COMPANY RESEARCH AND ANALYSIS REPORT

CAC Holdings Corporation

4725

Tokyo Stock Exchange First Section

4-Dec.-2018

FISCO Ltd. Analyst
Yoshihiro Maeda

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

An IT & healthcare group that is aiming to create new value through advanced ICT. Expectations for the announcements of the new medium-term management strategy and action plan with a sense of preparedness.

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 area through an active M&A strategy, and today, it has become an IT & healthcare group that is aiming to take a dramatic leap forward in its overseas business (it conducts business through 20 consolidated subsidiaries 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).

2. The financial base is solid and the FY12/18 results are trending within the initially expected range

Looking at the trends in the Company’s results in the period of the previous medium-term management strategy (FY12/15 to FY12/17), the growth in net sales was only 2% a year, and in this situation operating profit declined for three consecutive fiscal periods and the results for flow earnings were poor.

However, on looking at the trends in the representative indicators showing the stability of the Company’s financial structure, each are being maintained at sounds levels; specifically, the equity ratio at the end of FY12/14 was 54.3%→58.6% at the end of FY12/17, the current ratio was 257.8% at the end of FY12/14 →216.6% at the end of FY12/17, and net cash (cash and deposits-interest-bearing debt, plus cash in excess) was ¥3,133mn at the end of FY12/14 →¥4,080mn at the end of FY12/17.

In the FY12/18 1H consolidated results, net sales decreased 9.7% year-on-year (YoY) to ¥25,440mn, while operating income increased 31.6% to ¥534mn.

Although the rates of progress were low toward achieving the full fiscal year forecasts, which are net sales of ¥54,000mn (up 1.4% YoY) and operating profit of ¥1,600mn (up 129.1%), the results up to 1H trended within the initially expected range.

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 & 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. Refining the medium-term management strategy it is focusing on

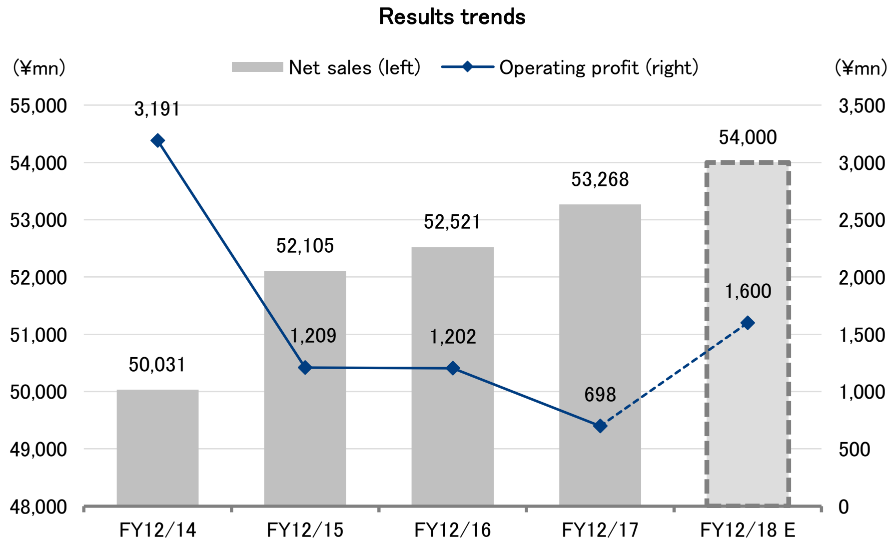
As the top priority issue of its management team, the Company is working to refine Determination 21, which is the new medium-term management strategy with FY12/18 as its first fiscal year.

In this medium-term management strategy, the Company sets out various measures, including 1) improving the earnings power of existing businesses, 2) creating and expanding new business domains, and 3) strengthening and revitalizing the Group. The strategy also indicates the numerical targets for its final fiscal year (FY12/21), of net sales of ¥70bn and operating income of ¥4bn.

This refining work, which is currently ongoing, is being progressed based on thorough discussions in the Board of Directors, and there is the feeling that there may even be a far reaching review of the initial plan. Going forward, we can expect it to create an action plan that further incorporates measures for "improving the earnings power of existing businesses."

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 & healthcare services company conducting a domestic IT business, an overseas IT business, and a CRO business.
- 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."
- Although results did not recover during the period of the previous medium-term management strategy, is making progress in responding to the clarified issues. We can expect the announcement of an action plan that further incorporates measures for "improving the earnings power of existing businesses" in the new medium-term management strategy.



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

Company profile

An independent SIer pioneer that has continued to take on challenges for more than half a century. Has gone through periods of IT business expansion and CRO business development, and is taking on the challenge of creating further enterprise value.

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 has been handed down for more than half a century and continues in the present day.

Looking back on the Company's history of more than half a century, we see that 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 area 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) area.

Company history relating to the domestic IT business

Period	Date	Event (organic business expansion, business expansion through M&A, selection and concentration such as through business withdrawal, etc.)
Foundation period	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%
Growth period	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
	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
IT business expansion period	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.
	2000	Acquired all of the shares of ARK Systems Co., Ltd., a systems operation and management services company, and made it a subsidiary. Established Web Progressive Co., Ltd., to conduct a multimedia business that utilizes the Internet as a joint venture between SHOGAKUKAN Inc., NEC Corporation, and the Company. Established NetAdvance Inc., to provide digital content services as a joint venture between SHOGAKUKAN Inc., FUJITSU LIMITED, 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. 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. 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.
	2005	Relocated the head office to Hakozaki-cho, Nihonbashi, Chuo Ward, Tokyo. 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)
	2007	Established kizasi Company, Inc., to conduct an Internet-related business

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

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; MIC Medical Corp., and clinical trust Co., Ltd., in 2009; and Sogo Rinsho Holdings Co., Ltd., 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.

