

Cybernet Systems Co., Ltd.

4312

Tokyo Stock Exchange Standard Market

16-Oct.-2023

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FISCO Ltd.

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

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Summary

Combining simulation technology with AI, AR/VR, and other advanced technologies to promote DX in the area of R&D

Cybernet Systems Co., Ltd. <4312> (hereafter, also “the Company”) is a major company for CAE (computer-aided engineering) software solution services that are used for design, R&D, and other aspects, centered on the manufacturing industry, and it also handles cloud security and other products. As a leading CAE company, it is a software product sales vendor for more than 35 companies, centered on products from Ansys<ANSS>, the world’s leading company in CAE products with an approximately 38% share of the global market, while as a pioneer for CAE solutions, it has about 2,400 companies and 350 universities and research institutes as its customers. In addition, it has three software development companies as its subsidiaries in Europe and the US, and also conducts a CAE solutions business in the Asian market, mainly in China and Taiwan. Approximately 60.0% of net sales on a Company stand-alone basis come from license renewals, so earnings are relatively stable, and ample financial assets of over ¥16bn on hand set the Company apart.

1. Overview of 1H FY12/23 results

In the 1H FY12/23 (January-June 2023) consolidated results, net sales increased 2.7% year on year (YoY) to ¥10,003mn, while operating income decreased 38.0% YoY to ¥640mn. In the Simulation Solution Services business, despite weakness in domestic sales of new licenses and sales subsidiaries in Asia, an increase in net sales was secured due to strong demand for license renewals from existing customers and growth in the IT Solution Services business, especially for security products. Profits, on the other hand, declined due to higher personnel and recruiting expenses associated with investment in human resources, as well as higher purchase costs stemming from yen depreciation. However, orders received increased steadily by 7.1% YoY to ¥11,317mn, and the backlog of orders at the end of 1H was up 12.9% to ¥9,504mn, so sales are expected to grow even further in 2H.

2. Outlook for FY12/23

For consolidated results in FY12/23, the Company maintained its initial forecasts for sales and profit growth, targeting net sales of ¥22,000mn (up 10.4% YoY) and operating income of ¥1,850mn (up 5.2%). It aims to achieve its full-year forecast by promoting its medium-term business plan goals which include strengthening products developed in-house and expanding business in Asia. Although the hurdle is a somewhat higher, as the Company needs to increase sales to around ¥12bn in 2H, we at FISCO believe the forecast is achievable as orders have been steady and projects that were postponed in Asia are expected to be recorded in 2H. In terms of profit, high purchase costs may pose a challenge if the exchange rate remains in the range of ¥140 per US dollar, but the Company plans to achieve its forecast by increasing sales while controlling costs.

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Summary

3. Medium-term business plan

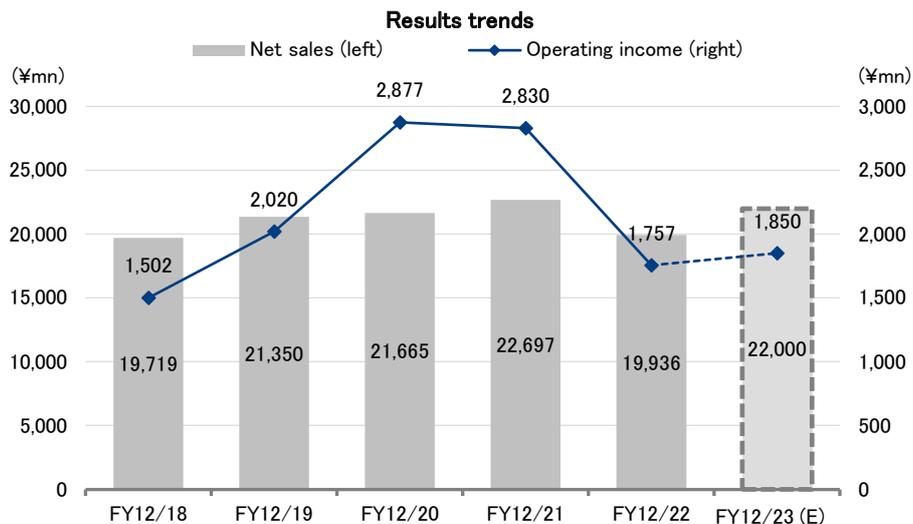
The Company started a medium-term business plan lasting five years from FY12/22. As a growth strategy, it will strive for sales growth by working on enhancement of in-house product development, expansion of business in Asia, DX promotion of manufacturing, and utilization of simulation technology in fields such as SDGs. At the same time, it will aim for high-level profit margins while balancing enhancement of businesses with high added value and growth investment. For numerical management targets, in FY12/26, the Company will aim for net sales of ¥30,000mn (up 50.5% compared to FY12/22), EBITDA (operating income + depreciation and amortization) of ¥3,800mn (up 23.7%). In-house developed products and services hold the key to attaining targets; while leveraging M&A, the Company plans to increase the net sales share of these products and services from 30% in FY12/22 to 40% in FY12/26, roughly double the amount of net sales in monetary terms. Since M&A can be financed with the Company's ample cash reserves of over ¥16bn, future trends will be closely watched.

4. Shareholder return policy

Regarding a shareholder return policy, the Company targets a DOE (Dividends on Equity) at 6.0% with the objective of paying stable dividends even during short-term profit declines, based on the principle of being within the scope of profit attributable to owners of parent. In FY12/23, the Company plans to pay a dividend per share of ¥29.0, unchanged from the previous fiscal year. It also intends to implement flexible treasury share acquisitions, comprehensively taking into account cash reserves, stock price levels, and other factors, with the most recent treasury share acquisition taking place in February to March 2022.

Key Points

- Has supported manufacturing in Japan for more than 38 years as a leading CAE company
- In 1H FY12/23, sales turned positive for the first time in two years due to demand for license renewals and strong sales of security products
- The Company aims for increased sales and profits in FY12/23 through sales expansion and cost control
- Continue proactive consideration of M&A opportunities to achieve net sales of ¥30,000mn and EBITDA of ¥3,800mn in FY12/26



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

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Company overview

Has supported manufacturing in Japan for more than 38 years as a leading CAE company

1. History

Cybernet Systems Co., Ltd. was established independently in April 1985 after Nihon CDC K.K., the Japanese subsidiary of Control Data Corp. (hereafter, CDC), a US-based pioneer in supercomputers, spun off its cybernet services business. Cybernet is a word made up by combining “cybernetics” (cyber) and “telephone network” (net), and refers to the computer service CDC provided globally from the 1970s to 1990 that allowed people to rent remote access to a computer by the hour. At that time, computers were expensive, so companies and research institutes used this service to carry out tasks such as scientific and technological calculations and simulations.

From 1990, the performance of computers improved dramatically and they became inexpensive, so these users have come to own their own computers, in which they have installed dedicated software to conduct design development, R&D and other tasks. Due to this change in use, as demand for cybernet services declined, the Company concluded sales distributor agreements with leading overseas software vendors, and converted to a business model of conducting sales and providing installation support services for these companies, thereby expanding its business.

In 1989, the Company became a subsidiary of Kobe Steel, Ltd. <5406>, and then in 1999, FUJISOFT ABC Incorporated (currently, FUJI SOFT INCORPORATED <9749>) acquired all of its shares and made it a wholly owned subsidiary (current ownership ratio is 52.4%). In October 2001, the Company’s shares were listed on the JASDAQ market (currently listed on the Tokyo Stock Exchange (TSE) Standard Market), and since 2005, it has actively progressed an M&A strategy with the aim of expanding its business area in the CAE field. Domestically, in 2005, it made subsidiaries of KGT Inc. (has advanced visualization technologies and network-related software) and PLAMEDIA CORPORATION (specializes in a plastics CAE business) in succession, and then in 2006, it acquired the business rights of Keihin Artwork, Inc. and EDA Connect Co., Ltd. and expanded its business areas. Also, recently in January 2020, it established CYBERNET MBSE Co., Ltd., which mainly provides engineering services related to MBSE*, including outsourced analysis and consulting.

* MBSE (Model-Based Systems Engineering) refers to a method for efficiently conducting analysis, design, and verification of system requirements from various perspectives using models for systems targeted for development. Alongside the high-functionality, and multi-functionality of systems, the process from requirement definitions through to design and verification has become increasingly complex, and MBSE makes possible efficient development through the modelling of these elements. MBSE is mainly used at development sites in the automobile industry.

