diamond Inc.	The Yomiuri Shimbun HD, Asahi Shimbun, The Japan Agricultural News, Japan Dental News Press, The Japan Financial News Co., Ltd.	SANKEI LIVING SHIMBUN Inc. Bandai Visual Co., Ltd., Sankei Medix Inc., N-Dricom, Inc., Neomedia Inc.	JAGAT Co., Ltd., Kinmei Printing Co., TOPPAN FORMS CO.,LTD. TONEGAWA, Omura Printing Co., Ltd., Takakuwa Art Printing Co., Ltd., Toyokuni Printing Co., Ltd., Miyazaki Minami Printing Co., Ltd., Imura Envelope Co., Inc.
Catalog	**Insurance / Finance**	**IR**	**Intranet / Documentation**
Le moir Co., Ltd., RINGBELL Co.,Ltd., MontBell Co., Ltd., LEGO Japan Ltd., Jojoen Co., LTD, Tanita Housingware Co., Ltd., Toei Video Company Ltd., Senshukai Co., Ltd., Lush Japan Co., Ltd., Gunze Limited, JAL Sales Co., Ltd., Tomy Company, Ltd.	National Federation of Workers and Consumers Insurance Cooperatives, Asahi Fire & Marine Insurance, Ace Securities Co., Ltd., Japan Cooperative Insurance Association Incorporated	Nomura Investor Relations Co.,Ltd. Mizuho Financial Group, Inc., Takara Printing Co., Ltd., IFIS Japan Ltd.	Hitachi Medical Computer Systems,inc. YANMAR TECHNICAL SERVICE Co., Ltd., NEC Mobiling, Ltd. Nissan Creative Services Co., Ltd., JA Akita,, Nankai Electric Railway Co., Ltd., Recruit Co., Ltd. Yoshimoto R and C Co., Ltd.
School / Education	**Portal / Media**	**Travel / Leisure**	**Others**
Waseda University, Keisen University, Musashino Academia Musicae, Chuo University Senior High School, Osaka University of Commerce	NEC, NTT Communications Corporation, NEC BIGLOBE, Ltd., Canon System and Support Inc., IPROS CORPORATION, PROTO CORPORATION, Fukkan.com	Hato Bus Co., Ltd. Hotel Okura Tokyo Bay, RESORT SOLUTION Co., Ltd. Okinawa Tourist Service, NOE Corp., R&C Tours	Riso Kagaku Corporation Shimizu Corporation, ZENROSAI (National Federation of Workers and Consumers Insurance Cooperatives), Minamiaso Tourism Association Liaison Committee, KAKEN TEST CENTER, Okura Zaimu Kyokai

Source：Company

■Startia’ s Strengths

○ COCOAR service

Many smartphone users access global maps. The technology used to produce digital maps and other information, enabling a perception of reality, is called augmented reality (AR). Startia’ s COCOAR service is based on this technology.

Companies use the COCOAR program to produce augmented reality versions of a wide range of content, including photographs, videos, audio programs, websites, and e-books. For example, a company can print an AR marker on its paper pamphlets. The recipient of a pamphlet can download the COCOAR application program for free, scan the AR marker with a camera, and view AR information that is not included in the paper pamphlet on the screen of a computer or smartphone.

The QR codes being widely used are similar to COCOAR. However, QR codes have many limitations and can be difficult to use. To overcome these problems, a QR user has to develop specialized content and applications, which is costly. The COCOAR program provides this specialized content and applications at low cost, making it more attractive than QR codes.

As the COCOAR program offers the advanced AR function, is easy to use, and is cheaper than the ActiBook program, it is easy to sell. In the medium term, it is likely to match the ActiBook program as a pillar of the web solutions division.