Company history relating to the CRO business

The CRO business development period

Date	Event (organic business expansion, business expansion through M&A, selection and concentration such as through business withdrawal, etc.)
2002	Starting providing PRASMA, a service to comprehensively support new drug research and development.
2006	Acquired the shares of Arm Systex Co., Ltd., which conducts a CRO business, and Arm Co., Ltd. made them subsidiaries of the Company
2007	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
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.

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

3. Acquisition of an Indian company opened the curtain on a period of the fully fledged development of the overseas IT business

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 (below, AFL), 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. (below, Sierra), which is a Singapore IT company that conducts a business for medical institutions in the Asia region (sold in 2017).

Company history relating to the overseas IT business

Overseas business development period

Date	Event (organic business expansion, business expansion through M&A, selection and concentration such as through business withdrawal, etc.)
1989	Established CAC America in New York City, U.S.
1990	Established CAC Europe in London City, U.K.
2000	Established the subsidiary CAC PACIFIC CORPORATION in San Jose City, USA.
	Established CAC Shanghai Corporation in Shanghai City, China, through a 100% investment by CAC Pacific.
2010	Established CAC India in Mumbai City, India.
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.
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.

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

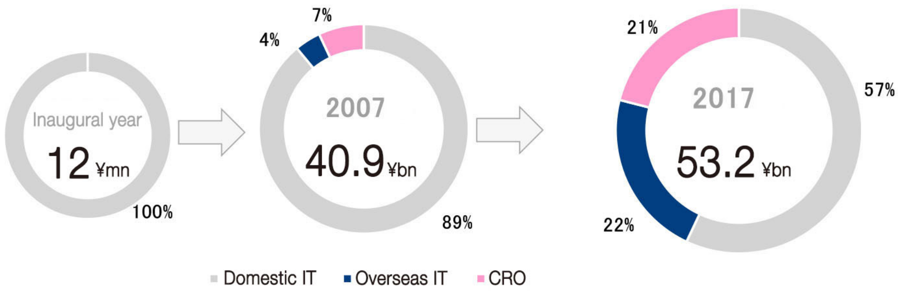
Business description

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."

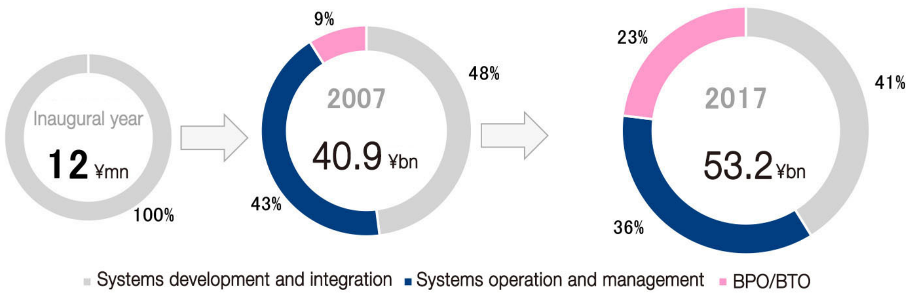
It has also been conducting an M&A strategy since 2014, and a direct reason for the review of the reportable segments was the fact that net sales from the overseas IT business had reached 20% of total net sales. We can expect the Company, which up to the present time has used overseas markets as its growth frontier, to take on the new challenge of growing in overseas markets.

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



Source: Prepared by FISCO from the securities report and the annual report

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



Source: Prepared by FISCO from the securities report and the annual report

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

The domestic IT business, which provides 57% of Company-wide net sales (FY12/17), 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, 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, and it boasts high market shares.

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

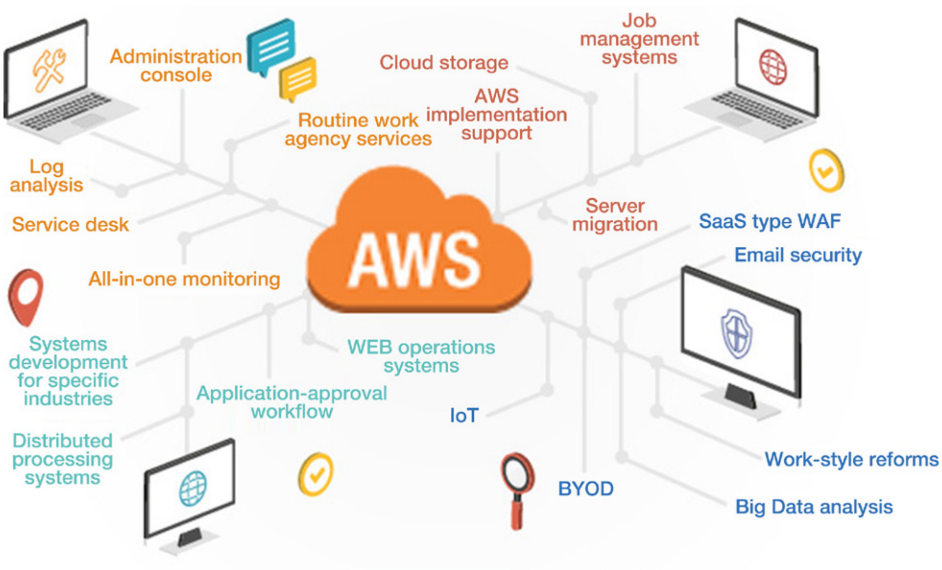
The origins of the systems operation and management services can be found in the investment in the specialist outsourcing services company (SSK) in 1971. The Company provides total services for the necessary functions for systems management, and currently these include operations process management, 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 is also strengthening its Cloud support at a rapid pace.

The acceleration of the shift to the Cloud has the aspect of causing existing businesses to contract for IT vendors. But the Company considers this negative aspect to be small and instead, it is positioning the shift to the Cloud as a new business opportunity and is actively conducting measures for it.

