

System Support Inc.

4396

Tokyo Stock Exchange First Section

21-Oct.-2021

FISCO Ltd. Analyst

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FISCO Ltd.

<https://www.fisco.co.jp>

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■ Summary

Expecting continual double-digit profit growth driven by ServiceNow, a DX support solution

System Support Inc. <4396> (hereinafter “the Company”) is an independent IT company that is continuously delivering growth centered on the Solutions Business, which includes support for the use of cloud systems, ERP and databases, based on technological capabilities at the highest level of the industry. The Company is headquartered in Ishikawa Prefecture, Japan. However, Tokyo, Nagoya, and Osaka are the primary hubs of the Company’s business activities. Also, the Company has a subsidiary in Silicon Valley in the US. Besides the Solutions Business, the Company also conducts recurring-revenue businesses such as the Outsourcing Business, which revolves around data center management, and the Product Business, which is mainly focused on providing cloud (SaaS) services. The Company has selected and requested to be included in the Prime Market, the new market segment of the Tokyo Stock Exchange that will be launched in April 2022.

1. Outline of results for FY6/21

In FY6/21, the Company set a new record high for results, with net sales increasing 7.9% YoY to ¥14,431mn, and operating profit rising 23.3% to ¥931mn. The impact of the COVID-19 pandemic remained mostly within the anticipated range and was minor. Net sales in the Solutions Business and the Outsourcing Business grew steadily, while net sales in the Product Business were flat YoY due to the completion of a large project that contributed to FY6/20 earnings. On the profit front, in addition to the impact of higher sales, growth of high-profit-margin sales related to ServiceNow*, improvement in the cost-of-sales ratio due to the spread of working from home, and reductions in various expenses such as sales expenses were factors behind the increase in profit.

* A cloud platform that standardizes and automates business processes, and supports improved productivity by employees and organizations. Over the past few years, it has started to rapidly become widely used as a DX solution not only in the US and Europe, but also in Japan.

2. FY6/22 forecasts

For FY6/22, the Company is forecasting net sales of ¥15,962mn, up 10.6% YoY, while operating profit is forecast at ¥1,080mn, up 16.0%, as the Company is forecasting double-digit growth in both sales and profit. The COVID-19 pandemic is ongoing, but companies’ DX investment is robust, and there has been hardly any impact on orders received. In particular, the Company is expecting strong growth in sales related to ServiceNow, which continues to gain traction as a tool for improving business productivity. ERP-related sales are also expected to continue to grow, centered on SAP cloud migration projects, while even sales in the Product Business, which saw sales slump in FY6/21 due to one-time factors, are expected to increase as the Company accumulates more subscribers. In terms of profits, the Company’s forecasts are predicated on sales expenses and other expenses returning to pre-COVID-19 levels, but with the COVID-19 pandemic still ongoing, it seems that these expenses are lower than the forecast. If there are no major changes in the market environment going forward, we at FISCO think that there is a strong possibility that FY6/22 results could exceed the Company’s forecasts.

Summary

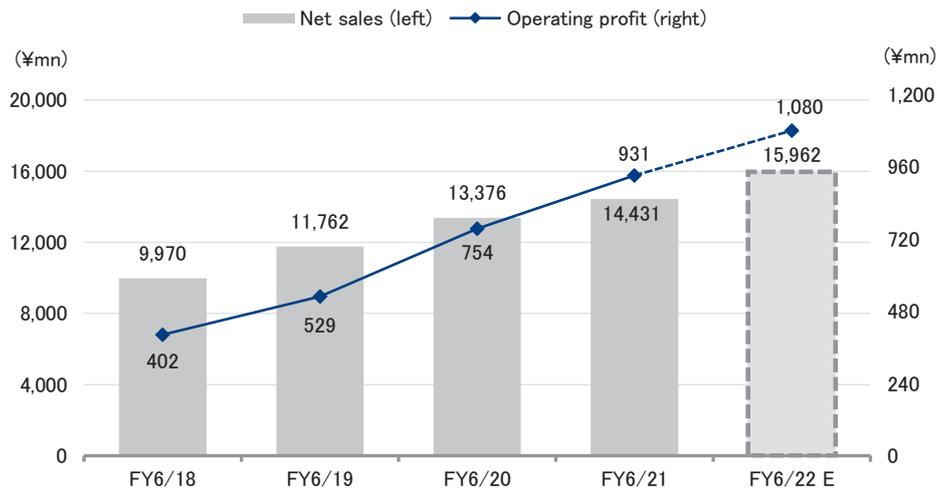
3. Growth strategy

The Company's medium- and long-term growth strategy is to drive stable growth in the mainstay Solutions Business and accelerate growth in the Outsourcing Business and Product Business further, with the aim of expanding business performance and improving earnings capabilities. In the Solutions Business, the Company will recruit and train human resources with sophisticated technological capabilities, in order to expand sales in businesses related to the cloud, ERP and databases, for which demand is surging. Notably, the Company has earned certification as an Elite Partner, the highest level of partnership, by ServiceNow, a platform that helps companies realize DX. The Company has the second-highest number of certified developers, making it a top-tier company, and the Company intends to continue to proactively expand sales while bolstering its development of human resources. With high profit margins, ServiceNow-related business is expected to help improve overall earnings capabilities too. Meanwhile, in the Outsourcing Business, the Company plans to capture demand for the use of data centers as backup capacity for customers' BCP measures, with the main target being companies building private clouds. Additionally, in the Product Business, the Company internally develops and supplies various cloud services that contribute to improved operating efficiency. The Company plans to upgrade and expand its sales agencies and strengthen web marketing, with the aim of achieving sales growth. Moreover, M&As are also viewed as a growth strategy in the Product Business.

Key Points

- An independent IT company that continues to grow by undertaking many projects involving Microsoft Azure, AWS (Amazon Web Services), ServiceNow, SAP and Oracle
- In FY6/21, the Company achieved increases in sales and profit exceeding its forecasts due to the expansion of orders received for cloud systems and ERP, as well as an improvement in the cost-of-sales ratio
- Supported by the growth in DX investment, double-digit increase in profit is expected to continue in FY6/22, and the profit forecast seems quite conservative
- The outlook is for growth in all business segments, with particularly strong growth continuing in the business related to ServiceNow

Results trends



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

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■ Company profile

An independent IT company that continues to grow by undertaking many projects involving Microsoft Azure, AWS, ServiceNow, SAP and Oracle

1. History

The Company was founded in 1980 in Kanazawa, Ishikawa Prefecture to provide data entry services and system development services. In the 1980s, business performance continued to grow steadily against the backdrop of favorable economic conditions. However, business results started to deteriorate following the collapse of Japan's bubble economy in the 1990s, putting the Company's survival at risk. In 1994, management was transferred from the Company's founder to the current Representative Director Ryoji Koshimizu. Under Mr. Koshimizu's leadership, the Company worked to rationalize management, and four years later, it had recovered enough to restore profitability. Subsequently, the Company developed its technological capabilities, which are said to be at the highest level of the industry for an independent enterprise, into a core strength. In addition, the Company developed many certified technology professionals specialized in the products and services of global IT companies, such as Microsoft Azure, AWS, SAP and Oracle. By doing so, the Company has expanded sales in the usage support fields for those products and services and has continuously increased its business performance.