Differences between QR codes and market augmented reality

Check items	QR code	Augmented reality marker
Design changes	× Impossible QR code fixing	○ Possible Paper design possible
Contents scalability	△ Limited Only through URL	○ Possible Because marker retains information
Three-dimensional object recognition	× Impossible Impossible apart from code	○ Possible Can recognize three dimensional objects
Marker size	△ Limited Can scan with camera	△ Limited Size recognizable with characteristic point
Secondary paper usage	× Impossible Need to print new code	○ Possible Can set where already printed

Source : Company

■Earnings Trends

Company surpassed its forecasts due to effective cost control

(1) H1 FY3/14 Results

In the first half of the fiscal year through March 2014, i.e., in H1 FY3/14, Startia reported a 19.2% year-on-year (y-o-y) rise in consolidated sales, but a 13.9% y-o-y decline in operating profit, a 14.6% fall in recurring profit, and a 13.4% drop in net profit. These results were better than the company had projected. The sales reported for H1 FY3/14 exceeded the company's forecast by 1.7%, while operating, recurring and net profits surpassed the company's forecasts by 49.0%, 51.5%, and 83.1% respectively.

The profit declines had been projected by the company because it is investing heavily in future growth this fiscal year. For instance, it is expanding its operations in Asia, and it hired 87 recent college graduates this year. Sales generated by the business solutions division and the network solutions division exceeded company forecasts, but sales generated by the Web solutions division fell short of the forecast because sales of the ActiBook software program were weaker than expected in Q1 FY3/14, but returned to the projected level in Q2. Profits surpassed company forecasts more than sales did because the company controlled its SGA costs strictly.

Summary Income Statement (¥mn), H1 FY3/13 and H1 FY3/14

	H1 FY3/13		H1 FY3/14				
	Actual	Sales ratio	Company Forecast	Actual	Sales ratio	y-o-y	Absolute change
Sales	3,090	100.0%	3,622	3,684	100.0%	19.2%	1.7%
Operating profit	237	7.7%	159	237	6.4%	-13.9%	49.1%
Recurring profit	283	9.2%	159	241	6.5%	-14.6%	51.6%
Net profit	167	5.4%	79	144	3.9%	-13.4%	82.3%

Maintains original forecasts, which appears conservative, given outperformance in H1

(2) Company Forecasts for FY3/14

For FY3/14, the company retained its original forecasts, projecting a 22.9% y-o-y rise in consolidated sales to ¥8,160mn, a 22% rise in operating profit to ¥800mn, a 22.1% increase in recurring profit to ¥800mn, and a 2.3% upturn in net profit to ¥400mn. Given the company's outperformance, relative to its forecasts in H1, its full-year forecast appear somewhat conservative.

Given the outperformance of the business solutions division in H1 FY3/14, relative to the company's forecasts, the company raised its forecasts for this division in H2 FY3/14. However, it lowered its H2 FY3/14 forecasts for the network solutions division and the web solutions division. Probably, the forecast downgrades for these divisions had two components, one component reflecting an offset for outperformance in H1 and another component reflecting more subdued expectations for the overseas operations of the networks solutions division and for the sale of software for creating e-books in the web solutions division. The web solutions division is developing new software programs for creating e-books in FY3/14, so customers will probably wait to purchase that software from FY3/15, rather than buy programs now available.

■Earnings Trends

Summary Income Statement (¥mn), FY3/12 - FY3/14E

	FY3/12			FY3/13			FY3/14		
	H1	H2	FY3/12	H1	H2	FY3/13	H1	H2 E	FY3/14E
Sales									
Web solutions	446	628	1,074	670	812	1,482	861	1,422	2,283
Network solutions	670	755	1,425	855	988	1,843	980	1,177	2,157
Business solutions	1,179	1,406	2,585	1,565	1,749	3,314	1,842	1,878	3,720
Total	2,295	2,789	5,084	3,090	3,549	6,639	3,683	4,477	8,160
Operating profit									
Web solutions	33	187	220	60	105	165	79	--	--
Network solutions	61	118	179	167	196	363	157	--	--
Business solutions	9	82	91	67	103	170	26	--	--
Total	103	387	490	294	404	698	262	--	--
Operating profit	88	371	459	276	380	656	237	563	800
Recurring profit	102	373	475	283	372	655	241	559	800
Net profit	57	221	278	167	224	391	144	256	400
EPS (¥)	11.6	44.7	56.2	33.7	45.0	78.6	28.7	50.4	79.1
Number of shares outstanding (000)	4,953	4,956	4,956	4,975	5,012	5,012	5,059	--	--
Equity ratio	73.9	70.2	70.2	73.3	70.9	70.9	74.7	--	--
Interest-bearing debt	175	141	141	112	0	0	0	--	--

Note: Estimates are by the company. Operating profits for segemet are before corporate costs and eliminations

■Medium-term Outlook

Current investments expected to accelerate profit growth from FY3/17

The company is about to achieve or exceed the targets set in its management plan for FY3/12 - FY3/14. In FY3/15-FY3/16, it will invest funds accumulated in FY3/12-FY3/14, aiming for faster profit growth from FY3/17.