Conversely, alongside the entry into Asia of Japanese companies and the growth of Asian companies, centered on China, the Company has also been establishing sales subsidiaries in various Asian countries. In 2004, it established CCA ENGINEERING SIMULATION SOFTWARE (Shanghai) CO., LTD. in order to prepare an environment to provide technological services in China at the same level as in Japan, and it began providing technological services relating to CAE, including consulting, outsourced analysis, and education. Next, in 2008, it established CYBERNET SYSTEMS TAIWAN Co., Ltd. in Taiwan to provide CAE solution services, including those related to optical, control, and formula processing. Then in 2017, it established CYFEM Inc. in South Korea, which provides optical-related CAE solution services, and in 2018, CYBERNET SYSTEMS MALAYSIA SDN. BHD. in Malaysia which provides machinery- and optical-related CAE solution services. In these ways, the Company has been strengthening its business development in the Asia region. Based on the termination of the distributor agreements with Synopsys (dated October 1, 2021), the Company dissolved CYFEM in South Korea on December 31, 2021.

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Also, in June 2009, the Company’s sales distributor agreement with The MathWorks, Inc. of the US, which was the main customer providing more than 30.0% of total net sales, ended (due to The MathWorks establishing a Japanese subsidiary). The Company also strengthened its in-house products by dealing directly with the risks inherent to the distributor business, such as significant decreases in earnings. Specifically, in 2009, it made subsidiaries of Sigmetrix, LLC of the US (hereafter, Sigmetrix; development and sales of tolerance*1 analysis software and consulting) and Waterloo Maple Inc. of Canada (hereafter, Maplesoft; development, sales, consulting and online services for formula analysis software, etc.). Then in 2010, it made a subsidiary of Noesis Solutions NV of Belgium (hereafter, Noesis; development, sales, and technological support for PIDO*2 tools).

*1 Tolerance: The allowable range of variation of the dimensions set at the time of design.

*2 PIDO (Process Integration and Design Optimization): A solutions tool for overall optimization that contributes to improving quality, shortening the development period, and reducing development costs through the automation, integration, and optimization of the product development process utilizing CAD/CAE.

History

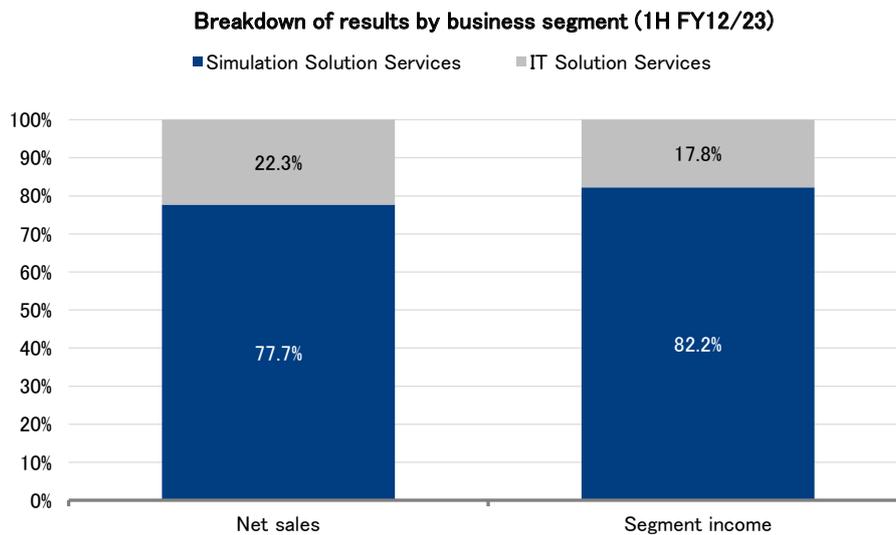
Date	Event
April 1985	Control Data Corp. (CDC) of the US separated its cybernet services business and established Cybernet Systems Co., Ltd.
April 1989	Kobe Steel, Ltd. <5406> acquired all of the Company's issued shares.
October 1999	FUJISOFT ABC Incorporated (currently, FUJI SOFT INCORPORATED <9749>) acquired all of the Company's issued shares and made it a wholly owned subsidiary.
October 2001	Listed on the JASDAQ market and increased capital to ¥995mn.
August 2003	Listed on the TSE Second Section.
September 2004	Listed on the TSE First Section.
December 2004	Established subsidiary CCA ENGINEERING SIMULATION SOFTWARE (Shanghai) CO., LTD. in Shanghai, China.
April 2005	KGT Inc. made a subsidiary through acquisition of all shares.
August 2005	PLAMEDIA CORPORATION made a subsidiary through acquisition of 95% of shares.
May 2006	Took over operation of Keihin Artwork Co., Ltd. and EDA Connect Co., Ltd.
August 2006	Established Cybernet CAE Systems (Shanghai) Co., Ltd. (currently, CYBERNET SYSTEMS (SHANGHAI) CO.,LTD.) in Shanghai, China.
July 2008	Established CYBERNET SYSTEMS TAIWAN Co., Ltd. in Hsinchu City, Taiwan.
July 2009	Made Sigmetrix, LLC a wholly owned subsidiary.
August 2009	Merged with PLAMEDIA CORPORATION.
September 2009	Made Waterloo Maple Inc. (Maplesoft) a wholly owned subsidiary.
May 2010	Merged with KGT Inc.
July 2010	Made Noesis Solutions NV a wholly owned subsidiary.
March 2012	Established CYBERNET SYSTEMS KOREA CO., LTD. in Seoul, South Korea (closed in 2015).
September 2017	Established subsidiary CYFEM Inc. in Seoul, Korea (dissolved in 2021).
November 2018	Established subsidiary CYBERNET SYSTEMS MALAYSIA SDN. BHD. in Malaysia.
January 2020	Established CYBERNET MBSE Co., Ltd.
April 2022	Moved to the TSE Standard Market.

Source: Prepared by FISCO from the Company’s website

Developing the Simulation Solution Services business and IT Solution Services business

2. Business description

The Cybernet Group develops solution services businesses in Japan and overseas through software and technology services (technological support, consulting, etc.). As these businesses areas are different, it discloses information on two business segments, the Simulation Solution Services and IT Solution Services. The Simulation Solution Services business is conducted by the Company and CYBERNET MBSE, and overseas by Maplesoft, Sigmetrix, Noesis, and the three sales subsidiaries in Asia (in China, Taiwan, and Malaysia) for the development and sales of products developed in-house. The IT Solution Services business is conducted by the Company. Looking at the breakdown of results by business segment in the 1H FY12/23, we see that the Simulation Solution Services business is the main business contributing 77.7% of net sales and 82.2% of segment income. In addition, as of June 30, 2023, the Company had 583 consolidated employees, of which approximately 45% were engineers.



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

(1) Business model

To simply explain the business model, the Group has concluded sales distributor agreements with leading software vendors in Japan and overseas, and it sells software products (including in-house Group products) to customers such as companies, universities, and research institutes. Also, when conducting sales, it provides solution services that meet customer needs, including engineering services* so that customers can skillfully use the products. In addition, it contributes to improving product quality by providing feedback on customer needs to vendors, which are the developers.

* Consulting services in order for customers to effectively use the software, including software installation support, technological support, and outsourced analysis.

Company overview

In particular, as a pioneering company in the simulation solutions field in Japan, it has accumulated an abundance of experience and technologies across 38 years, and it has solution capabilities to guide customers to the solutions to their various challenges. Therefore, it has built strong relationships of trust with them, and at the same time, it has acquired an excellent reputation among vendors, which are the developers. For example, Ansys, Inc. of the US, which is currently its main business-partner vendor, certified the Company as an Ansys Elite Channel Partner*1 for nine consecutive years from 2015, and the top rated in the Asia region. In addition, the Company received the 2022 Highest New Market Growth*2 award in the sales field for its achievements in developing new markets, and the 2022 Best Brand Awareness*3 award in the marketing field. As well, its Chinese subsidiary won the Ansys 2022 Asia Pacific Partner of the Year award for the first time for its sales performance and customer support capabilities.