Looking at business expansion initiatives since 2000, the Company founded eNet Solutions Co., Ltd., a subsidiary that conducts data center services, in 2000. In 2004, the Company entered into an Oracle EBS Technical Partner contract with Oracle Corporation Japan <4716>. With this contract, the Company would go on to proactively undertake system integration and deployment projects for Oracle products. In addition, the Company launched the Product Business to sell internally developed software products as a new income-generating business following systems development and data center services. As its first such product, the Company commenced sales of Tate Yakusha, a construction work information management system, in 2005.

Moreover, in 2009, the Company founded STS Medic Inc., a subsidiary engaged in the development and sales of specialized software for the medical industry. Thereafter, the Company built a solid business foundation by making use of M&As. For example, T4C Co., Ltd., a service partner of the major ERP provider SAP, and ACROSS Solutions, Inc., which had been providing system solutions to the distribution industry, were successively converted into subsidiaries of the Company in 2010 and 2012, respectively. The Company has also entered overseas markets. Notably, in 2013, the Company established a subsidiary in the US for the purpose of gathering information and supplying IT services in the country. Additionally, in 2016, it set up a subsidiary in Canada to provide outsourcing services (such as accounting services) to Japanese companies in North America. These initiatives have led to the Group structure in place today. In August 2018, the Company was listed on the Tokyo Stock Exchange Mothers Market. In August 2019, one year later, the Company achieved the listing of its shares on the Tokyo Stock Exchange First Section. The Company has selected and requested to be included in the Prime Market, the new market segment of the Tokyo Stock Exchange that will be launched in April 2022.

Company profile

History

Date	Major event
January 1980	Founded in Kanazawa, Ishikawa Prefecture, providing data entry and system development services.
November 2000	Financed and founded eNet Solutions Co., Ltd.
January 2004	Entered into an Oracle EBS Technical Partner contract with Oracle Corporation Japan <4716>
February 2005	Commenced sales of "Tate Yakusha," a construction work information management system
March 2009	Financed and founded STS Medic Inc.
May 2010	Acquired shares of T4C Co., Ltd. and made it a subsidiary
June 2011	Entered into an SAP Service Partner contract with SAP Japan Co., Ltd.
March 2012	Acquired shares of ACROSS Solutions, Inc. and made it a subsidiary
April 2012	Began providing services for Cloud Koubou powered by Amazon Web Services, a cloud support service
July 2013	Financed and founded STS Innovation, Inc. in the United States
August 2013	Began providing services for PinMap, a customer data mapping service
October 2013	Entered into an APN Consulting Partner agreement with Amazon Japan K.K.
March 2015	Acquired additional shares of T4C Co., Ltd. and ACROSS Solutions, Inc. and made them wholly owned subsidiaries STS Innovation financed and founded FrontLine International, Inc. in the United States (absorbed through a merger in April 2017)
September 2015	Entered into a basic partnership contract with ServiceNow, Inc.
January 2016	Financed and founded STS Innovation Canada, Inc. in Canada
February 2016	Commenced sales of the cloud-based shift management system "SHIFTEE"
August 2018	Listed on the Tokyo Stock Exchange Mothers Market
August 2018	Commenced sales of the attendance/work management system "Shugyo Yakusha"
August 2019	Listed market changed to the Tokyo Stock Exchange First Section

Source: Prepared by FISCO from the Company's website and securities reports

Focusing on the Solutions Business as the mainstay business, while expanding into the Outsourcing Business and Product Business, which will be recurring-revenue businesses

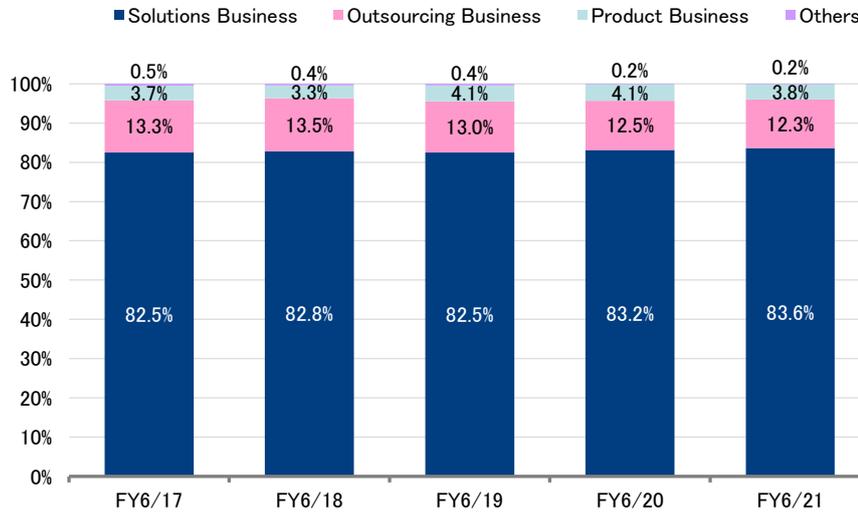
2. Business description

The System Support Group comprises the Company and its six consolidated subsidiaries. The Group discloses information based on three segments, specifically the Solutions Business, Outsourcing Business and Product Business. Looking at the ratio of sales in each segment over the past five years, the composition has been generally stable with the Solutions Business accounting for approximately 83% of sales, the Outsourcing Business 13%, and the Product Business 4%. During this period, overall net sales have grown by roughly 1.6 times, and each of the three business segments have been growing at the same pace.

Looking at the profit margin (gross profit margin) for each segment, the mainstay Solutions Business and the Outsourcing Business have steadily remained in the low 20% range and the low 30% range, respectively, while the Product Business has had relatively high gross profit margins in the 50% range. Among these, the stability of the Solutions Business is what is receiving attention. In the system development industry, many companies are experiencing unstable profitability due to projects being drawn out or defects emerging, but the Company has been able to maintain a certain level of profitability. This is proof that the Company possesses strong technological and project management capabilities, and we at FISCO view these as the Company's strengths.