Overall image of Cloud services using AWS

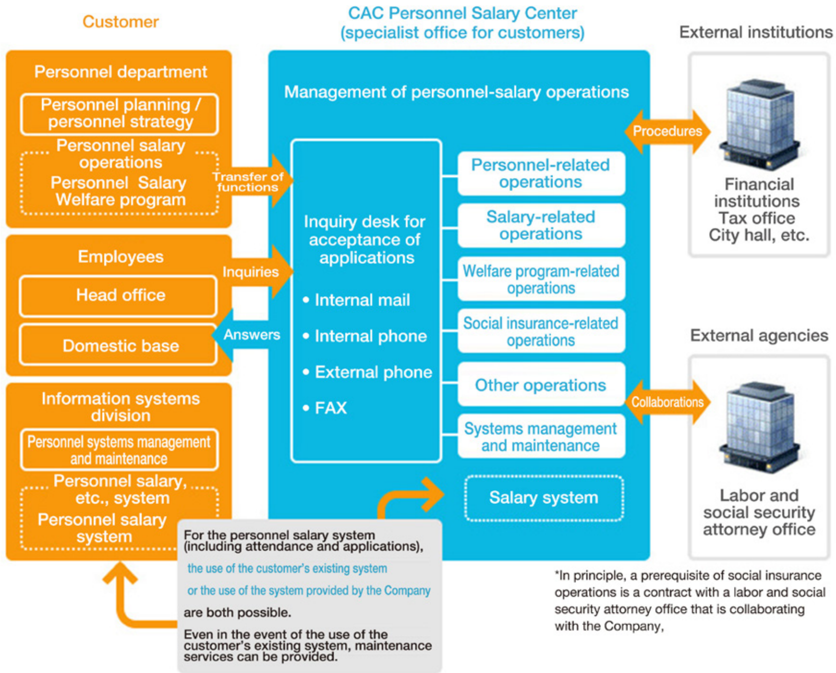


Source: Company website

(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.

Overall image of HR BPO services



Source: Company website

2. Taking on the challenge of the overseas IT business as the growth frontier

The overseas IT business is conducted by the 11 overseas companies in the Group (as of April 1, 2018), and it includes systems development and integration services, systems operation and management services, and maintenance services.

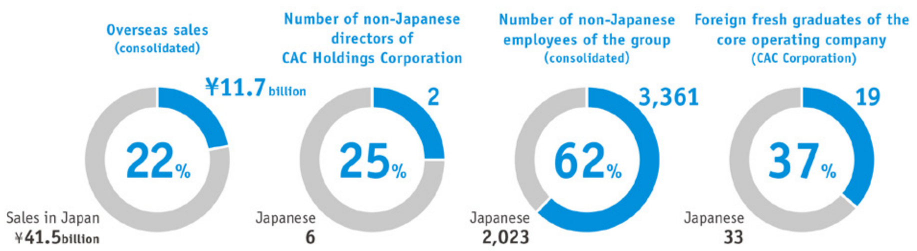
Global network

Source: Company's annual report

From an early stage, the Company understood overseas markets to be its growth frontier, such as preceding its industry peers in entering-into them in the 1970s. It has also actively conducted M&A and other measures, and since 2015, the overseas sales ratio has exceeded 20% (22% in 2017, of which, Asia contributed 74%), and during the period of 2015 to 2017, it grew in scale to be larger than the CRO business.

In terms of the organization and personnel also, it has been noticeable that the Company has been strengthening its global business development capabilities, such as having a ratio of foreign directors of 25% and a ratio of foreign employees of 62%.

Ratios of net sales and personnel from overseas



Source: Company's annual report 2018

Conversely, in a situation of requiring a rapid expansion in scale, the issues for the M&A strategy (due diligence and PMI) have become clear, including the occurrence of unexpected losses in the companies acquired and being forced to separate the business, even at an early stage.

For its overseas IT business, the Company recognizes that it is shifting from the main stage, of global support for its customers of Japanese companies and offshore utilization of overseas Group companies, to a stage of focusing on India and China due to their enormous local markets.

On this point, AFL, which it made a subsidiary in 2014, has excellent customers at each of its bases, including in the U.S., the U.K., and the Middle East, as well as manufacturing company and financial institution customers at its main base in India, and it is worthy of attention as a bridgehead to enter-into local overseas markets.

Also, AFL has a track record in Japan and elsewhere of sales of hundreds of millions of yen in relation to the growth field of ADAS (Advanced Driver-Assistance System). Its incorporation into the Group is extremely significant in terms of acquiring a foothold for a business for vehicles, which, despite being an enormous industry, the Company has a scarce track record in up to the present time.

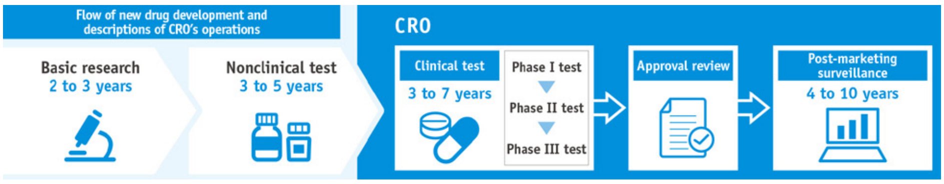
In the ADAS field, there is enormous scope for utilizing the emotional recognition AI technologies of Affectiva of the U.S., in which the Company has invested and concluded a sales agency agreement, and we can expect developments in the future.

With regards to the overseas IT business that has both growth potential and issues, in the refined version of Determination 21, the new medium-term management strategy, just as the name suggests, it incorporates an action plan with a sense of preparedness for the future.