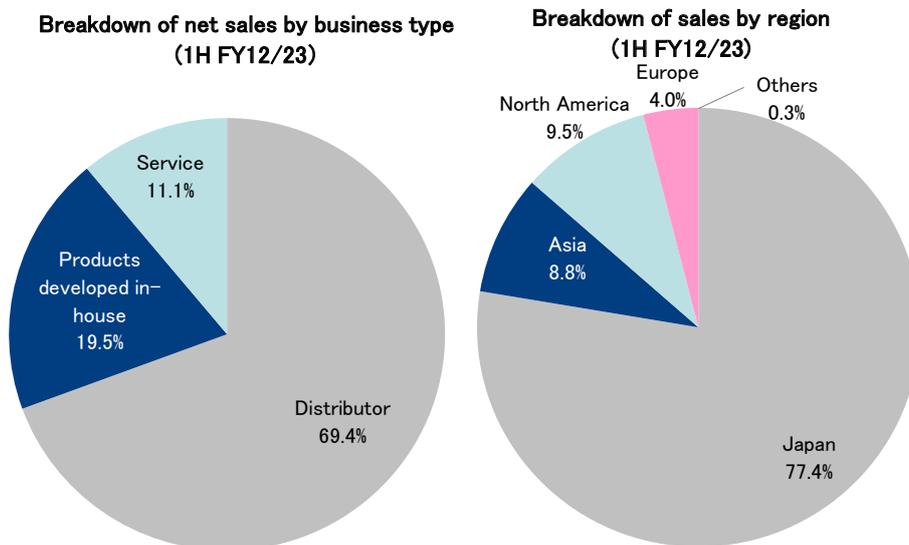
*1 Ansys Elite Channel Partner is a title granted to organizations recognized for making the most significant contribution to sales activities for Ansys software. The Company was certified for the first time among domestic distributors for nine consecutive years from 2015. It has met the stringent conditions for certification, and has been evaluated for achieving the highest level of customer satisfaction.

*2 The 2022 Highest New Market Growth award is given to a distributor that has contributed to the development of new markets. The Company was recognized for its track record of introducing many new customers to the optical products it began handling in October 2021 (Ansys Speos®, Ansys Lumerical, and Ansys Zemax OpticStudio).

*3 The 2022 Best Brand Awareness award is given to the distributor that has made the greatest contribution to raising Ansys brand recognition through various marketing activities. In addition to disseminating information via the internet and e-mail newsletters, the Company holds a large-scale online event once a year to introduce the latest technical information on Ansys software and other digital engineering products.

(2) Net sales by business type and region

Net sales can be broken down into three business types: distributor sales for products developed by vendors, sales of products developed in-house, and sales of various types of solution services (engineering services, education and training services, etc.). In 1H FY12/23 consolidated results, distributor sales contributed 69.4% of net sales, products developed in-house 19.5%, and services 11.1%. Also, looking at the breakdown of net sales by region, Japan contributed 77.4%, Asia 8.8%, North America 9.5%, and Europe 4.0%, from which we understand that the domestic distributor business is the main business. Going forward, however, the Company's strategy is to aim for further growth by increasing sales of products developed in-house and services, and overseas sales such as in Asia.



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

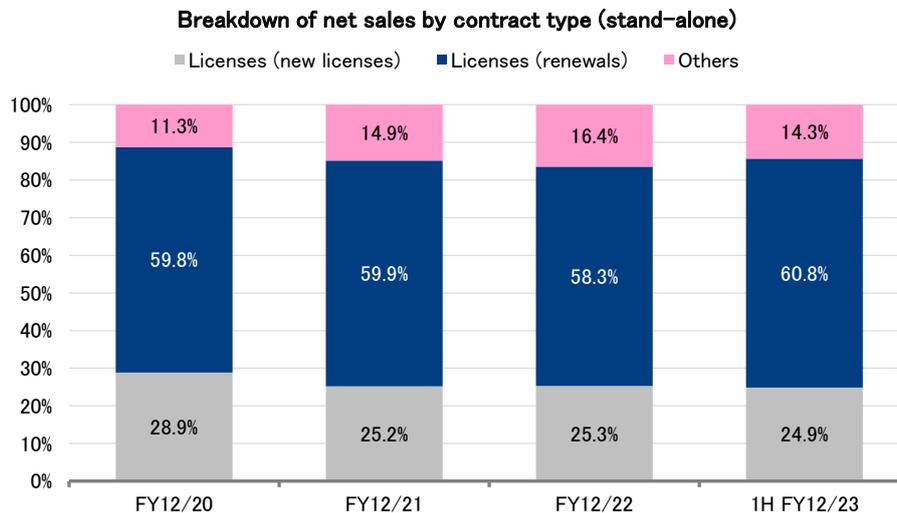
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(3) Net sales by contract type and industry

Net sales can be broken down by contract type into licenses and others. Furthermore, licenses are divided into new license fees when installing a new software product (initial installation fee and one-year usage fee + maintenance fee) and renewal fees from the second year onwards (one-year usage fee + maintenance fee). It works by adding various optional services in line with customers' needs. Conversely, sales other than from licenses include those from engineering services, education and training services, and hardware.

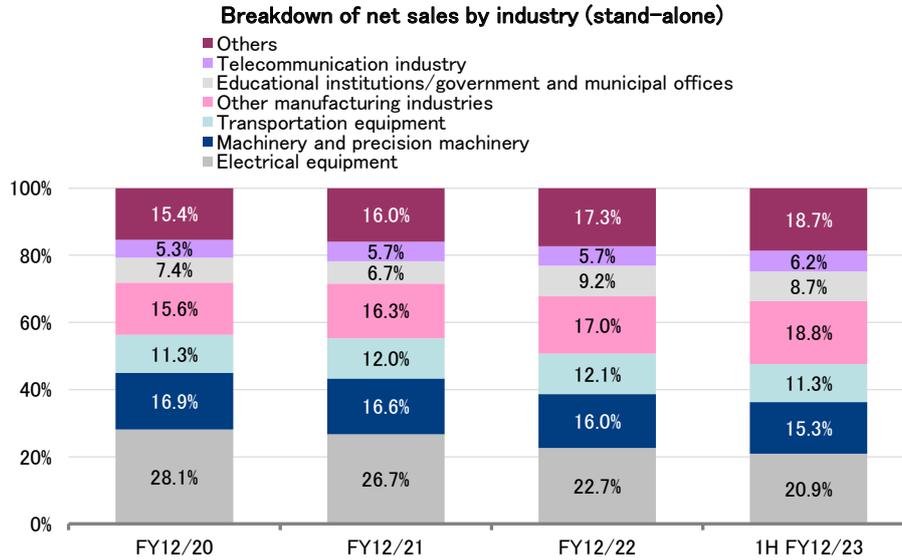
Looking at the breakdown of net sales by contract type in 1H FY12/23 on a Company stand-alone basis, license renewals contributed 60.8%, new licenses 24.9%, and others 14.3%. License renewals' share is the highest, representing a stable earnings source for the Company. This is because the majority of the company's customers are major companies, universities, and research institutes, and once one of the mainstay CAE software products is installed, there are hardly any cases of it being replaced with another company's product from the viewpoint of continuity.



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

Looking at the breakdown of net sales by industry in 1H FY12/23 on a Company stand-alone basis, the highest was electrical equipment at 20.9%, followed by other manufacturing industries at 18.8%, machinery and precision machinery at 15.3%, and transportation equipment at 11.3%. Net sales to the manufacturing industry were more than 66.4% of overall sales. However, in the last few years, the proportion of net sales to non-manufacturing industries has been growing gradually due to the growth of the simulation utilization domain to a wider range of fields, including telecommunications, healthcare, and construction. (FY12/20 28.1% → 1H FY12/23 33.6%)

Company overview



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

In Simulation Solution Services business, Ansys products, the world leader in the CAE sector, are the mainstay products

3. Business segments

(1) Simulation Solution Services

The mainstay Simulation Solution Services business provides various CAE software products according to each field, including those related to machinery, optical, electrical and electronic, and control. CAE is the name for technologies to simulate and analyze in virtual models created on computers aspects such as tests and experiments that have been conventionally carried out using a prototype in the R&D process for manufacturing. Using CAE software dramatically reduces the number of prototype tests and experiments, and makes it possible to conduct simulations under physical conditions that cannot actually be created in the real world. It can be said that this software not only improves development efficiency, but also contributes to realizing manufacturing that is considerate of the environment by leading to reduction of waste and other materials created in prototype testing. The scope of application is wide, ranging from fields like automotive, electronic equipment and devices to machinery and precision machinery, telecommunications, medical and construction fields.