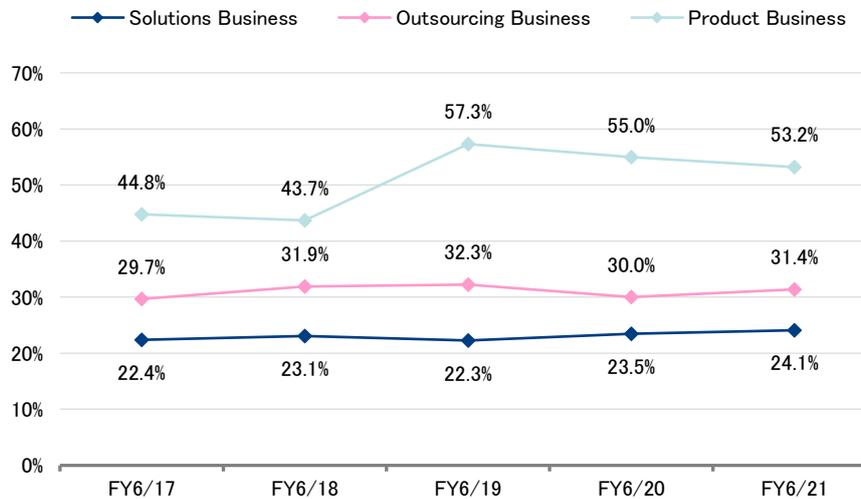
Company profile

Composition of net sales by business segment



Note: Percentages are calculated using pre-adjusted figures
 Source: Prepared by FISCO from the Company's financial results

Gross profit margin by business segment



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

(1) Business description for each business segment

a) Solutions Business

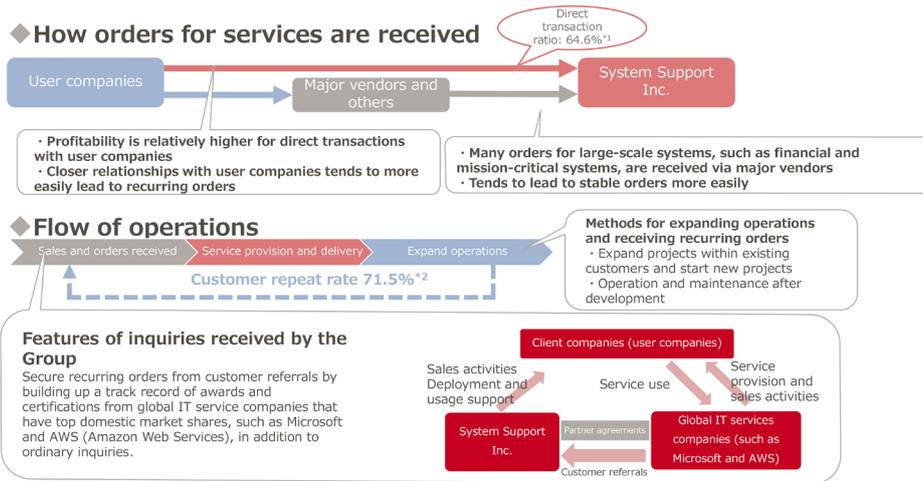
In the Solutions Business, as an independent IT company, the Company provides technological support related to usage and deployment of cloud services and ERP packages and building databases and other infrastructure, centered on consulting, design, development, and operation and maintenance of IT systems for client companies. Its strengths lie in its wide range of customers across all manner of business sectors and operations, and its ability to support a complete spectrum of development processes on a one-stop basis.

Company profile

In terms of the sales composition for FY6/21, contracted development of IT systems represented over 40%, ERP-related services (such as deployment and maintenance and operation of SAP and ERP) accounted for just over 20%, and the remainder was from cloud-related services (deployment and migration support for cloud services such as Microsoft Azure, AWS, and ServiceNow*) and database-related services (design, construction, and maintenance and operation of Oracle databases). In addition, direct transactions with end customers represented just over 60% of the orders received by the Company, with the remainder comprising subcontracted orders received via major SI vendors and other partners. Projects undertaken through direct transactions with customers have relatively high profit margins and tend to lead to recurring orders more easily as closer relationships are developed with customers through such projects. Meanwhile, subcontracted projects have the feature of tending to lead to stable orders more easily. This is because these projects often cover longer periods of time as they primarily involve large-scale projects, such as systems for financial institutions and mission-critical systems.

* ServiceNow is a cloud service for standardizing business processes. It is provided by ServiceNow, Inc. of the US. Looking at examples of usage, the information system departments of companies use the service when they need to centrally manage assets, work flows, incidents and so forth for the purpose of streamlining operations. The Company was one of the first Japanese companies to enter into a partner agreement with ServiceNow in 2015, and has a top-tier track record for deploying the service in Japan.

Main features of the order-receipt scheme in the Solutions Business



Source: The Company's results briefing materials

Moreover, one of the features of the Company is that it is a group of technology professionals, with engineers representing more than 80% of personnel in the Solutions Business. The Company needs only a relatively small number of sales personnel because it receives many customer-referred projects from Microsoft, AWS and Oracle. These projects are referred to the Company based on its abundance of personnel with sophisticated technological capabilities and its extensive development track record for projects related to the cloud, databases, etc.

Company profile

Track record of main certifications and awards

Microsoft Azure	AWS
<ul style="list-style-type: none"> • Obtained Gold Cloud Platform Competency Certification Certified as a partner with an outstanding track record in expanding Microsoft Azure • Obtained Advanced Specialization*¹ Obtained certification as a partner with sophisticated expertise in specific solution fields • Received three consecutive MVP awards • Received consecutive awards in the data platform field since 2017*² 	<ul style="list-style-type: none"> • Obtained Oracle Competency in the AWS Competency Program*³ • Received the APN Partner Award "Rising Star of the Year" (FY2014)
Oracle	
<ul style="list-style-type: none"> • Received Oracle Database-related awards for 14 consecutive years*⁴ • Received Oracle Certification Award 2020 and other awards from Oracle Corporation Japan 	

*1 Obtained in the field of migrating Windows Servers and SQL Servers to Microsoft Azure.

*2 Award received by the Company's employees.

*3 A program to identify, validate, and promote Advanced and Premier tier partners in the AWS Partner Network (APN) that have demonstrated technical expertise and proven customer success pertaining to AWS.

*4 As of June 30, 2021.

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

b) Outsourcing Business

In the Outsourcing Business, data centers managed by subsidiary eNet Solutions Co., Ltd. at three locations in Japan (Tokyo and Kanazawa) account for around 70% of net sales from management services. These services are used as infrastructure for the private clouds of companies and for BCP measures and data backup management. Also, in 2006, as a value-added service that acts as a hook for acquiring data center customers, the Company began providing Safetylink24, an emergency notification and safety confirmation service that automatically distributes safety confirmation messages for employees linked to earthquake information (currently around 800 companies are subscribed to this service). In 2010, the Company began offering ActionPassport, an electronic work flow system (approximately 300 companies subscribed), and in 2017, the Company began providing a service that allows customers to easily use IBM Japan, Ltd.'s IBM Watson Explorer (an AI-driven search and analysis platform) with a monthly charge plan. These value-added services have a recurring-revenue business model based on monthly fees, so revenue increases in line with growth in the number of subscribers. As of June 2021, the number of customers using the Company's data centers amounted to approximately 1,000 companies.

The Company also has other sources of sales, including training for client companies pertaining to systems that the Company was involved in developing in the Solutions Business and operation and maintenance of help desk services, along with data analysis and entry services.

c) Product Business

In the Product Business, the Group is engaged in the development and sales of products (software). It also customizes products according to customer needs. Products are sold via sales agencies, in addition to direct sales to customers. The Product Business's current main products are Tate Yakusha for the construction industry and the MOS mobile order receipt and placement system for the wholesale and retail sectors, both of which account for around 30% of net sales. While the Company does receive orders for large custom development projects from time to time, the majority of sales in the Product Business are generated through monthly fees from cloud (SaaS) services. Therefore, this business has a recurring-revenue business model where revenue increases in line with growth in the number of subscribers.