(1) Management given stock options as incentive to perform

FY3/14 is the final year of the company's current medium-term (three-year) plan. The company's forecasts for FY3/14 indicate that it should accomplish the targets of its three-year plan. The company does not plan to a medium-term plan for coming years. Instead, it set an operating profit target of more than ¥2bn for FY3/15 and FY3/16 combined. In August 2013, the company announced the establishment of a stock option plan as part of the compensation for its managers. If the company achieves its targeted operating profit for FY3/15 and FY3/16, the management will be able to exercise their stock options.

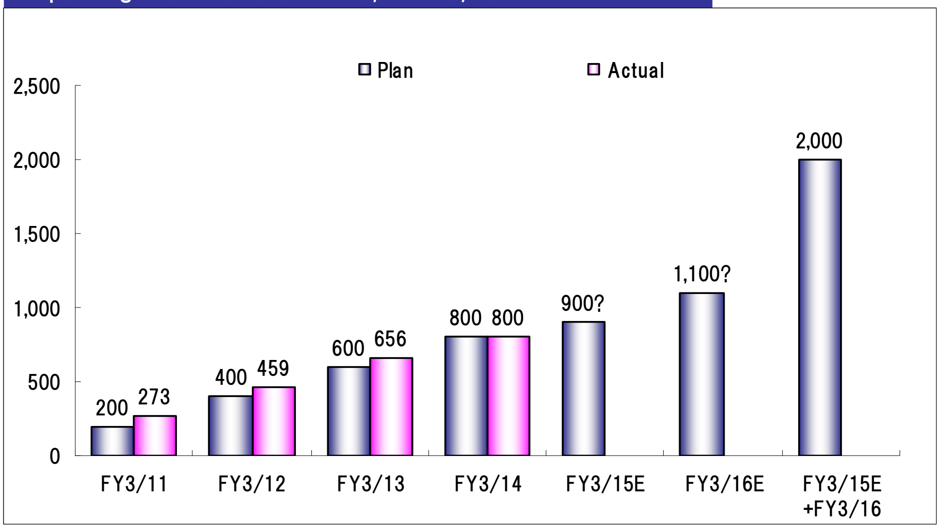
The current medium-term plan originally set operating profit targets of ¥400mn for FY3/12, ¥600mn for FY3/13, and ¥800mn for FY3/14. These targets were surpassed in FY3/12 and FY3/13, and the target for FY3/14 is likely to be met or exceeded. Thus, a two-year operating profit target of ¥2bn may seem too low to some shareholders and investors, but this is not necessarily the case.

■Medium-term Outlook

In FY3/14 and FY3/15, the company is investing heavily. In spring 2014, the company plans to hire 87 new college graduates, the same number it hired in spring 2013. It is also investing to improve the security of its network solutions division, to develop new sales office, and to develop software in the web solutions division. Although the company has not disclosed the amount of its investments over these two years, we estimate it at ¥300-500mn. Some of these investments should have an immediate on operations, so the company may well exceed its ¥2bn operating profit target for FY3/15 to FY3/16. It could probably not earn a larger operating profit until two years beginning in FY3/17.

Still, the company' s management may consider an operating profit target of ¥2bn over the next two fiscal years to be quite challenging. The target may be interpreted as an indication that top management will require lower managers to work hard to continue to make wise choices about the company' s technology road map and customer demands.

Operating Profit Targets (¥mn) for FY3/11-FY3/16 and Operating Profit Achieved in FY3/11-FY3/13



Note: Forecasts for FY3/15 and FY3/16 are by Fisco. All other forecasts are by the company.