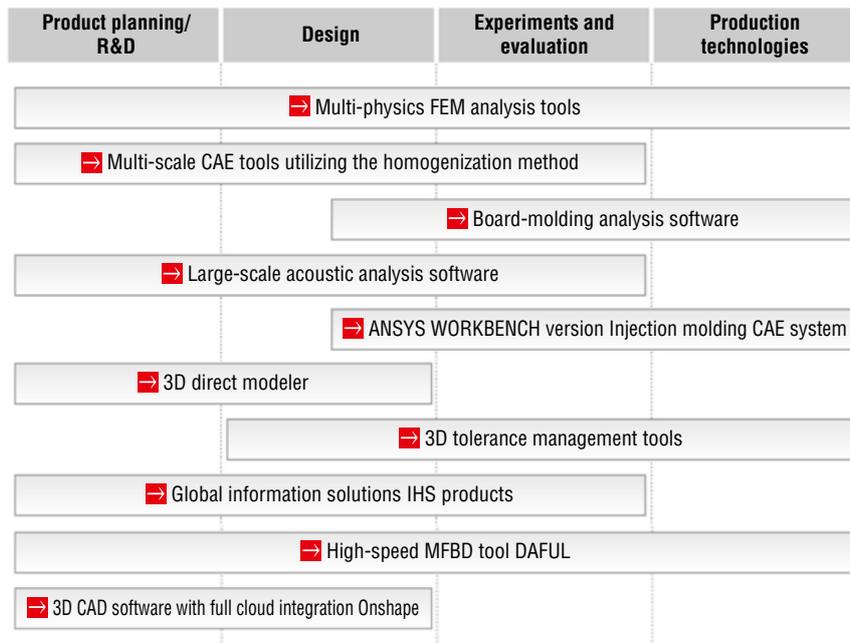
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Mainstay products consist of multi-physics analysis tools* from Ansys, which is the world’s largest company in the machine-related CAE field with an approximately 38% share of the global market, and is used by many companies and research institutes in Japan as the general-purpose analysis tools that make every type of analysis possible, including structure, heat transfer, electromagnetic field, piezoelectric, acoustic, heat fluid, and dropping analyses. Also, for the optical field, the distributor agreement with Synopsys terminated on October 1, 2021, so the Company concluded new distributor agreement for Ansys’s optical-related solution products on October 2, 2021, and the Company started selling the products. Other than these, the Group also handles the products of the leading development vendors in their respective industries and in-house products developed by Group companies. It proposes solutions that are optimized to meet customer needs.

* Tools used in R&D settings to obtain a more accurate understanding of phenomena by analyzing combinations of multiple physical phenomena. In the real world, multiple physical phenomena (structure, magnetic field, electrical current, fluid, heat transfer, etc.) interact simultaneously. When those physical phenomena are analyzed separately, it may not be possible to accurately predict the behavior of the development subject.

List of machinery-related CAE



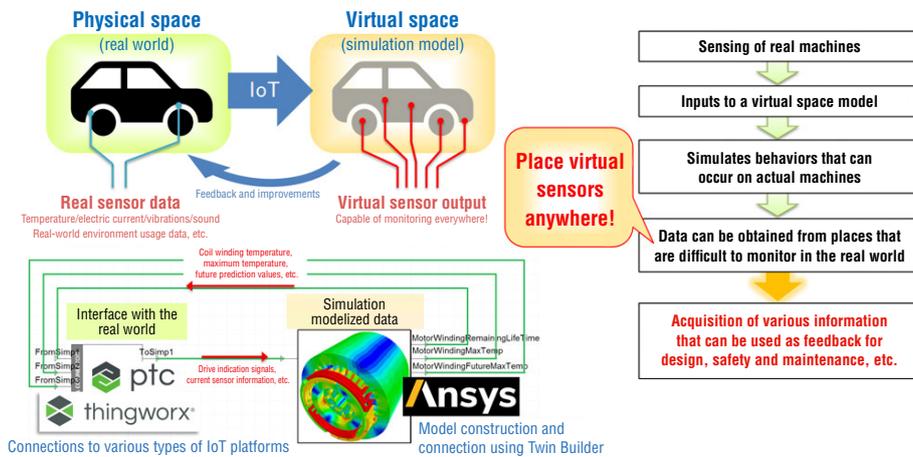
Source: The Company's website

Furthermore, the Company is concentrating on DX business utilizing advanced digital technology such as AR/VR solutions, big data visualization tool, IoT platform implementation support, digital twin construction support, and AI system construction services. Although the scale of sales is still small, DX business has a strong affinity with simulation technology and is being spotlighted as a solution service where rapid growth can be expected while helping to improve customer productivity.

Company overview

For example, IoT/digital twin refers to a development method in which a model of physical equipment actually operating at a manufacturing development site is created in a virtual space (on a computer). In this method, evaluations of the physical equipment's current state are made and various simulation tests are conducted by accumulating information about the equipment in real time through IoT sensors and transmitting it to the virtual space. Combining verification data from the real world and simulation data from the virtual space realizes the sophistication and optimization of the manufacturing process. Because of this, it is expected to grow in demand in the automotive and other industries.

Example of the utilization of IoT/digital twin



Source: The Company's website

AI system construction services improve operational efficiency by harnessing artificial intelligence, which dramatically speeds up calculations in CAE. It uses Neural Concept Shape, a data-driven AI system construction method that uses deep learning to construct surrogate AI systems. Demand for these services is increasing in fields that require CAE analysis for design parameters.

(2) IT Solution Services

In IT Solution Services business, sales of various information security products, including cloud security and end-point security, make up the majority of net sales. The Company provides optimal solutions that fulfill customers' needs by handling products from multiple vendors such as Broadcom Inc. (previously Symantec Corporation).

In the CAE field, a strength is solution capabilities based on know-how and technological capabilities accumulated more than 38 years

4. Strengths and business risks

The Company's strengths can be summarized as the following three points.

(1) Sophisticated know-how backed up by experience

It has accumulated a rich track record from more than 38 years of providing support for manufacturing R&D and design development through CAE simulation technologies. The know-how and extensive and advanced technological capabilities it has accumulated are its assets, and a strength is being able to provide solutions that other companies cannot imitate.

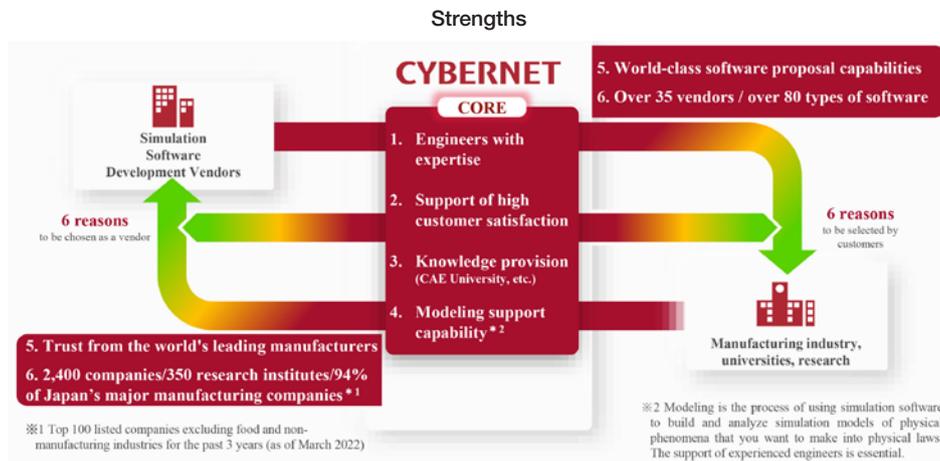
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(2) Extensive specialty and global partner network and customer base

Leading with Ansys, the largest CAE software company, the Company collaborates with more than 35 leading vendors in Japan and overseas, and conducts sales and support for more than 80 types of products. Therefore, a strength is its ability to propose optimized solutions to address customers' various challenges by combining multiple software and know-how. It also communicates feedback from customers to vendors, which are the developers, and they use that feedback for product improvements. So, another strength can be said to be that it is building strong relations with both customers and vendors.

By leveraging these strengths, the Company has developed consolidated subsidiaries within Japan and overseas, and provides products and services to approximately 2,400 companies, primarily international ones, and 350 universities and research institutes. The fact that the Company is building a wide customer base could be another one of its strengths. In Japan, more than 90% of Japan's top 100 listed companies in terms of net sales (excluding food and non-manufacturing sectors) are the Company's customers.