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Company profile

Outline of major products

Name	Provider	Description	Number of subscribing companies*
Tate Yakusha	System Support Inc.	A construction work information management system. The monthly charge for the basic version is ¥36,000 per 5 users (initial cost: ¥240,000). The professional version is offered at a monthly charge of ¥39,800 per 5 users (initial cost: ¥480,000).	636
MOS	ACROSS Solutions, Inc.	A mobile order receipt and placement system. For the full version, the initial cost starts at ¥350,000, options at ¥100,000, and the monthly charge at ¥20,000 (with actual figures depending on the number of accounts needed by the party placing the order).	457
SHIFTEE	System Support Inc.	A cloud-based shift management system. The monthly charge for the full version is ¥400 per user (separate charges apply for customization).	81
Shugyo Yakusha	System Support Inc.	An attendance/work management system. The monthly charge for the cloud version is ¥200 per user (separate charges apply for the on-premise version).	75
T-File	STS Medic Inc.	Medical image filing system	N.A.

* As of June 30, 2021.

Source: Prepared by FISCO from the Company's website and results briefing materials

(2) Group companies and the number of employees

The Company's subsidiaries specialize in different functions and business sectors so that they can constantly provide new solutions to customers with proactivity and speed in each company's specialty area. In addition, the number of employees was 1,126 on a consolidated basis as of the end of June 2021 (an increase of 87 people YoY). The Group's workforce has increased every year in step with growth in the size of its business. Of the total, the number of employees of the Company on a non-consolidated basis was representing more than 80% of Group-wide employees.

Description of main businesses and number of employees of Group companies

Name of company	Solutions Business	Outsourcing Business	Product Business	Number of employees
System Support Inc.	System development, infrastructure construction support, cloud service deployment support	System operation and maintenance, data entry services	Development and sales of Tate Yakusha, a construction work information management system, and other products	943
eNet Solutions Co., Ltd.	Deployment of various solutions	Data centers and related platform services	-	64
T4C Co., Ltd.	ERP product deployment consulting	-	-	76
STS Medic Inc.	Sale and installation of medical devices and other items	-	Sales and deployment support for T-File, a medical image filing system	11
ACROSS Solutions, Inc.	-	-	Development and sale of MOS mobile order receipt and placement system	23
STS Innovation, Inc.	-	Outsourcing service for management operations	-	6
STS Innovation Canada Inc.	-	Outsourcing services for management operations	-	3

* Other businesses (overseas information provision service, overseas media business, staff referral business, etc.) are conducted by STS Innovation, Inc.

Source: Prepared by FISCO from the Company's securities reports

Results trends

In FY6/21, the Company achieved increases in sales and profit exceeding its forecasts due to the expansion of orders received for cloud systems and ERP as well as an improvement in the cost-of-sales ratio

1. Outline of results for FY6/21

In FY6/21, the Company set a new record high for consolidated results for another consecutive year, with net sales increasing 7.9% YoY to ¥14,431mn, operating profit rising 23.3% to ¥931mn, ordinary profit up 34.1% to ¥954mn, and profit attributable to owners of parent up 49.9% to ¥674mn. In addition, results even exceeded the Company's forecasts which had been upwardly revised in May 2021.

Consolidated results for FY6/21

	FY6/20		Company forecast*	FY6/21			Achievement rate
	Results	% of net sales		Results	% of net sales	YoY	
Net sales	13,376	-	14,342	14,431	-	7.9%	0.6%
Cost of sales	9,983	74.6%	-	10,688	74.1%	7.1%	-
SG&A expenses	2,637	19.7%	-	2,811	19.5%	6.6%	-
Operating profit	754	5.6%	848	931	6.5%	23.3%	9.8%
Ordinary profit	712	5.3%	866	954	6.6%	34.1%	10.2%
Extraordinary losses	54	-	-	24	-	-	-
Profit attributable to owners of parent	450	3.4%	592	674	4.7%	49.9%	13.9%

* Revised forecast results announced in May 2021

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

The negative impact on net sales from the COVID-19 pandemic was approximately the level that had been anticipated at the beginning of FY6/21. Overall, companies have had a strong appetite for investment in DX, and the Company's overall revenue was driven by growth in the Solutions Business due to deployments of cloud systems for improving work efficiency and more orders for deployments of ERP. Revenue also increased in the Outsourcing Business due to the increase in monthly billing revenue. Meanwhile, revenue in the Product Business was flat YoY due to the absence of a large customization project that contributed to sales in FY6/20.

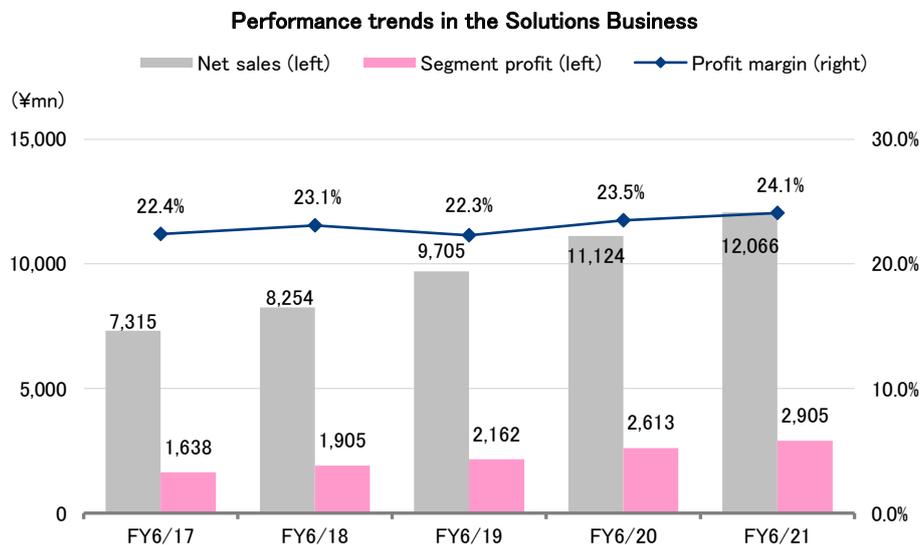
The cost-of-sales ratio decreased 0.5 percentage points from 74.6% in FY6/20 to 74.1% in FY6/21, owing to an improved product mix and decreased fixed costs associated with the shift to working from home. SG&A expenses increased 6.6% due to the rise in personnel costs, but the SG&A expenses ratio declined 0.2 percentage points YoY due to the curbing of sales expenses as a result of cancellations of trade exhibitions and the introduction of online sales activities. These factors helped push up the operating margin from 5.6% in FY6/20 to 6.5% in FY6/21, the highest level in the past few years. Non-operating income/expenses improved by ¥66mn YoY, mainly due to a ¥34mn increase in subsidiary income and the non-recurrence of listing expenses of ¥17mn recorded in the previous fiscal year.

In the Solutions Business, there was continued strong growth in sales related to ServiceNow, which supports operational productivity improvements

2. Trends by business segment

(1) Solutions Business

In the Solutions Business, net sales rose 8.5% YoY to ¥12,066mn, and segment profit increased 11.2% to ¥2,905mn. There were strong orders in the field of cloud service usage support, such as deployments of the cloud system ServiceNow aimed at making system maintenance and operation more efficient, as well as ERP deployment projects. The segment's profit margin increased from 23.5% to 24.1%, mainly due to an increase in the ratio of high profit margin ServiceNow sales.