3. The CRO business has grown to be one of the two pillars of earnings

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. It provides 21% of total net sales (FY12/17), but in terms of profit scale, it has grown to be one of the two pillars of earnings, competing with the domestic IT business to be the leading earner.

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 (below, 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."

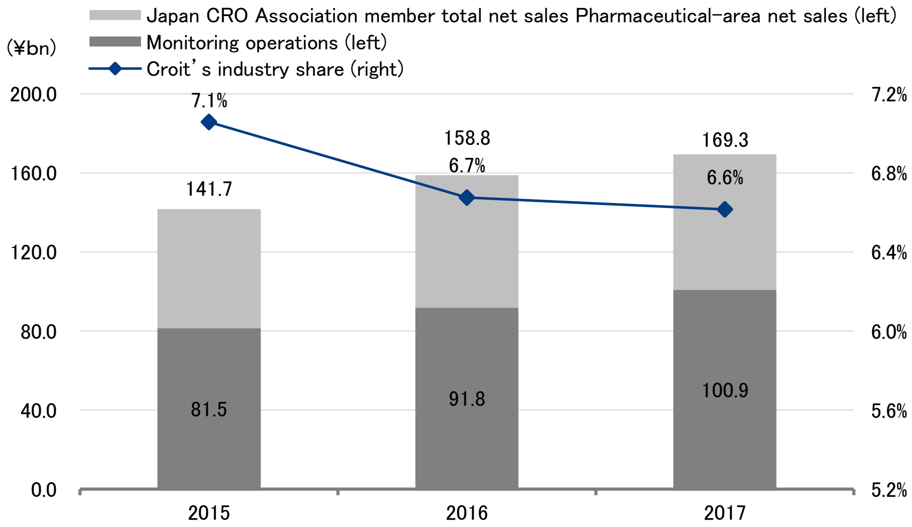
Croit provides support to its 170 customer companies in a range of operational fields; specifically, it conducts pharmacovigilance services (percentage of total net sales in FY12/17, 48.8%), clinical trial operations (23.9%), operations after the drug's manufacture and sale (10.0%), application-related operations (5.4%), and other operations (4.1%). 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.

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.

(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) its industry share is trending at the slightly low level of around 7%, 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.

Trends in net sales in the CRO industry and the Company's industry share



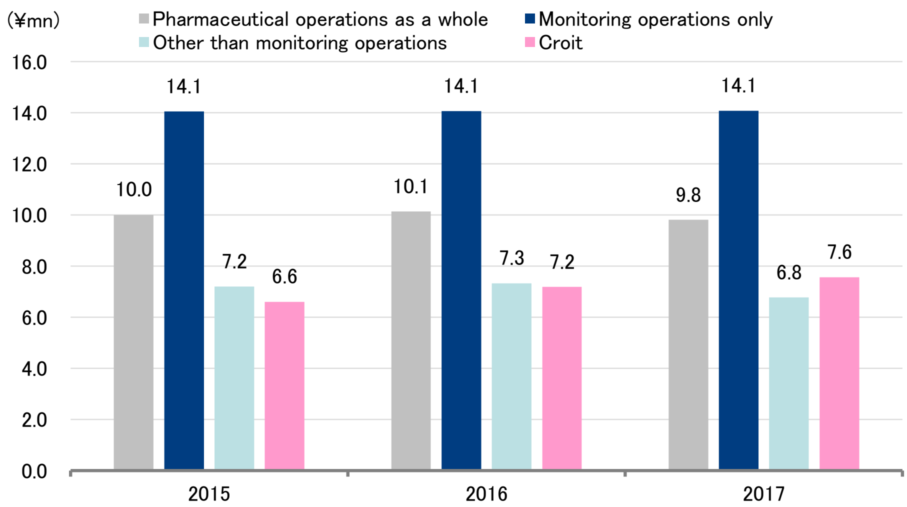
Source: prepared by FISCO from the Japan CRO Association's Annual Report and CAC Croit's Fact Book

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 in the last two years was 11.3%, which was above the rate for the industry as a whole of 9.3%, 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.

CRO operations net sales per capita



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

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 also, by slightly more than 5%. In contrast to this, the labor productivity of the industry as a whole for monitoring operations was unchanged in 2016 and 2017, while for operations other than monitoring operations, it improved by slightly less than 2% in 2016 and worsened by slightly less than 8% in 2017, which makes Croit's improvement rate even more remarkable.

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 2018, within the total number of employees of 1,480 people, 716 were mate employees (employees of cooperating companies).

(3) Launch of a compound sharing library 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 a compound sharing library 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.

The actual recording of sales will likely start from 2019, while it seems that its use by three to five companies has already been confirmed and that its annual contribution to results will be in a range of ¥300mn to ¥500mn.

A feature of this business we should pay attention to is the fact that it is a typical example of CSV (social contribution through a Creating Shared Value 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

The financial base is solid and the FY12/18 results are trending within the initially expected range

1. Issues were clarified in the previous medium-term management strategy period

Looking at how the Company's results trended during the period of the previous medium-term management strategy (FY12/15 to FY12/17), net sales grew by only 2% a year, and in this situation, operating profit declined for three consecutive periods and the results for flow earnings were poor.

Looking at net sales and the profit margin by service, it can be said that first, the problems were clearly the slump in sales in the domestic IT business and the recording of unexpected losses in the overseas IT business.