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

(3) Highly stable earnings structure and industry environment

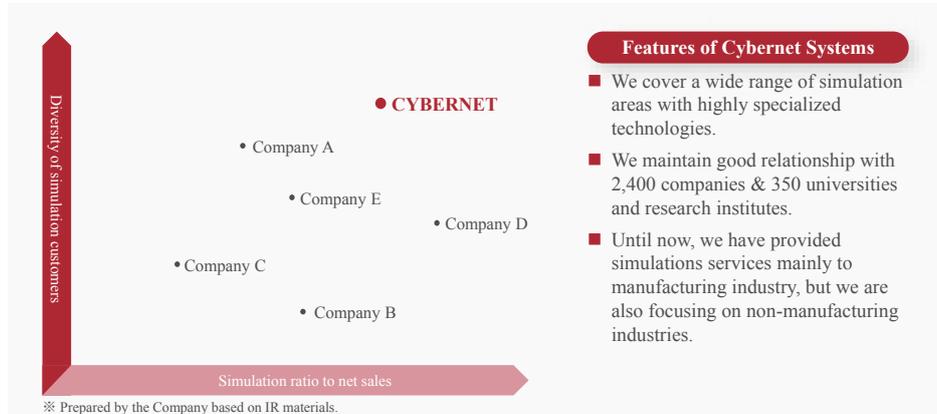
One of the Company's strengths is its earnings stability. Contributing factors are the large share of net sales (over 50%) of license renewal fees from existing customers and high renewal rate, small risk of price wars in the CAE business due to limited competition, and that R&D budgets are less likely to be cut in an economic or business performance downturn, because R&D is the source of companies' competitiveness.

Competitor companies in the CAE software distributor business include IDAJ Co., LTD. and ITOCHU Techno-Solutions Corporation <4739>, which are Ansys's sales distributors; ARGO GRAPHICS Inc. <7595>, which is a sales distributor of Dassault of France; and Information Services International-Dentsu, Ltd. (ISID) <4812>, which handles products including those of Siemens of Germany. The Company differentiates itself by being a simulation solutions specialist and having customers in diverse business sectors.

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Company features



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

(4) Risk factors

A risk factor is that the sales distributor business contributes more than 70% of net sales, so results would be negatively affected if main distributor agreements were to be terminated. In actuality, FY12/22 sales and profit declined due to the termination of the distributor agreement with Synopsys on October 1, 2021. In principle, sales distributor agreements with development vendors are non-exclusive, short term and subject to renewal. As for cases where agreements end up being terminated, changes in developers' sales strategies due to M&A, changes in management, and so forth are among possible scenarios. The reason for the termination of the distributor agreement with Synopsys was that Synopsys switched its sales style from distributor sales to direct sales on a global basis.

In order to reduce these business risks, the Company plans to develop its in-house developed products as well as its solution services including engineering services. With respect to the sales distributor business, the Company's strategy is to continue searching for promising development vendors and expand its product lineup. Moreover, Ansys, which is the Company's main business partner, is establishing its own Japanese corporations, and in this situation, it has positioned the Company as an excellent sales partner and has built strong business relations with it. So, at the current time, we at FISCO view the risk of cancelling the agreement as extremely low.

Results trends

In 1H FY12/23, sales turned positive for the first time in two years due to demand for license renewals and strong sales of security products

1. Overview of 1H FY12/23 results

In the 1H FY12/23 consolidated results, net sales increased 2.7% YoY to ¥10,003mn for the first increase in two years, while each category of profit fell by double digits; operating income decreased 38.0% to ¥640mn, ordinary income decreased 37.4% to ¥613mn, and profit attributable to owners of parent decreased 49.5% to ¥289mn.

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Results trends

1H FY12/23 consolidated results

(¥mn)

	1H FY12/22		1H FY12/23		YoY	Progress toward the full-year forecast
	Results	% of sales	Results	% of sales		
Net sales	9,736	-	10,003	-	2.7%	45.5%
Cost of sales	5,707	58.6%	6,054	60.5%	6.1%	-
Gross profit	4,029	41.4%	3,948	39.5%	-2.0%	-
SG&A expenses	2,995	30.8%	3,308	33.1%	10.4%	-
Operating income	1,033	10.6%	640	6.4%	-38.0%	34.6%
Ordinary income	979	10.1%	613	6.1%	-37.4%	33.2%
Profit attributable to owners of parent	573	5.9%	289	2.9%	-49.5%	27.6%
Consolidated employees at the end of 1H	568		583		2.6%	

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

In the Simulation Solution Services business, despite weakness in domestic sales of new licenses and sales subsidiaries in Asia, an increase in net sales was secured due to strong sales for maintenance contracts renewals and growth in the IT Solution Services business, mainly due to sales of cloud security solutions. By region, net sales increased 2.0% YoY to ¥7,745mn in Japan, decreased 11.1% to ¥880mn in Asia, and increased 22.9% to ¥948mn in North America and 12.1% to ¥398mn in Europe. In Asia, sales unexpectedly declined 29.4% to ¥471mn in 2Q due to customers' reduced willingness to make purchases in China and Taiwan and the postponing of deliveries for some projects until the 3Q or later. On the other hand, sales in Europe and the US rose by double digits, partly due to the effect of yen depreciation, and sales on a local currency basis also increased. The average exchange rate of the yen was about 10% lower than in the same period of the previous year, resulting in double-digit sales growth in North America on a local currency basis as well.

By subsidiary, sales declined at Sigmetrix, which had grown in the previous fiscal year. This was due to a decline in willingness to invest because of deteriorating business performance of IT and other companies in the US. However, Sigmetrix expects a recovery in 2H as it has strengthened its sales structure by increasing the number of employees in July. On the other hand, sales at Maplesoft increased as the impact of COVID-19 has died down, budgets at client universities have recovered, and orders for the enterprise business, which has been a key focus area, have begun to grow. Since October 2022, Maplesoft's efforts to increase orders for large-scale projects for the enterprise market by establishing a specialized team of about ten individuals have started to yield results, and steady growth is expected in 2H. Sales of Noesis in Europe increased due to higher sales to North America and Germany. However, each subsidiary's contribution to profit was minor as personnel expenses increased due to the revision of wages to address inflation.

Net sales by region (consolidated)

(¥mn)

	1H FY12/21	1H FY12/22	1H FY12/23	YoY
Japan	9,917	7,591	7,745	2.0%
Asia	1,553	990	880	-11.1%
North America	663	771	948	22.9%
Europe	341	355	398	12.1%
Others	31	27	30	11.3%
Total	12,507	9,736	10,003	2.7%

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

Results trends

The main reasons for the rise in the cost of sales ratio from 58.6% to 60.5% YoY were a deterioration of the sales mix in the distributor business and the impact of high purchase costs for security software stemming from yen depreciation, as well as increased personnel expenses due to the strengthening of the personnel structure and the provision of inflation allowances. As for the sales mix, the proportion of net sales from highly profitable Ansys products declined, and conversely, the proportion of products and services with high cost of sales ratios rose. As a result, gross profit declined 2.0% YoY to ¥3,948mn.

SG&A expenses increased 10.4% YoY to ¥3,308mn, and ratio of SG&A expenses rose 2.3 percentage points YoY to 33.1%. Main factors behind the increase were higher expenses for personnel, recruiting, travel, and advertising. Excluding the overseas subsidiaries, which were boosted by the weak yen, SG&A expenses were more or less in line with the Company's forecast. The Company is working to strengthen its personnel structure, and recruitment also progressed well, with a total of 36 new employees (15 new graduates and 21 mid-career hires) joining the company in 1H compared to 15 in the same period of the previous fiscal year.

While expenses generally increased in line with the Company's forecast, profit declined due to sluggish sales and the yen's depreciation. However, orders received, a leading indicator of sales, grew steadily by 7.1% YoY to ¥11,317mn. The backlog of orders at the end of 1H was ¥9,504mn, up 12.9% YoY, and the Company expects increased sales and a return to profitability in 2H.

(1) Results trends by segments

a) Simulation Solution Services

In Simulation Solution Services, net sales increased 1.3% YoY to ¥7,769mn and segment income declined 20.9% to ¥1,115mn. Looking at the breakdown of net sales, distributor sales declined 1.7% YoY to ¥5,004mn, whereas sales of products developed in-house increased 6.6% to ¥1,761mn and sales of services steadily rose 8.6% to ¥1,003mn. In terms of profit, deterioration of the sales mix and increased personnel expenses were the main factors causing decreased profits.

Distributor sales decreased due to weakness in domestic sales of new licenses and sales subsidiaries in Asia, despite strong demand for license renewals in Japan. Sales of products developed in-house increased at overseas subsidiaries, and service revenue was strong for analysis support for design work, AI and AR-related engineering services, and other services. While sales of the EndoBRAIN@-EYE* software to support diagnosis in colorectal endoscopy using artificial intelligence developed by the Company remained relatively stable. However, Olympus, with whom the Company is collaborating, has released a product integrated with an endoscope to improve convenience, and plans to continue working toward insurance coverage in Japan and overseas.