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

Looking at net sales by field, sales related to database and cloud platforms grew 13.2% YoY to ¥3,116mn, as the trend of increasing revenue continued. In addition to an increase in deployments of cloud systems such as AWS and Microsoft Azure, Oracle Database cloud migration projects were also strong. Also, although the scale is still small, there was steady growth in recurring revenue for account resale (monthly usage fees that arise based on customers' cloud usage) for each cloud platform.

ServiceNow-related net sales grew significantly by 64.4% YoY to ¥1,169mn. In FY6/19, net sales were ¥377mn, so this represents a rapid tripling of growth in two years. As companies advance digital transformation of management, demand has grown rapidly over the past 1-2 years for ServiceNow as a cloud platform that allows companies to efficiently realize standardization and automation of business processes. In 2015, the Company became one of the first Japanese companies to enter into a partner agreement with ServiceNow, and building up a track record of deployments while developing certified engineers has led to strong growth. The number of competitors has been increasing recently, but partially due to the fact that there is still a lack of engineers in the Kansai area, the Company is often able to win orders for large projects from large companies, and this has had an impact.

Results trends

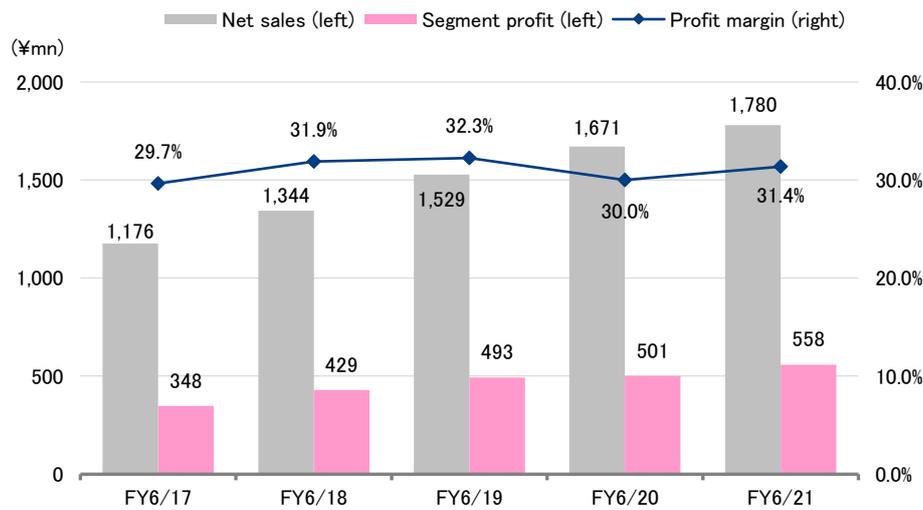
ERP-related net sales increased 8.3% to ¥2,604mn. Among companies deploying ERP, there continues to be a shift to migrate from existing products to SAP S/4 HANA based on the fact that maintenance support for the existing SAP ERP product will terminate in 2027. In this environment, the Company is proactively developing engineers and responding to the robust demand. Also, the Company is building a framework for providing nearshore support for ERP maintenance in the Hokuriku area, and the Company's ability to offer ERP-related consulting, development, infrastructure building and maintenance services in a one-stop manner is a strength and a factor behind the growth in sales.

Net sales in other contracted systems development declined 1.5% YoY to ¥5,177mn. This was mainly due to the completion of a large contracted development project that contributed to earnings in FY6/20, and net sales actually increased compared to two fiscal years ago (¥4,489mn).

(2) Outsourcing Business

Net sales in the Outsourcing Business increased 6.5% YoY to ¥1,780mn, while segment profit rose 11.3% to ¥558mn. Sales from data center services, including AI-related services, increased steadily. Monthly data center usage fees also continued to increase during the period, and the segment profit margin also rose from 30.0% in FY6/20 to 31.4% in FY6/21, owing to the positive impact of higher sales.

Performance trend in the Outsourcing Business



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

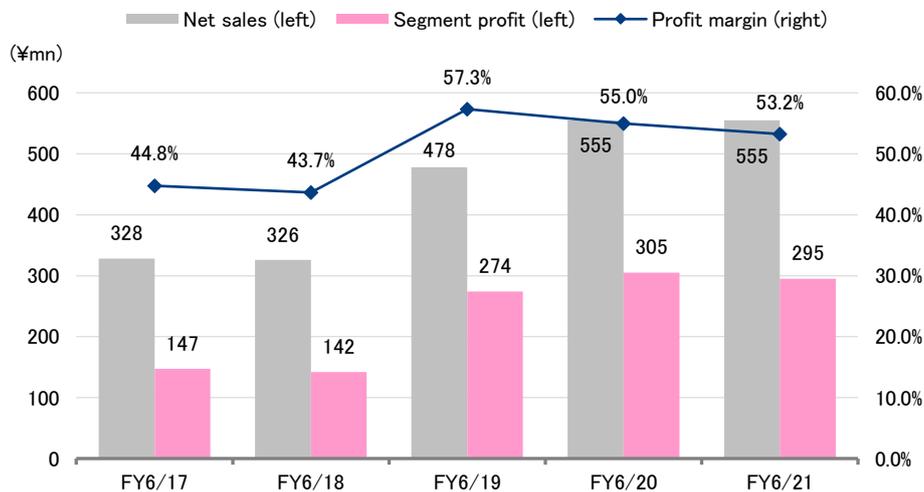
(3) Product Business

In the Product Business, net sales increased 0.1% YoY to ¥555mn, and segment profit declined 3.1% to ¥295mn. While net sales increased due to the buildup in the number of subscribers to MOS, Shugyo Yakusha, and SHIFTEE, the minimal increase was mainly due to the non-recurrence of a large customization project for Tate Yakusha that contributed to an increase in revenue in FY6/20. Excluding this factor, revenue otherwise increased steadily. The segment profit margin decreased from 55.0% to 53.2%, due to the impact of the non-recurrence of the large customization project.