Aiming for a profit structure based on balanced sales mix

(2) Balance between one-time sales and steady revenue

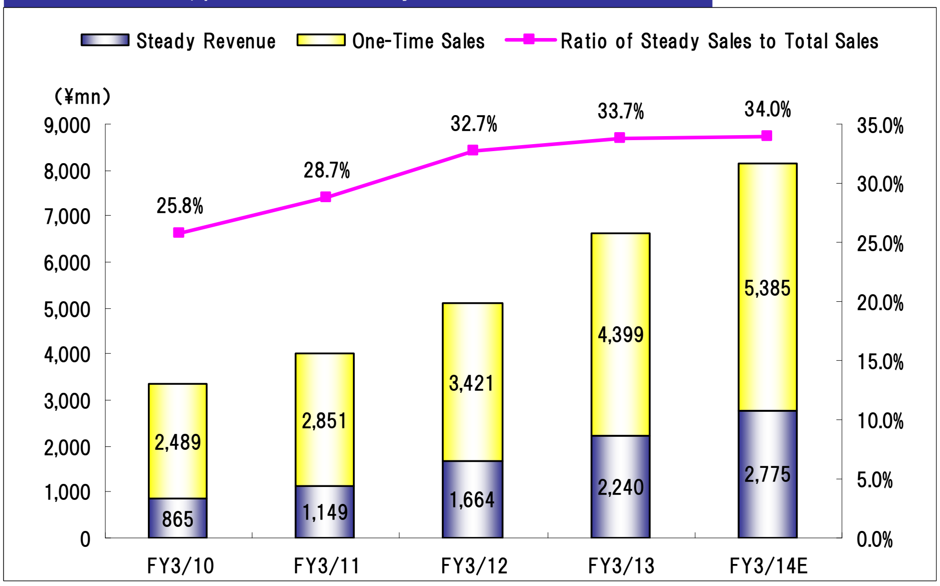
The company' s business results over the medium term will also be affected by the balance between one-time sales and steady revenue over an extended period. While continuing to increase its one-time sales, the company is trying to increase its steady revenue. Steady revenue is generally derived from services for equipment that has already been sold, so this revenue entails very little sales cost. Furthermore, steady revenue reduces the seasonality of sales and profits.

Currently, the company derives steady revenue from its hosting service, its Managed Gate rental of network equipment, its counter service for its multi-function printers, and from incentives from Softbank to continue the Otoku Line telephone service. The Managed Gate rental of network equipment and the counter service for multi-function printers are the leading sources of steady revenue.

■Medium-term Outlook

Although steady revenue is growing, so are one-time sales. Thus, the sales weighting of steady revenue is growing slowly. However, today's one-time sales lead to tomorrow's steady revenue. As long as the company balances its revenue from these sources, it is likely to expand its sales and profits over the medium term.

Breakdown of Total Sales (¥mn) into Steady Revenue and One-Time Sales, plus Ratio of Steady Sales to Total Sales



■Shareholder Return Policy

Plans to increase dividend to reflect profit growth and special occasions

As Startia requires funds for its rapid growth, it currently limits its target dividend payout ratio to 10%. More mature companies may maintain a dividend payout ratio of 30%. However, Startia aims to increase its dividend reflecting its profit growth, anniversaries or other special occasions.

Although Startia does not deal in goods for general consumers, it is considering the implementation of special gifts for its shareholders. These would improve its overall shareholder returns.

■Risks and Issues

Company needs to acquire and train talented employees to maintain its human resources strength

Based on Startia's business model and the competitiveness of its products and services, there is no obvious obstacle to its growth. However, the company's greatest need appears to be sales capability, even more than technology. If so, its work force is vital, and the company's greatest danger would be a failure to recruit and train employees as scheduled.

The company is aware of this risk and is addressing it. In spring 2013, it hired 87 new college graduates and opened the East Tokyo Branch Office in Daito Ward, which included a new employee training center. The company's personnel policy should probably concentrate on retaining new employees, rather than on their contribution to sales and profits. It is not unusual for 20-30% of new employees in Japan to quit in their first year of employment, but as of September 2013, only one of the 87 college graduates hired last spring had quit.

Startia plans to hire 87 new college graduates in spring 2014, and it will probably continue to hire aggressively in future years. As of the end of September 2013, its workforce composition was as shown in the table below.

Composition of Startia Workforce at the end of September 2013

	Sales people	Technicians	Managers	Total
Startia	172	99	77	348
Startia Lab	84	48	6	138
Startia Group	256	147	83	486

FISCO