* A software that assists doctors in detecting polyps, etc. by alerting when it detects a lesion, using AI to analyze images taken by a colonoscope. This product was approved in Japan as managed medical equipment (class II) in 2020, and is being sold to medical institutions as a set along with endoscopes manufactured by Olympus.

b) IT Solution Services

In IT Solution Services, sales increased while profits decreased, with net sales rising 7.9% YoY to ¥2,234mn and segment profit declining 17.0% to ¥241mn. Distributor sales increased 7.7% YoY to ¥1,941mn, sales of products developed in-house rose 11.5% to ¥187mn, and service revenue grew 5.1% to ¥105mn. Sales of "CrowdStrike," a cloud-based endpoint security product, and "Netskope," a security solution for cloud environments, were strong as new work styles such as telecommuting became more commonplace. In terms of profit, higher cost of goods due to the weaker yen and higher personnel expenses led to lower profits.

Results trends

(2) Sales trends by industry and contract type (stand-alone basis)

On a stand-alone basis, net sales increased 2.8% YoY to ¥7,705mn. Looking at the YoY growth rate of sales by industry, sales of electrical equipment and transportation equipment fell 3.2% and 11.1%, respectively, due to weak sales of new licenses, while machinery and precision machinery and other manufacturing industries grew 5.5% and 9.5%, respectively, due to increased demand for license renewals. In addition, telecommunications and others increased by 13.9% and 9.5%, respectively, mainly due to an increase in security products.

Net sales by industry (stand-alone)

	(¥mn)			
	1H FY12/21	1H FY12/22	1H FY12/23	YoY
Electrical equipment	2,395	1,667	1,614	-3.2%
Machinery and precision machinery	1,550	1,117	1,179	5.5%
Transportation equipment	1,078	982	873	-11.1%
Other manufacturing industries	1,399	1,324	1,449	9.5%
Educational institutions/government and municipal offices	628	675	674	-0.2%
Telecommunication industry	492	418	475	13.9%
Others	1,424	1,314	1,439	9.5%
Total	8,969	7,499	7,705	2.8%

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

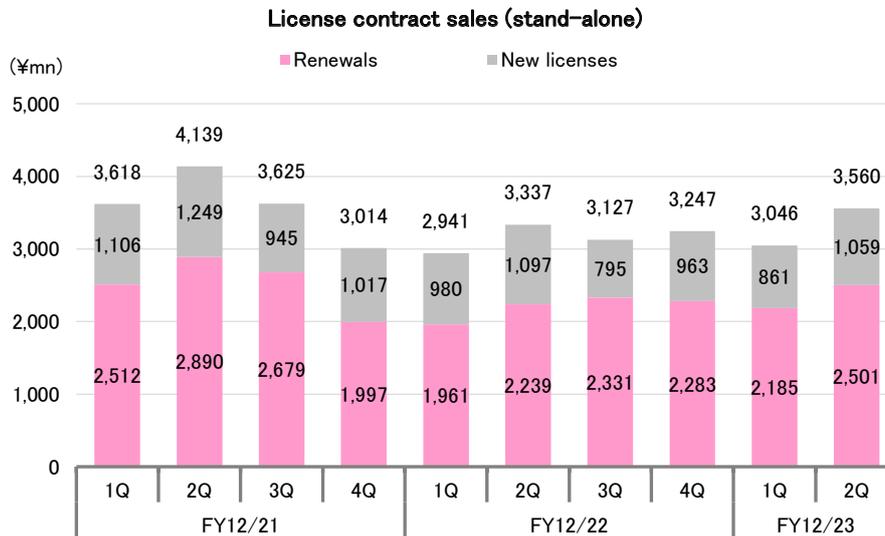
Looking at sales by contract type, sales from licenses grew 5.2% YoY. New licenses were sluggish, declining 7.6%, while renewals were strong, up 11.6%. On a quarterly basis, sales of new licenses have been on a downward trend YoY, but license renewals have increased for three consecutive quarters since Q4 FY12/22, and negative impacts accompanying the termination of the distributor agreements with Synopsys (October 2021) has been completely erased. Sales of Ansys's optical systems products, which will replace Synopsys products, have also been steadily increasing and are expected to contribute to future sales growth. Net sales other than those from licenses declined 10.0% YoY. This was due to a 33.1% decline in hardware sales and a 78.5% drop in other sales, despite a solid 5.8% increase in service sales.

Net sales by contract type (stand-alone)

	(¥mn)			
	1H FY12/21	1H FY12/22	1H FY12/23	YoY
Licenses	7,693	6,279	6,607	5.2%
New licenses	2,286	2,078	1,920	-7.6%
Renewals	5,406	4,200	4,686	11.6%
Others	1,275	1,219	1,098	-10.0%
Service	-	879	930	5.8%
Hardware	-	207	138	-33.1%
Others	-	132	28	-78.5%
Total	8,969	7,499	7,705	2.8%
(Recurring revenue business sales ratio)	60.3%	56.0%	60.8%	

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

Results trends



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

Has ample financial assets exceeding ¥16bn under debt-free management, plans to use for M&A and other growth investments and investor returns

2. Financial condition

Looking at the financial condition at the end of 1H FY12/23, total assets were up ¥1,239mn compared to the end of the previous fiscal year to ¥25,394mn. The main influencing factors in current assets included a decrease of ¥915mn in notes and accounts receivable-trade, and contract assets, while financial assets (cash and deposits, short-term investment securities) and advance payments to suppliers increased by ¥1,459mn and ¥759mn, respectively. In noncurrent assets, intangible assets increased ¥143mn in conjunction with the deployment of a core operating system. The Company will bring the new core operating system online in 2H FY12/23.

Total liabilities were up ¥1,207mn compared to the end of the previous fiscal year to ¥10,612mn. In current liabilities, advances received increased by ¥880mn and income taxes payable increased ¥273mn. The increase in advances received can be viewed positively because they will become future sales. In noncurrent liabilities, retirement benefit liability increased ¥22mn. Total net assets were up ¥32mn compared to the end of the previous fiscal year to ¥14,781mn. In addition to posting profit attributable to owners of parent of ¥289mn and dividend payments of ¥437mn, foreign currency translation adjustment increased ¥180mn in conjunction with the depreciation of the yen.

Looking at management indicators, the capital adequacy ratio was 57.6%, down from 60.3% at the end of the previous fiscal year. However, the Company has ample financial assets exceeding ¥16bn under debt-free management, so its finances can be judged to be very sound. With ample cash on hand, the Company plans to invest for growth, such as through M&A, and reward shareholders.

Results trends

Consolidated balance sheet

	FY12/20	FY12/21	FY12/22	1H FY12/23	Change
	(¥mn)				
Current assets	20,205	21,526	22,231	23,280	1,049
(Financial assets)	14,888	16,009	15,348	16,807	1,459
Noncurrent assets	2,037	1,744	1,924	2,114	190
Total assets	22,242	23,270	24,155	25,394	1,239
Current liabilities	6,488	6,472	8,359	9,533	1,173
(Advances received)	2,006	2,270	5,442	6,323	880
Noncurrent liabilities	1,273	1,065	1,046	1,079	33
Total liabilities	7,762	7,538	9,405	10,612	1,207
(Interest-bearing debt)	-	-	-	-	-
Total net assets	14,480	15,732	14,749	14,781	32
(Stability)					
Capital adequacy ratio	64.2%	66.3%	60.3%	57.6%	-2.8pt
Interest-bearing debt ratio	-	-	-	-	-

Note: Financial assets = cash and deposits + short-term investment securities + short-term loans receivable
 Source: Prepared by FISCO from the Company's financial results

The Company aims for increased sales and profits in FY12/23 through sales expansion and cost control

3. Outlook for FY12/23

For consolidated results in FY12/23, the Company maintained its initial forecasts for both sales and profit to increase with net sales increasing 10.4% YoY to ¥22,000mn, operating income up 5.2% YoY to ¥1,850mn, ordinary income up 9.2% to ¥1,850mn, and profit attributable to owners of parent up 5.0% to ¥1,050mn. Although the progress rate of net sales through 1H was slightly low at 45.5%, the Company aims to achieve its forecast by working on its growth strategies of strengthening products developed in-house and expanding business in Asia. Sales in Asia are expected to improve in 2H, partly due to the contribution of projects that have been postponed, and steady growth is also expected for products developed in-house at subsidiaries in Europe and the US. Therefore, we at FISCO believe that sales of new licenses in Japan, which were weak in 1H, are the key to achieving the Company's forecast.