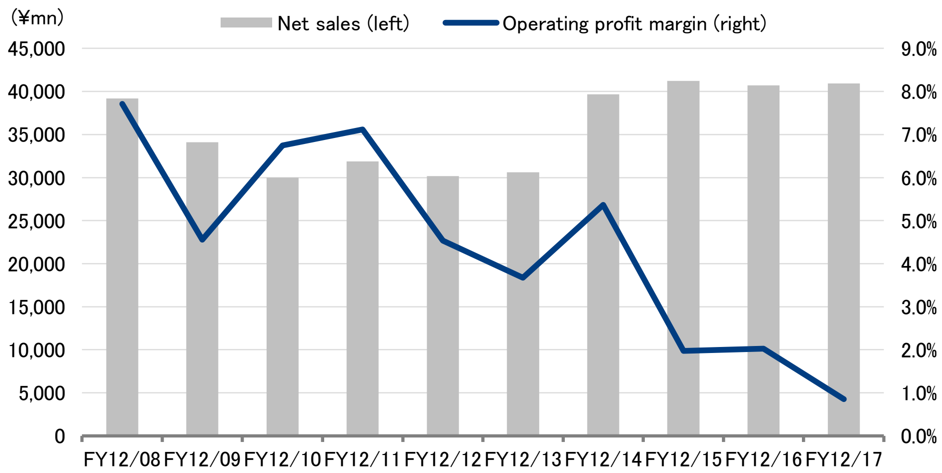
During the period of the previous medium-term management strategy, within BPO/BTO services (former reportable segment), the CRO business (new reportable segment) accounted for more than 90% of sales. Therefore, there is no problem in thinking that adding systems operation and management services (former reportable segment) to systems development and integration services (former reportable segment) is basically the same as "the domestic IT business + the overseas IT business" (new reportable segments).

Through making subsidiaries of AFL in 2014 and Sierra in 2015, net sales in the overseas IT business grew to a scale of ¥10bn, from which it is clear that sales in the domestic IT business slumped. On the other hand, between 2015 and 2017, AFL recorded losses of approximately ¥3bn (including extraordinary losses), which included an allowance for doubtful accounts and an impairment loss on goodwill, business infrastructure improvement expenses, a loss on the sale of a subsidiary, and an increase in SG&A expenses. Sierra also incurred a loss of more than ¥500mn due to unprofitable major projects in 2017.

In the context of these issues, going forward it will be necessary to pay attention to how the Company responds to the domestic factors. But for the overseas business, AFL has already completed a round of business structural reforms, and for Sierra also, the transfer of all shares was completed in December 2017.

As a result, in the overseas IT business, segment income, which was a loss of ¥224mn in FY12/18 1Q, became income of ¥38mn in 2Q on a quarterly basis, and the effects of the Company's responses are already starting to appear.

Trends in net sales and the profit margin for the
"systems development and integration + systems operations and management business"



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

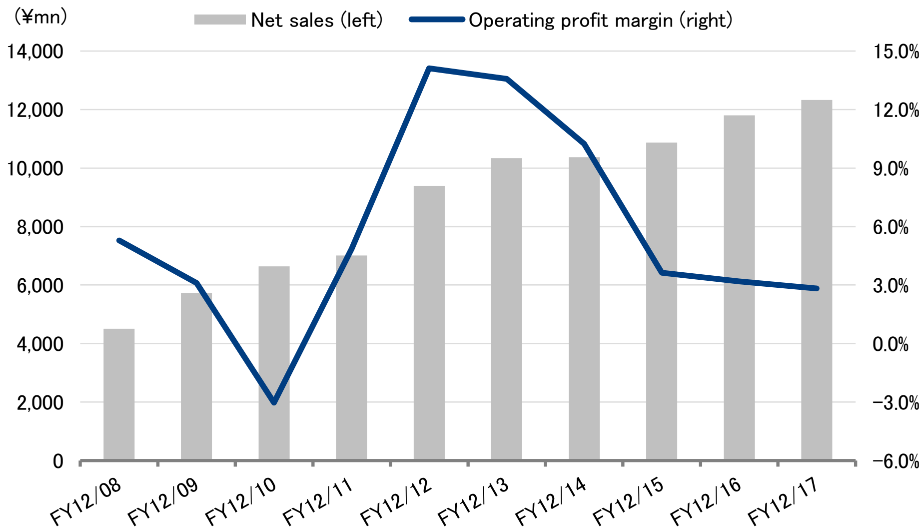
Looking at the trends in net sales and the profit margin in the BPO/BTO services business (former reportable segments; in recent years, the CRO business has contributed more than 90% of the net sales in this business), we see that on the one hand, while experiencing some slight plateaus, the scale of the CRO business has been steadily expanding, but on the other hand, it has become apparent that the major fluctuations in the profit margin is an issue.

It has been noted that the main reason for the major fluctuations in the profit margin is the occurrence of unprofitable projects caused by the form of the contract with pharmaceutical companies.

This is because in the Company's mainstay operations of pharmacovigilance (collecting and accumulating information on pharmaceuticals' side effects and making applications), it is extremely difficult to accurately predict the occurrence of side effects, so there is no choice but to deploy ample human resources at peak times, and so unprofitable projects frequently occur.

Through negotiations with the pharmaceutical companies, the Company is shifting the contract form from payments that vary according to the volume of operations, to a method in which a variable amount is added to a fixed, basic amount according to the volume of operations. Although there may be a view that this is too late and the damage has already been done, it can be said to show that the Company is responding to a fundamental issue in the CRO business, and when combined with the improved productivity through the utilization of ICT, we think it is highly likely that it will improve profitability and stabilize profits.