Results trends

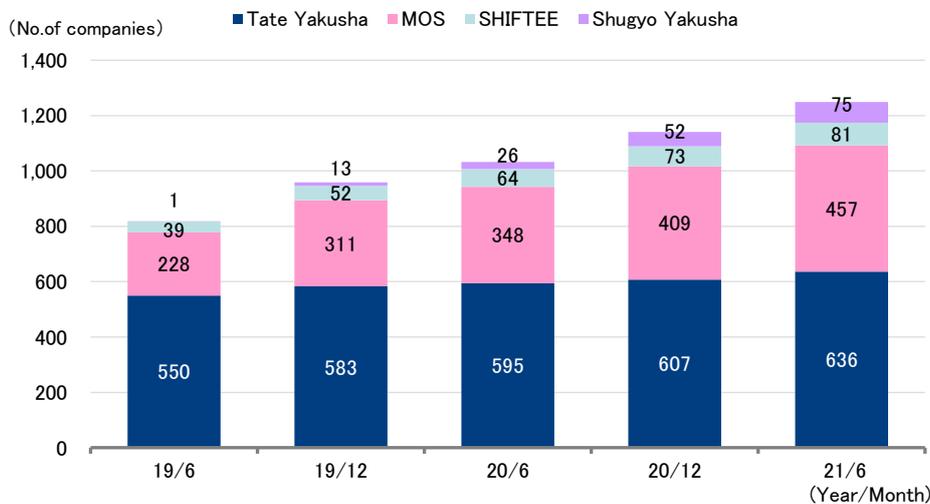
The number of subscribers by major product as of June 30, 2021 was 636 companies for Tate Yakusha (up 41 companies YoY), 457 companies for MOS (up 109 companies), 81 companies for SHIFTEE (up 17 companies) and 75 companies for Shugyo Yakusha (up 49 companies). The main revenue drivers are Tate Yakusha and MOS, while SHIFTEE, which was launched in 2016, turned profitable on a full fiscal year basis for the first time. It appears Shugyo Yakusha, which the Company launched in 2018, will take some time to monetize given the fact that functional upgrades and other development are still ongoing, but sales based on referrals from partnering regional banks are increasing, and it is starting to be used by large companies, so growth can be expected going forward. In addition to attendance/work management, Shugyo Yakusha allows users to manage and analyze man-hours for various operations and projects, and it is becoming more widely deployed as a tool supporting productivity improvements and work style reforms in companies.

Performance trends in the Product Business



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

Number of companies deploying each product



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

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Results trends

The Company's financial position is sound, and the operating margin remains on an upward trend

3. Financial condition and business indicators

Looking at the Company's financial condition at the end of FY6/21, total assets were ¥6,662mn, an increase of ¥714mn from the end of FY6/20. In terms of the main factors behind this change, under current assets, cash and deposits increased by ¥310mn, and notes and accounts receivable - trade increased by ¥371mn, accompanying the expansion of business. Under non-current assets, property, plant and equipment increased by ¥27mn.

Total liabilities were ¥3,669mn, an increase of ¥129mn from the end of FY6/20. While interest-bearing debt decreased by ¥62mn, accounts payable - trade increased by ¥178mn and income taxes payable and accounts payable - other both increased by ¥27mn. Total net assets were ¥2,993mn, an increase of ¥585mn from the end of FY6/20. Retained earnings increased by ¥573mn, primarily due to the recording of profit attributable to owners of parent, partially offset by the payment of dividends.

Looking at business indicators, the equity ratio rose from 40.5% at the end of FY6/20 to 44.9% in step with earnings growth. Meanwhile, the interest-bearing debt ratio declined from 42.1% to 31.8%, and it can be said that the Company's financial soundness has greatly improved over the past few years. Net cash (cash and deposits - interest-bearing debt) was ¥1,744mn, which is 2.4 times higher than the level in FY6/19, as the financial base continues to strengthen.

Regarding profitability, the operating margin has remained on an upward trend, rising from 4.0% in FY6/18 to 6.5% in FY6/21. This is mainly because the Company has almost no unprofitable projects as it has carried out internal project management and the number of high-profit-margin projects has been increasing. The Company has maintained high profitability with ROA and ROE at or above 10%.

Consolidated balance sheet

	(¥mn)				
	FY6/18	FY6/19	FY6/20	FY6/21	vs. prior fiscal year-end
Current assets	3,103	4,223	4,631	5,319	687
(Cash and deposits)	1,436	1,881	2,387	2,697	310
Non-current assets	1,063	1,141	1,316	1,342	26
Total assets	4,166	5,365	5,947	6,662	714
Total liabilities	3,608	3,387	3,540	3,669	129
(Interest-bearing debt)	1,499	1,145	1,015	952	-62
Total net assets	558	1,977	2,407	2,993	585
(Security)					
Equity ratio	13.4%	36.9%	40.5%	44.9%	4.4pt
Interest-bearing debt ratio	246.1%	58.0%	42.1%	31.8%	-10.4pt
(Profitability)					
ROA	9.4%	10.6%	12.6%	15.1%	2.5pt
ROE	48.4%	27.2%	20.5%	25.0%	4.5pt
Operating margin	4.0%	4.5%	5.6%	6.5%	0.9pt

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

■ Outlook

Supported by the growth in DX investment, double-digit growth in profit is expected to continue in FY6/22, and the profit forecast seems quite conservative

1. Outlook for FY6/22

For the FY6/22 consolidated results, the Company is forecasting net sales of ¥15,962mn, (up 10.6% YoY), operating profit of ¥1,080mn (up 16.0%), ordinary profit of ¥1,066mn (up 11.7%), and profit attributable to owners of parent of ¥745mn (up 10.5%), as the Company is forecasting double-digit growth in both sales and profits. Although the uncertain situation in the domestic economic outlook is ongoing as the COVID-19 pandemic becomes drawn out, companies will continue to have a strong appetite for investment in DX aimed at strengthening their competitiveness and growth potential, and the Company will aim to increase sales and profits by capturing this demand with certainty.

Consolidated outlook for FY6/22

	FY6/21		FY6/22		YoY
	Results	% of net sales	Company forecast	% of net sales	
Net sales	14,431	-	15,962	-	10.6%
Cost of sales	10,688	74.1%	-	-	-
SG&A expenses	2,811	19.5%	-	-	-
Operating profit	931	6.5%	1,080	6.8%	16.0%
Ordinary profit	954	6.6%	1,066	6.7%	11.7%
Extraordinary losses	24	-	-	-	-
Profit attributable to owners of parent	674	4.7%	745	4.7%	10.5%
Profit per share (¥)	65.45		71.97		

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

The Company's forecasts are based on the following assumptions about the impact of the COVID-19 pandemic on business.

- Depending on the situation with customers' business results, there is expected to be an impact on the Group's business results due to IT investment budget contractions and project postponements. However, despite this, the Group has a low level of dependence on specific customers, and the Group's customers belong to a wide range of industries, so the impact should be minor.
- Even if a state of emergency is declared, it will be possible to continue business based on the fact that the work-from-home system is in place and business meetings and internal meetings are being held online.

The Company is forecasting net sales to increase by approximately 10% in each business segment. Meanwhile, on the expense front, the Company is forecasting that sales activity costs, including advertising, travel, and entertainment expenses, which had been declining amid the COVID-19 pandemic, will return to pre-COVID-19 levels. Still, it actually seems that as the COVID-19 pandemic continues on, these costs are falling short of its forecasts. As a result, if there are no major changes to the market environment going forward and net sales are achieved as forecast, at FISCO we think that there is a strong possibility that profits will exceed the Company's forecast, similar to the previous fiscal year.