In terms of profit, the hurdles to achieving the Company's forecast are high, including factors such as increased costs, an expected increase in depreciation accompanying the start of operation of its new core system (July 2023), and the policy of aggressive investment in human resources, especially through hiring in DX-related and MBSE fields where needs are strong. Despite these obstacles, the Company intends to increase profits by expanding sales and controlling costs.

Results trends

FY12/23 consolidated results outlook

	FY12/22		FY12/23		YoY
	Results	% of sales	Company forecast	% of sales	
Net sales	19,936	-	22,000	-	10.4%
Operating income	1,757	8.8%	1,850	8.4%	5.2%
Ordinary income	1,693	8.5%	1,850	8.4%	9.2%
Profit attributable to owners of parent	999	5.0%	1,050	4.8%	5.0%
EBITDA	2,014	10.1%	2,170	9.9%	7.7%
Net income per share (yen)	32.31		33.99		
ROE	6.7%		7.2%		

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

In the Simulation Solution Services business, high growth is expected to continue in the DX business, including AR/VR solutions and AI system construction services in Japan, as well as in engineering services such as MBSE. Ansys's optical product sales are also expected to expand steadily, as the Company has begun handling its products not only in Japan but also in China, Taiwan, and Malaysia. Among overseas subsidiaries, Sigmetrix is expected to see a recovery in sales due to its strengthened sales structure, and Maplesoft is also expected to see sales growth due to increased orders not only from education facilities but also from companies. Noesis and Maplesoft plan to launch new products from the next fiscal year and beyond, so further sales expansion is expected. Meanwhile, orders for the Company's big data visualization tool BIGDAT@Analysis* have gradually begun to grow as a result of version upgrades, and are expected to contribute to sales growth.

* Visualize and analyze vast amounts of IoT data to quickly grasp the current status of production lines and equipment at plants, enabling more efficient predictive maintenance for equipment failures and other problems.

In the IT Solution Services business, sales of information security products, particularly cloud security solutions and next-generation endpoint security, are expected to continue to grow. Additionally, as a new initiative, the Company began offering MDR services in July 2023 to monitor and operate endpoint security for its customers. This was in response to growing customer demand for advanced security knowledge, which is needed to counter cyber-attacks which are growing more elaborate every year. The Company aims to further expand its business scale by providing total solutions, from the installation, monitoring, and operation of security products to the investigation of potential risks and the planning of countermeasures. In terms of profit, the Company is gradually starting to raise prices in response to higher purchase costs resulting from the weak yen, but if the yen remains in the range of ¥140 per US dollar in 2H, we at FISCO estimate that profits may decline.

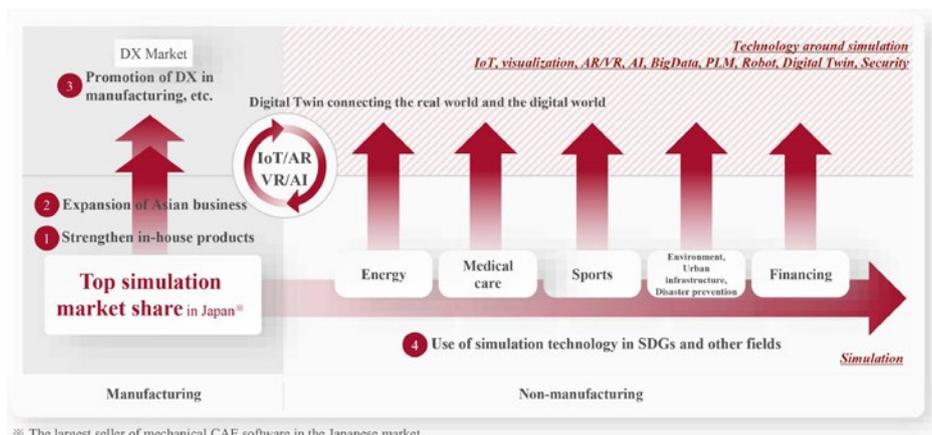
Medium-term business plan

Continue proactive consideration of M&A opportunities to achieve net sales of ¥30,000mn and EBITDA of ¥3,800mn in FY12/26

1. Progress of the medium-term business plan

In February 2022, the Company announced a 5-year medium-term business plan (from FY12/22 to FY12/26) in order to achieve enhanced corporate value from a long-term perspective. In addition to its core simulation technology, the Company will use peripheral technologies such as IoT, AR, VR and AI to enable DX support for manufacturing. The Company has also announced plans to strengthen its business development in areas outside of manufacturing such as energy, medical care, sports, environment and disaster prevention, and finance, aiming to grow as a company that contributes to solving various social challenges through simulation technology.

The Company's DX support



※ The largest seller of mechanical CAE software in the Japanese market.

Source: The Company's supplemental results briefing materials

For numerical management targets for FY12/26, the Company has set goals for net sales of ¥30,000mn (up 32.2% compared to FY12/21), EBITDA of ¥3,800mn (up 23.7%), profit attributable to owners of parent of ¥2,200mn (up 23.1%) and ROE of 12.0%. A numerical target has been set for EBITDA rather than operating income because the Company has leveraging M&A in its sights. As for M&A targets, the Company is mainly considering companies in Japan and overseas that provide technical consulting and engineering services, regardless of size or location, including distributors with a different customer base from its own and software development companies. Moreover, as KPI, the Company will raise the ratio of in-house products and services development from 24.2% in FY12/21 to 40.0% in FY12/26, and the ratio of overseas sales from 23.3% to 25.0% in the same period. In addition, as a long-term goal (for roughly 2030) for the business portfolio, the Company's policy will be to move forward on business development with a ratio of sales of in-house products and services of 50.0%, overseas sales of 40.0% and sales from non-manufacturing (stand-alone) of 50.0% (compared to 28.6% in FY12/21) as its targets.

Medium-term business plan

Although results for the first year (FY12/22) fell slightly short of the Company's forecast, the ratio of in-house product and services development and overseas sales improved YoY to 30.1% and 23.5%, respectively. Although progress has been somewhat lower than forecasted for 1H FY12/23, as previously mentioned, in addition to the steady growth in sales of products and services developed in-house, the hiring and training of human resources, which is also a source of growth, is progressing smoothly. The effects of human resource investment, including the expansion of overseas business, are expected to become apparent and put the Company on a growth trajectory for the future.

Medium-term business plan numerical targets

	(¥mn)				
	FY12/21 results	FY12/22 results	FY12/23 forecasts	FY12/24 targets	FY12/26 targets
Net sales	22,697	19,936	22,000	24,500	30,000
EBITDA*	3,072	2,014	2,170	2,800	3,800
EBITDA margin	13.5%	10.1%	9.9%	11.4%	12.7%
Profit attributable to owners of parent	1,786	999	1,050	1,600	2,200
ROE	12.0%	6.7%	7.2%	9.5%	12.0%
KPI					
Sales composition ratio of in-house product and services	24.2%	30.1%	-	35.0%	40.0%
Overseas net sales composition ratio	23.3%	23.5%	-	23.0%	25.0%

* EBITDA = operating income + depreciation and amortization

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

2. Growth strategy

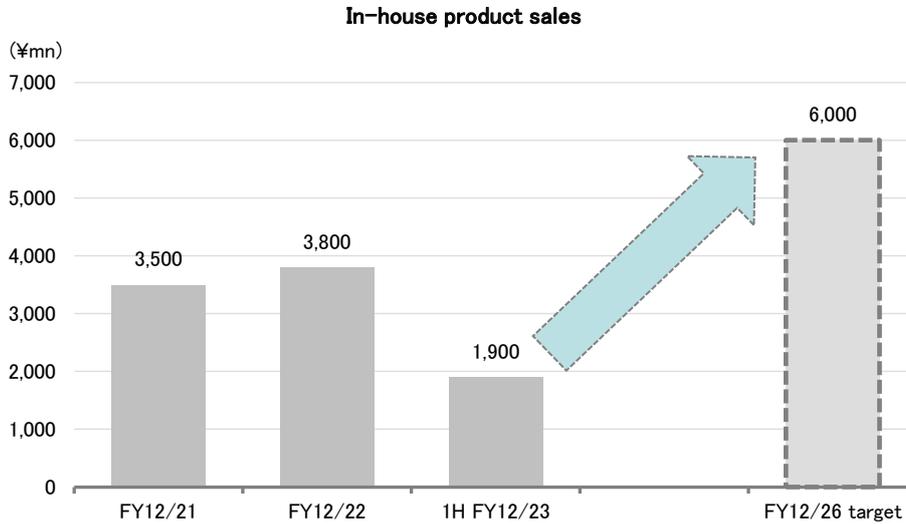
The Company will work on three areas as its basic policy for the long-term enhancement of corporate value: topline growth, high profit margins and proactive shareholder return. For topline growth, the Company targets 30% net sales growth in five years by leveraging investment in human resources and M&A to strengthen products developed in-house, expanding business in Asia, promoting DX in manufacturing, and promoting the use of simulation technology in SDGs and other fields. It plans to raise its EBITDA margin from 10.1% in FY12/22 to 12.7% in FY12/26 by maintaining a balance between high added-value businesses and growth investment. Regarding shareholder return policies, the Company is committed to stable dividends, with a targeted DOE of 6.0%, and intends to proactively engage in treasury share buybacks, depending on the share price level. The Company has defined the following four areas as priority strategies for topline growth.