Trends in net sales and the profit margin in the BPO/BTO services business



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

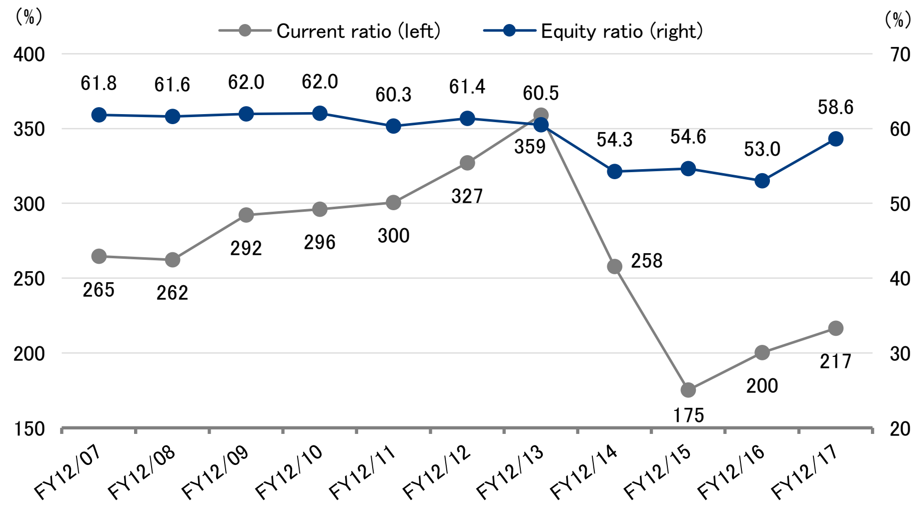
2. Has a solid financial base, while the focus is also on its large holdings of Recruit shares

Looking at the trends in the representative indicators of the stability of the financial structure, we see each are being maintained at a sound level. Specifically, the equity ratio at the end of FY12/14 was 54.3%→58.6% at the end of FY12/17, the current ratio was 257.8% at the end of FY12/14 →216.6% at the end of FY12/17, and net cash (cash and deposits minus interest-bearing debt, plus shows cash in excess) was ¥3,133mn at the end of FY12/14 →¥4,080mn at the end of FY12/17.

What we should focus on here is that, in a situation of the recording of continuous gains on the sales of securities due to the rise in the prices of shares, including of Recruit Holdings <6098> (below, Recruit), the value of the Company's investment securities, which forms its non-current assets, has greatly increased.

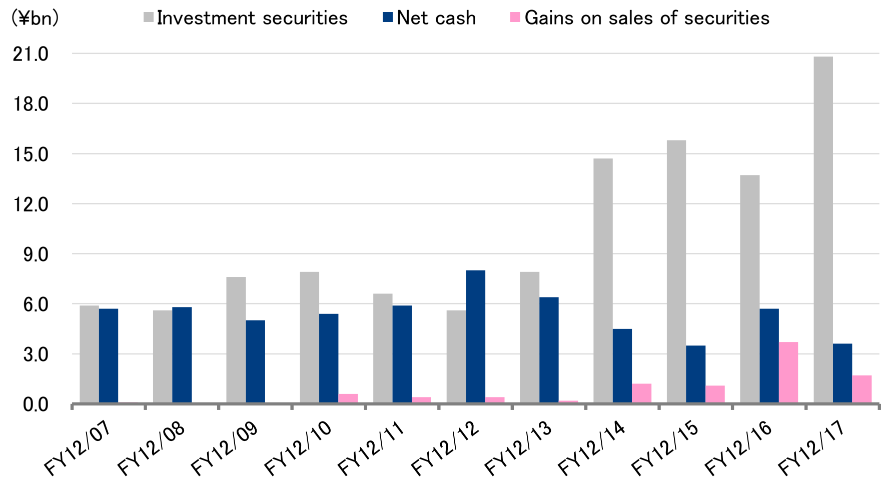
The value of the Recruit shares held by the Company is ¥14,868mn (end of FY12/17), which accounts for the majority of its total balance of investment securities (¥20,788mn). Holding a large volume of Recruit shares, which have high market liquidity (highly convertible) and a low acquisition book value, has the effect of greatly increasing the current ratio and net cash in actual terms. This holding of shares with high market liquidity can be said to support the Company's flexible financial strategy.

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

Simplified statements of income

(¥mn)

	FY12/14	FY12/15	FY12/16	FY12/17	FY12/18 E
Net sales	50,031	52,105	52,521	53,268	54,000
YoY	22.1%	4.1%	0.8%	1.4%	1.4%
Cost of sales	39,963	42,315	42,041	42,996	-
YoY	22.1%	5.9%	-0.6%	2.3%	-
Gross profit	10,067	9,790	10,479	10,272	-
YoY	22.2%	-2.8%	7.0%	-2.0%	-
SG&A expenses	6,876	8,581	9,277	9,573	-
YoY	20.4%	24.8%	8.1%	3.2%	-
Operating profit	3,191	1,209	1,202	698	1,600
YoY	26.2%	-62.1%	-0.6%	-41.9%	129.1%
Ordinary profit	3,000	1,080	937	717	1,500
YoY	12.6%	-64.0%	-13.3%	-23.4%	108.9%
Profit attributable to owners of parent	2,343	-142	2,039	1,100	1,100
YoY	54.7%	-	-	-46.0%	-0.0%

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

Simplified balance sheet

(¥mn)

	FY12/14	FY12/15	FY12/16	FY12/17	Change
Current assets	29,815	25,300	26,468	24,084	-2,384
Cash and deposits	9,881	8,983	11,428	8,551	-2,877
Notes and accounts receivable - trade	10,612	12,081	10,318	10,440	122
Non-current assets	23,571	26,483	23,876	30,041	6,165
Property, plant and equipment	1,928	1,883	1,731	1,392	-339
Intangible assets	4,236	5,315	4,736	3,871	-865
Investments and other assets	17,406	19,284	17,408	24,777	7,369
Total assets	53,387	51,783	50,344	54,125	3,781
Current liabilities	11,563	14,434	13,218	11,120	-2,098
Notes and accounts payable - trade	3,841	3,907	3,324	3,431	107
Short-term loans payable	2,465	5,070	3,382	2,856	-526
Non-current liabilities	11,513	8,055	9,442	10,576	1,134
Bonds payable	300	-	-	-	-
Long-term loans payable	2,598	463	2,373	2,084	-289
Total liabilities	23,077	22,489	22,661	21,696	-965
(Interest-bearing debt)	5,363	5,533	5,755	4,940	-815
Total net assets	30,310	29,293	27,683	32,429	4,756

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

3. The FY12/18 results trended within the initially expected range

In the FY12/18 1H consolidated results, net sales decreased 9.7% YoY to ¥25,440mn and operating profit increased 31.6% to ¥534mn.