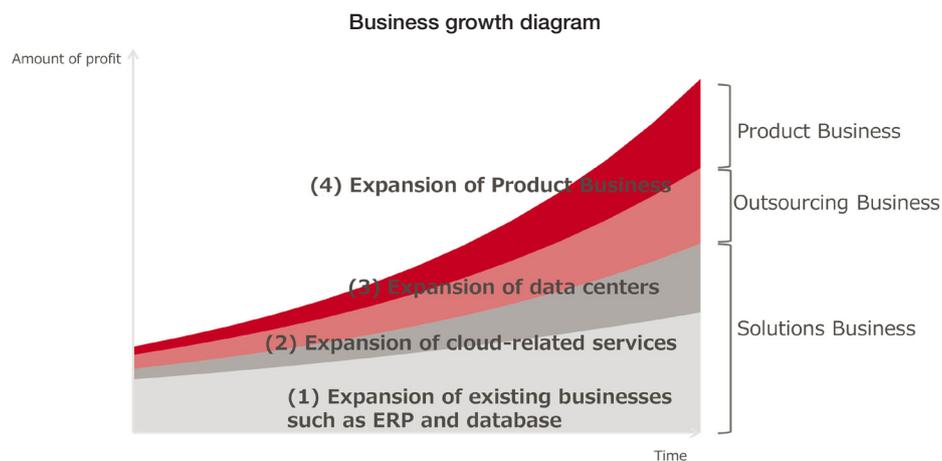
Outlook

Regarding human resources, the Company will continue to bolster hiring, and will work on increasing the number of certified professionals in cloud services. Regarding hiring, the Company hired 60 new graduates in April 2021 and 89 mid-career employees over the course of the year. In FY6/22, expecting both to be at a slightly higher level than the previous year, the Company will carry out local hiring at its business offices in Tokyo, Nagoya, Osaka and Kanazawa. By working to create employee-friendly workplaces and enhance the education and training system, the Company's attrition rate improved from 7.7% in FY6/20 to 5.9% in FY6/21. The Company will strive for further growth going forward by focusing its efforts on the hiring and development of personnel which will be the foundation for growth.

Outlook is for growth in all business segments, with particularly strong growth in business related to ServiceNow

2. Outlook and growth strategy by business segment

The Company's growth strategy for the future is to continue double-digit growth by working to expand existing businesses related to the cloud, ERP, and databases in the Solutions Business, and to achieve balanced growth in the Outsourcing Business, which includes data center services, and the Product Business, both of which will become recurring-revenue businesses. The outlook and key initiatives for each business in FY6/22 are as follows.



Source: The Company's results briefing materials

(1) Solutions Business

In the Solutions Business, the Company will continue aiming for double-digit growth by leveraging its strong technological capabilities and winning orders in the three areas related to the cloud and databases, ServiceNow, and ERP.

a) ServiceNow

Regarding ServiceNow-related business, demand is strong and there are more inquiries than the Company's human resources can handle, and it seems that the number of cases in which the Company is the prime contractor and utilizes external partners is increasing. At FISCO, we think that if progress is made on personnel development and expansion of external partners, there is a good chance that sales will increase further.

Outlook

As mentioned above, ServiceNow is a cloud platform service that has various functions that contribute to the standardization and automation of business operations, and use of it has been rapidly spreading and expanding in the last few years. In Japan, growth is accelerating as companies' efforts to shift to DX are speeding up, triggered by the COVID-19 pandemic. ServiceNow Japan (joint venture) has set further expansion and strengthening of the partner ecosystem in order to handle robust demand as one of the business strategies for 2021. In response to the increasing needs for products for industries, the Company's policy is to strengthen cooperation with partners possessing expertise in each industry. Also, the Company has set a goal of doubling the number of certified engineers in Japan from the current level of roughly 600 engineers to 1,200 engineers. This is evidence that the Company thinks that there is plenty of latent demand. Recently, the Company is strengthening initiatives on DX promotion solutions for local governments, and it appears that the strategy is to cultivate the market not only targeting companies but also the public sector. Based on the above, at FISCO we predict that there will continue to be strong growth in demand for ServiceNow over the medium term.

Meanwhile, given the fact that it is a high growth area, it is also expected that there will be an increase in companies entering the field and that competition will become fierce. In Japan, the Company entered into a partner agreement with ServiceNow at an early stage, and it has been aggressively working to expand sales. In recognition of this track record, the Company became the first Japanese company to be certified as a Bronze Services Partner* in 2017 and later as an Elite Partner in 2019. As of June 2021, including the Company, there are nine Japanese companies certified as Elite Partners, and these Elite Partners and new partners are expected to develop their human resources going forward. We, at FISCO believe that the key to future growth is how well the Company is able to increase the number of certified engineers. In addition, as one strategy for differentiating itself from the competition, the Company is developing applications (function to work with LINE, etc.) to complement the standard functions of ServiceNow.

* Criteria for certification under the ServiceNow partner program include factors such as customer satisfaction and track record of sales and deployment. The Company ranked second in Japan as of June 30, 2021 in terms of the total number of ServiceNow development certifications it has obtained, which is 84.

ServiceNow Japanese corporate partners

Category	Company name
Elite	System Support, Fujitsu <6702>, NTT Communications Corporation, NTT Data <9613>, NTT DATA INTELLILINK Corporation, NTT DATA SMS CORPORATION, Hitachi <6501>, Hitachi Solutions, Ltd., COMTURE CORPORATION <3844>
Premier	NTT COMWARE CORPORATION, KYOWA EXEO CORPORATION <1951>, ITOCHU Techno-Solutions Corporation <4739>, JSOL Corporation, Mitsubishi Research Institute DCS Co., Ltd., Mitsui Knowledge Industry Co., Ltd., Ricoh <7752>, Rocco Co., Ltd.
Specialist	Alpha Communications Corporation, Blueship Co., Ltd., DTS <9682>, IT VALUE EXPERTS Inc., Japan Business Systems, Inc., NEC <6701>, Net One Systems Co., Ltd. <7518>, NS Solutions Corporation <2327>, SCSK <9719>, TDC SOFT <4687>, transcosmos <9715>, CNS <7076>

Source: Prepared by FISCO from ServiceNow materials (as of June 30, 2021)

b) Database and cloud infrastructure

Concerning database and cloud infrastructure-related business, the Company is expected to continue to see an increase in projects to help customers construct and migrate to cloud platforms, such as Microsoft Azure and AWS. In addition, it will develop and provide account resale and option services for each cloud platform. Through these measures, the Company's strategy is to accumulate recurring revenue. Moreover, recently, based on the increase in inquiries about the Google Cloud Platform (GCP), the Company has developed ADDPLAT, a next-generation data analytics platform using the Google Cloud service, and it began offering this platform in June 2021. The distinctive feature of this service is that users can perform big data analysis at a low cost and quickly, and it can be utilized in management strategies and marketing initiatives. The Company has approximately 40 Google Cloud-certified engineers, and is able to respond to diverse needs, so similar to Microsoft Azure and AWS, it is expected to contribute to sales growth.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Outlook

Elsewhere, as for business related to AWS, in 2014, the Company became first in Japan to be certified for Oracle Competency*, an APN partner program of AWS, and orders are expected to stably increase going forward, centered on Oracle Database cloud migration projects. As the majority of these deployment projects for major cloud platform services are based on referrals from customers, the Company is able to continually secure orders without incurring sales and marketing costs. Also, unlike customized development projects, project management is relatively easy, so there is little risk of fluctuations in profitability, and therefore profit is forecast to grow stably along with the increase in sales.