(1) Strengthen in-house product development

The Company has seen some of the risks of the sales distributor business surface and it aims to increase the proportion of net sales from in-house products and services to counter the risk of losing sales distributor business and to improve profitability. Among these, the Company aims to increase sales of products developed in-house by approximately 1.5 times, from ¥3,800mn in FY12/22 to ¥6,000mn in FY12/26. In addition to strengthening overseas software development subsidiaries and development structure in Japan to promote differentiation by enhancing its product lineups and bolstering functionality, the Company will also continue to consider M&A opportunities.

Medium-term business plan

Among overseas subsidiaries, Maplesoft plans has organized a specialized team dedicated to seeing out new customers among large corporations by the end of 2022. The company to focus on customer development not only in North America, but also in Japan, China, and Germany. In addition to expanding partnerships, it plans to license OEM technology and launch new products in 2024. Sigmetrix will strengthen the functionalities of 3D tolerance analysis tools while expanding globally, and Noesis will provide the Optimus process integration and design optimization software platform and engineering services to corporate customers in Europe, the US, and China, in addition to launching new products, with the aim of sales growth. For in-house products, the Company plans to expand sales of its big data visualization tool, which provides an IoT solution, and expects growth of software to support diagnosis in colorectal endoscopy using artificial intelligence. This software is dependent on sales activities by Olympus, but is approved for sale in Hong Kong, India, Thailand, Vietnam, and South Korea as well as Japan. Sales could expand rapidly once the product is covered by insurance.

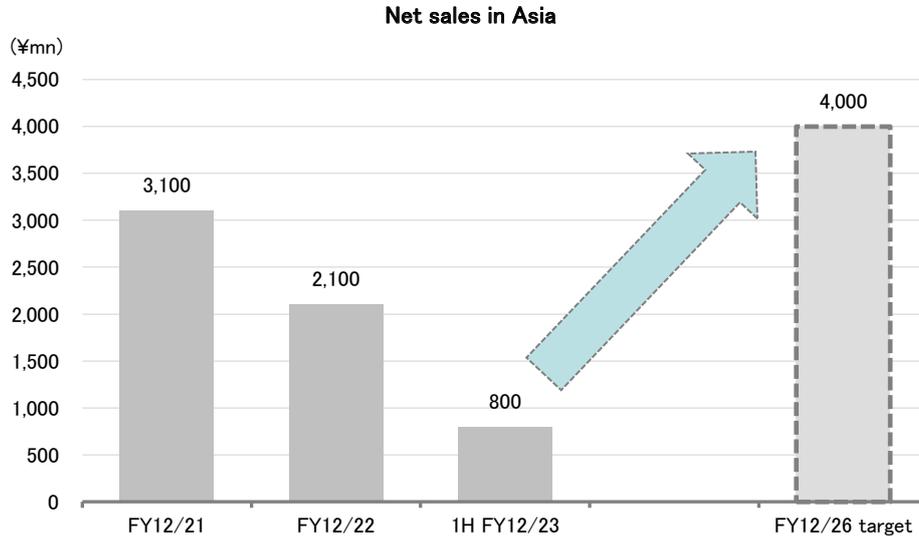


Source: Prepared by FISCO from the Company's supplemental results briefing materials

(2) Expand business in Asia

The Company will move ahead on expanding business in Asia by leveraging its experience in providing simulation technologies to major manufacturers in Japan. Sales to Asia declined in FY12/22 due to the loss of sales of Synopsys products and have been sluggish through 1H FY12/23 due to worsening business confidence in the electronics industry. However, as the manufacturing industry in Asia has high potential for growth, we at FISCO expect the Company will shift to a high-growth trajectory from 2024 onward. Sales of optical products in addition to machinery for mainstay Ansys products are expected to increase, and the Company will also develop its DX business centered on IoT solutions and its IT Solution Services business to expand sales to Asia from ¥2,100mn in FY12/22 to ¥4,000mn in FY12/26.

Medium-term business plan



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

(3) Promote DX in manufacturing

The Company will support promotion of DX in manufacturing through its core technology of simulation technology and MBSE, the latest development method, and advanced technologies such as IoT, AI, and AR/VR. The Company's strength lies in its technologies, including AI, digital twin, big data analysis, and others that have a strong affinity for simulation, and in its ability to provide high value-added solutions combining these technologies. The Company expects high growth in related sales in the future. The Company aims to enhance new products and solutions that counter cyber-attacks to grow the IT Solution Services business.

(4) Utilizing simulation technology in fields such as SDGs

Through its business activities, the Company is working to contribute to fields that tackle the SDGs, such as the realization of a decarbonized society, solving environmental issues, and promoting health by harnessing the simulation technologies and know-how it has acquired.

Specific examples of installation cases include using simulation technology to analyze and optimize the design of wind power generation equipment to improve its power generation efficiency and safety, thereby contributing to reduced CO₂ emissions. In addition, the use of multi-physics analysis tools in the development of smaller inverters and motors with improved performance lowers the cost of EVs. Multi-physics analysis tools improve the efficiency of the development process by combining multiple parameters for simulation.

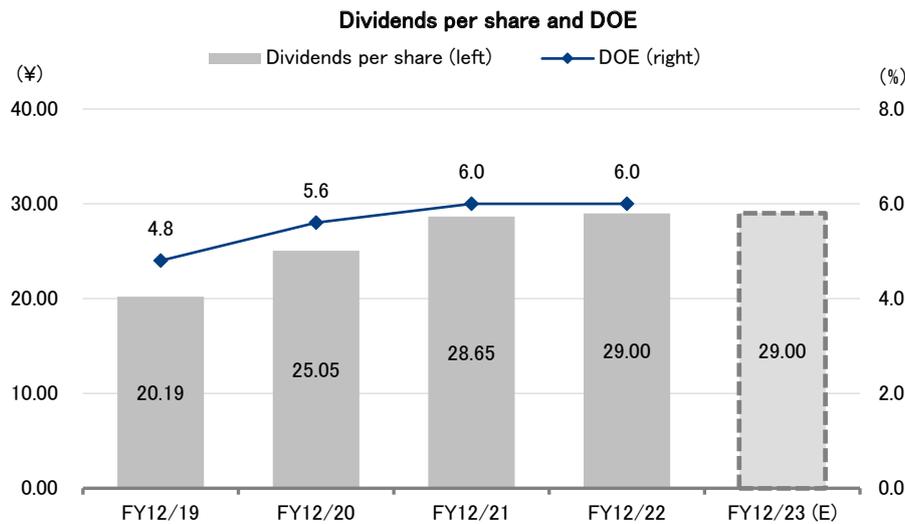
The Company sees huge potential to utilize simulation technologies in non-manufacturing industries as well, such as supporting efficient operation of urban infrastructure and financial institutions' compliance work using big data analysis and simulation technologies. Moreover, there is a wide range of domains where simulation technology can be applied, such as healthcare, construction, and environmental sectors. The Company's strategy for long-term growth is aggressive cultivation of this demand.

Shareholder return policy

The Company's policy is to emphasize stable dividends and aim for a DOE of 6.0%

The Company revised its shareholder return policy in FY12/22. Specifically, its dividend policy to a DOE of 6.0% based on the principle of being within the scope of profit attributable to owners of parent so that dividend increases can be maintained even in periods of short-term decreases in profits in consideration of maintaining capital levels to raise capital efficiency, including future ROE (under the previous policy, the higher of a 50% dividend payout ratio and DOE of 3.0%). In FY12/23, based on this policy, the Company plans to pay a dividend per share of ¥29.0, unchanged from the previous fiscal year. A dividend increase can be expected if net assets increase as a result of earnings expansion.

The Company intends to consider flexible treasury share acquisitions from the viewpoint of capital efficiency, depending on the share price. Recently, the Company acquired 320,000 shares for ¥209mn with a buyback period of February 15 to March 18, 2022.



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



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