The rates of progress were low toward achieving the full fiscal year forecasts, of net sales of ¥54,000mn (up 1.4% YoY) and operating profit of ¥1,600mn (up 129.1%). However, the Company has projects for trust banks that are scheduled to be recorded as sales in 4Q, so the results up to 1H are within the initially expected range.

Looking at the indicators of financial stability at the end of June 2018, the equity ratio was 58.6% and the current ratio was 205.6%, so both are being maintained at sound levels. Also, net cash was ¥4,980mn and the valuation of investment securities was ¥22,248mn, both of which were higher amounts than at the end of FY12/17.

Financial results forecast

	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent		EPS
	¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥mn	YoY (%)	¥
FY12/17	53,268	1.4	698	-41.9	717	-23.4	1,100	-46.0	59.69
FY12/18 E	54,000	1.4	1,600	129.1	1,500	108.9	1,100	-0.0	59.67
FY12/18 1H	25,440	-9.7	534	31.6	477	48.4	283	-48.4	15.39

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 & 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.

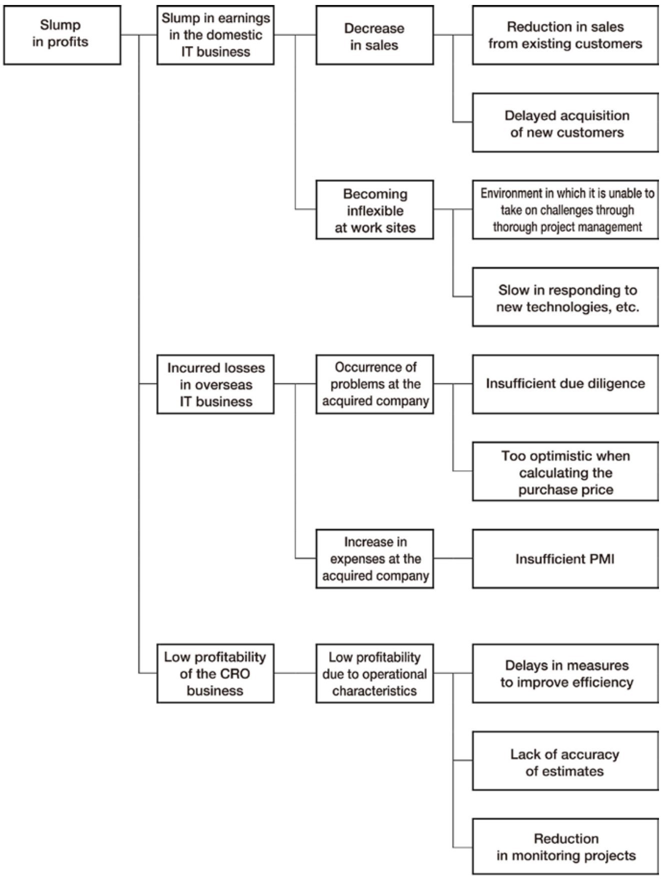
Also, the fact that the Company launched an overseas IT business in advance of its industry peers and developed the CRO business to be one of its two pillars of earnings can be said to be a benefit of the good relations with its "excellent customer base" that it has built as Japan's first independent 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. Issues tend to occur as the reverse side of strengths

On using a Why Tree analysis to search for the factors behind the slump in the Company's profits, it becomes apparent that 1) "taking on challenges," which should have been a method, ended up becoming a purpose, such as that the due diligence and PMI that form the basis of an M&A were insufficient due to the excessive pursuit of sales expansion in overseas markets, and 2) because its customer base is excellent and relations with customers are good, it was too slow in implementing measures that it should have taken much earlier.

Analysis of the causes of the slump in profits (Why Tree)



Source: Prepared by FISCO based on information collected

Business outlook

Refining the medium-term management strategy it is focusing on

As a priority issue for the management team, the Company has been working to refine Determination 21, which is the new medium-term management strategy with FY12/18 as its first fiscal year.

In this medium-term management strategy, the Company sets out various measures, including 1) improving the earnings power of existing businesses, 2) creating and expanding new business domains, and 3) strengthening and revitalizing the Group. The strategy also indicates the numerical targets for its final fiscal year (FY12/21), of net sales of ¥70bn and operating profit of ¥4bn.

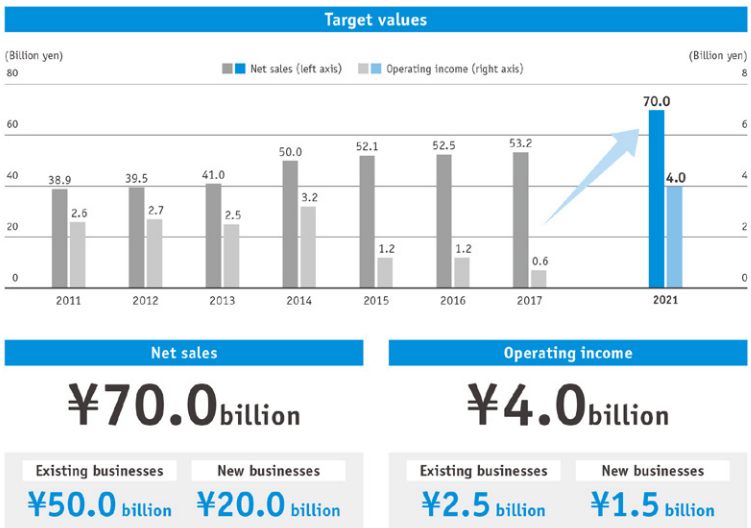
This refining work, which is currently ongoing, is being progressed based on thorough discussions in the Board of Directors, and there is the feeling that there may even be a far reaching review of the initial plan.