* Oracle Competency is a program where AWS evaluates and certifies partners that have the technologies and track record needed to provide total support for the design, deployment, management and operation of Oracle-based workloads implemented on the AWS cloud. As of June 2021, five companies have earned this certification in Japan.

ADDPLAT overview



Source: The Company's website

c) ERP

There is currently a rush on SAP ERP migration projects ahead of the termination of maintenance in 2027, and growth of approximately 10% is expected to continue at least through 2027. Currently, demand is divided between companies migrating from the current system of SAP ERP to the next-generation solution SAP S/4 HANA, and companies who will continue using SAP ERP for the time being. Moreover, SAP S/4 HANA is provided in on-premise and SaaS versions. The on-premise version can be used with AWS, Google's public cloud, SAP's private cloud and other platforms, so there have been many cloud migration support projects.

With regard to SAP ERP, the Company and its subsidiary T4C have approximately 180 technology professionals combined, providing support for development in main areas and all levels (infrastructure, middleware, and applications). Moreover, the Company and T4C possess technologies and expertise in ERP products other than SAP ERP. One of their strengths is that they can provide a broad range of stable services according to customer needs. To address increasing demand in the run-up to 2027, the Company plans to target steady growth by continuing to work to increase and train technology professionals while building a framework for providing nearshore support related to the maintenance of existing systems in the Hokuriku area. There is significant competition for ERP usage support services, but for large-scale projects, the Company often does not directly receive orders for such projects in consideration of the risks involved. In many cases, Nomura Research Institute, Ltd. (NRI) <4307> and Accenture Japan Ltd. are the primary contractors with which the Company works on such large-scale projects.

Outlook

(2) Outsourcing Business

In the Outsourcing Business, the Company will continue to focus on building up data center services, which will form a recurring-revenue business. The Company has established data centers in two locations in Kanazawa, an area with a low risk of earthquake activity. It can expect growth in demand for the use of these data centers as backup capacity for BCP measures. The targeted customers are companies building private clouds. The Company will aim to grow by acquiring new customers and increasing sales per customer, with its proprietary value-added services as a hook. There is still more than enough processing capacity at its data centers and, by ramping up servers as needed, the Company can achieve sales growth. As of June 2021, recurring revenue of data center services, excluding initial costs, are around ¥92mn on a monthly basis, and monthly sales have been continuously achieving growth in the 6-9% range in comparison to the same months of the previous year. Growth is expected to continue at a similar pace going forward.

Priority measures: Data centers

◆ **Outline**

- The Group has established its own data centers in Kanazawa and Tokyo and provides private cloud services from these data centers.
- Recurring revenue can be generated based on the assumption of long-term use of data centers.

◆ **Features of the Group**

- Data centers can also be used for BCP measures by locating them in Kanazawa, where there are few earthquakes.
- Targeting a different customer segment than for public clouds.
- Efforts will be made to increase the utilization rate of data centers by offering services with proprietary added value on data center platforms, along with using these services as a hook to attract customers.

Data center services

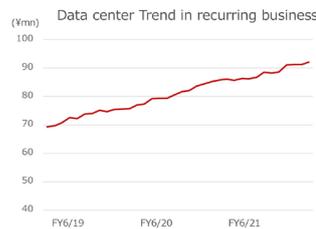
Offer proprietary services such as AI-driven analytics on the data center platform

Magic Insight
A service that allows customers to use IBM Watson Explorer (ASP/SaaS) for a monthly charge

Safetylink 24
Safety confirmation system with a track record of deployment at more than 800 companies nationwide

Private cloud

*Source: JMA Seismic Intensity Database
Number of earthquakes observed in 2020 with a seismic intensity of 1 or greater on the JMA Seismic Intensity Scale: 5 (Maximum seismic intensity: 3)



Source: The Company's results briefing materials

(3) Product Business

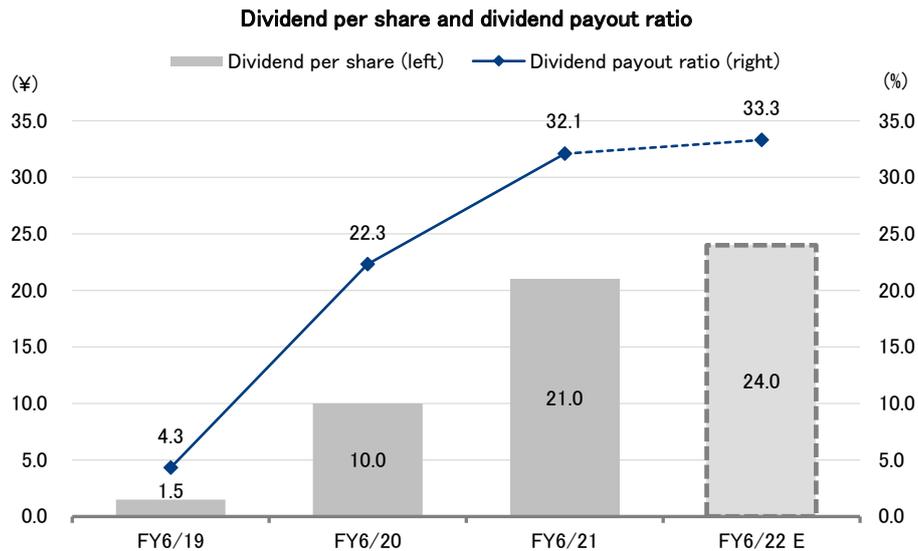
For the Product Business, the Company's strategy is to increase the number of subscribers to drive revenue growth. To this end, the Company will improve the functionality of each product, strengthen sales via sales agencies, and conduct online marketing, as well as work to customize products to match customer needs. Tate Yakusha, MOS, and SHIFTEE have already become profitable, and from here on, any increase in sales of these products will lead directly to increases in profit, excluding the development costs incurred to strengthen product functionality.

In addition, for MOS and Shugyo Yakusha, inquiries for large projects and customization needs have been increasing via agencies in response to tailwinds from changes in the market environment such as wider adoption of work style reforms and working from home. Compared to competing services, the high cost competitiveness and ability to customize seem to be seen positively. While there is robust demand, the shortage of development personnel is an issue, and going forward, the Company will aim to grow the business while strengthening its personnel system. In the Product Business, the Company also intends to consider M&A opportunities.

Shareholder return policy

Policy calls for maintaining stable dividends based on consideration of factors such as earnings levels

The Company regards the return of profits to shareholders as an important management issue, and has indicated its basic policy on distributing profits is to provide stable dividends based on consideration of factors such as earnings levels, while ensuring adequate internal reserves needed for future business expansion and strengthening the management structure. It will also strive to improve the level of dividends according to business results and profit levels. With respect to the dividend per share for FY6/22, the Company plans to increase the dividend amount ¥3.0 YoY to ¥24.0, which would mark the third consecutive year of dividend increases since its listing on the stock market. The targeted dividend payout ratio is believed to be in the low 30% range, so if the dividend payout ratio falls below 30%, we at FISCO believe that further dividend increases can be expected.



Note: The Company conducted a two-for-one stock split in June 2020. Figures for FY6/19 have been retrospectively adjusted
Source: Prepared by FISCO from the Company's financial results



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