When presenting the strategy's content, it seems highly likely that it will create an action plan that further incorporates measures for "improving the earnings power of existing businesses."

Specifically, we will be paying attention to whether or not it includes the following points; 1) Measures to acquire new customers in the domestic IT business, 2) measures to further raise the gross margin at the time of ordering in the domestic IT business, 3) measures to keep down unprofitable projects, 4) measures to promote the development of local markets in the overseas IT business, 5) measure to increase sales and improve productivity in the CRO business, 6) setting targets for medium-term cost reductions, and 7) setting KPI for these measures and presenting a process chart for them.

Furthermore, we also hope that the lessons learned from the past M&A successes and failures will be formalized within the Company. In an M&A strategy, "the ability to select," "the ability to be selected," "and the ability to fully utilize" are crucial, and these should be backed by a company's core competencies. In the case of the Company, which has many strengths, it is considered that it is able to formalize them independently.

Determination 21, the new medium-term management strategy



Source: Company's annual report

Shareholder returns

Management's intentions can be felt in the recent dividend policy

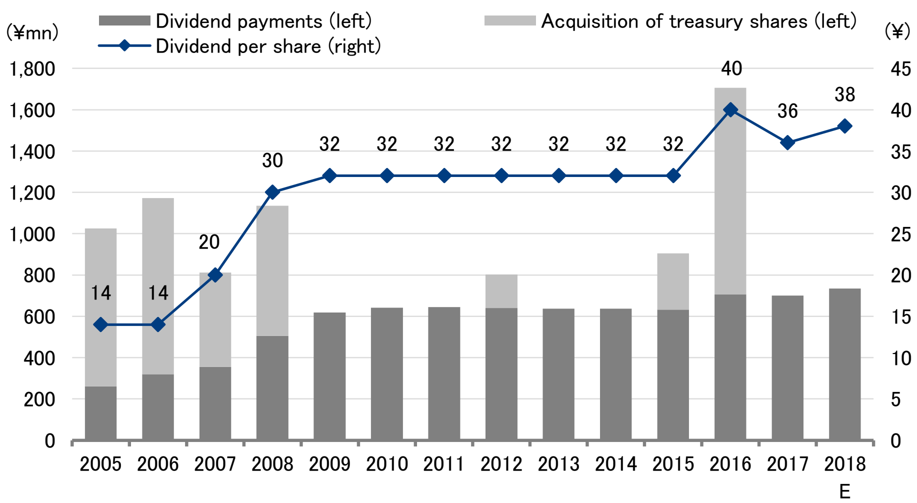
The Company cites "achieving a balance between investment for growth and stably returning profits to shareholders" as its financial strategy.

In fact, on looking at dividend payments from 2000 onwards, we see that it has reduced the dividend only once, in FY12/17, which was following the payment of a commemorative dividend on the 50th anniversary of its foundation, and that even in FY12/17, in which profits declined greatly, the dividend reduction was still only half (a reduction of ¥4 per share) of the commemorative dividend (¥8 per share).

For the FY12/18 forecast, the Company has announced that it will increase the dividend per share by ¥2, even though profit attributable to owners of parent is expected to be unchanged YoY.

On this point, when considering that it continuously paid a dividend of ¥32 from 2009 to 2015, and from a dividend policy in which it has increased (or is scheduled to increase) the dividend in two of the most three recent fiscal periods, we can feel the strength of management's intentions, in which it continuously has returning profits to shareholders in mind.

Dividend payments and the acquisition of treasury shares



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

Update

Ordinary profit increased 105.5% in FY12/18 3Q, and the CRO business contributed to results

CAC Holdings <4725> announced its FY12/18 3Q (January to September, 2018) consolidated results on November 9th. Net sales decreased 7.2% year-on-year (YoY) to ¥37,394mn, operating profit increased 84.6% to ¥881mn, ordinary profit rose 105.5% to ¥811mn, and profit attributable to owners of parent declined 32.9% to ¥468mn.

In this 3Q, net sales decreased due to factors including the decline in sales in the overseas IT business, mainly from the effects of the removal from the scope of consolidation of the two overseas subsidiaries that were sold in the previous fiscal year alongside the rebuilding of the overseas business, and also the decline in sales in the domestic IT business. However, profits increased greatly despite the impact of the decline in sales, including from the improvement in the profitability of the CRO business.

In the domestic IT business, net sales declined 3.2% YoY to ¥21,689mn, including due to the decreases in hardware sales to large customers and sales to financial institutions. Segment income fell 24.8% to ¥537mn, mainly because of the impact of the lower sales.

In the overseas IT business, net sales decreased 22.5% YoY to ¥7,455mn, including from the effects of the rebuilding of this business in the previous fiscal year and the decline in sales from the Indian and U.S. subsidiaries. Segment income was a loss of ¥226mn (a loss of ¥365mn in the same period in the previous fiscal year), primarily from the effects of the business restructuring.

In the CRO business, net sales trended at around the same level as in the same period in the previous fiscal year, decreasing 0.2% YoY to ¥8,250mn. Segment income increased 344.0% to ¥570mn, mainly because of the elimination of low-profit projects and the reduction in costs.

The initial forecasts for the FY12/18 full year consolidated results have been left unchanged, which are for net sales to increase 1.4% YoY to ¥54,000mn, operating profit to rise 129.1% to ¥1,600mn, ordinary profit to climb 108.9% to ¥1,500mn, and profit attributable to owners of the parent to decrease 0.0% to ¥1,100mn.

Disclaimer