COMPANY RESEARCH AND ANALYSIS REPORT

R&D COMPUTER CO., LTD.

3924

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FISCO Ltd. Analyst
Ken Sagawa

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

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Summary

Success of growth strategy for promoting high value-added business and changes to revenue structure

R&D COMPUTER CO., LTD. <3924> (hereafter, also "the Company") is an independent, medium-sized systems integrator that celebrated the 50th anniversary of its foundation in January 2021. The Company's proactive approach to M&A has prompted rapid expansion with respect to what it considers the growth area of package-based SI services, in addition to its stable business foundations of systems integration services and infrastructure solutions services. Changes in revenue structure have appeared, such as alleviation of seasonality and successful growth strategies. During the first year of the three-year plan, the Company nearly achieved the FY3/25 operating profit margin target (¥1,620mn) and is on course to achieve the operating profit ratio target for the final fiscal year.

1. Outline of consolidated results for FY3/24 1H

In FY3/24 1H, the Company achieved new record highs in 1H sales and all profit levels, with consolidated net sales increasing 19.6% year on year (YoY) to ¥6,465mn and operating profit increasing 72.1% to ¥761mn. The Company exceeded its initial plan by 12.2% for net sales and 29.8% for operating profit. In net sales, the Company's three services lines were all higher YoY, with systems integration and package-based SI growing by over 20%. The operating profit margin trended between 1 and 2% for 1Q, when there is a lull in demand, but for 1H exceeded 10% for the first time.

2. Full-year consolidated results forecast for FY3/24 and medium-term management plan

The Company's full-year consolidated forecast has been revised upward, with net sales forecast to increase 14.9% YoY to ¥13,300mn and operating profit to increase 32.1% to ¥1,615mn. Compared to the initial plan, net sales are 7.2% higher and operating profit 13.0% higher. In net sales by service line, the net sales forecast for the systems integration service has been revised upward by ¥500mn compared to the initial forecast, and the package-based SI services by ¥400mn. This reflects favorable performance in the SAP enterprise resource planning (ERP) packages and the Super Stream accounting package. However, 2H net sales in the systems integration services have not been lower than 1H even once in the past five years, and we at FISCO therefore consider that the upwardly revised forecast appears to be on the conservative side.

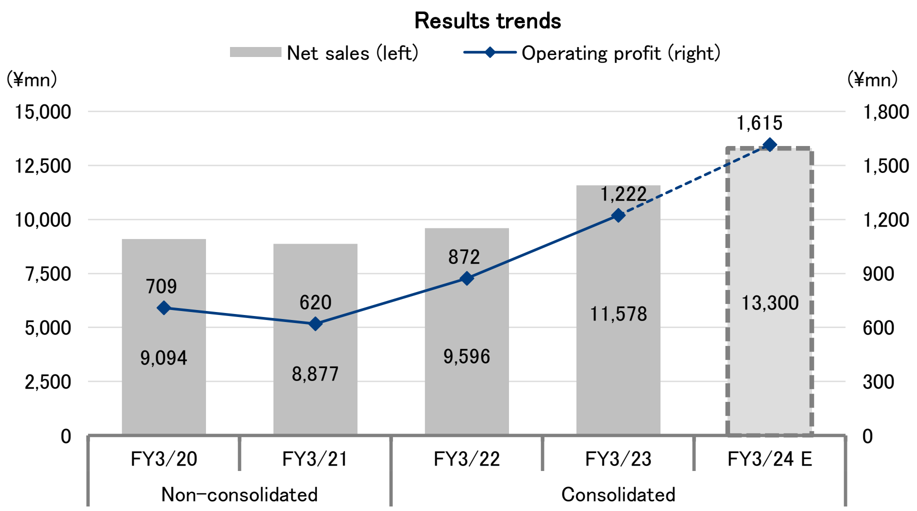
The upwardly revised forecast figures for operating profit are close to the plan figure for FY3/25 (¥1,620mn), the second year in the medium-term management plan, VISION 2025 (FY3/24 to FY3/26). The revised operating profit margin forecast of 12.1% is expected to meet the target value (12.0%) for the final fiscal year of the medium-term management plan. The Company's growth strategy is to emphasize the promotion of high-value-added businesses, increase earning capability, and respond to dramatic changes in the IT services industry. In low-code development, the Company is striving to nurture development personnel centered on GeneXus and Microsoft Power Platform. In agile development, the Company is urgently working to establish in-house standards. Moreover, from 2H, it has begun examining issues such as acquiring the necessary skills to formulate and implement proposal models utilizing Salesforce, ServiceNow, and Microsoft's generative AI service.

3. Dividend policy

The three-year dividend payout ratio standard for VISION 2025 is 50% or higher, an increase from the previous standard of 40%. On November 1, 2023, the Company conducted a two-for-one stock split of its common stock. The dividend plan for FY3/24, adjusted for this stock split, is ¥30.0 per share, assuming the expected dividend payout ratio of 50.2%, an increase from ¥20.0 under the initial plan (¥40.0 before reflecting the stock split). This represents a significant increase of ¥12.5 in the dividend YoY.

Key Points

- FY3/24 forecast appears conservative, despite upward revision
- Better-than-planned progress on medium-term management plan VISION 2025 from the first fiscal year
- FY3/24 dividend expected to be ¥30.0, up ¥12.5 YoY due to increase in profit and raising of dividend payout ratio



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

Company profile

Significant increase in profitability due to package-based SI growth strategy

1. Company profile

The Company has a long history as an independent systems integrator, celebrating 50 years since its 1971 foundation in January 2021. Unusual for the information services industry, it was established by an educational institute. "With all our heart" as the Company creed, and it conducts business based on its three corporate philosophies of "1) Create value for customers and pursue customer satisfaction to increase corporate value, 2) As a group of professionals, open up a path for the next generation and become a leading information technologies company, and 3) Always maintain and uphold an innovative corporate culture.

Since it was established by an educational institute, one of its features is its passion for educating employees. It encourages employees to acquire not only IT-related qualifications, but other business-related qualifications as well, and on average each employee holds three or more qualifications. Employees having skills and knowledge both in IT and customers' businesses makes it possible to develop systems that provide high levels of customer satisfaction.

2. History

At the time of its foundation in 1971, the Company began transactions with FUJITSU <6702> in the development of a banking system, which led to expansion of its business scope centering around the outsourced development of financial systems for banks and insurance companies. In 2006, it started infrastructure-related services for systems integration services as the infrastructure solutions services. The Company began collaborating with Salesforce.com, Inc. (currently Salesforce Japan Co., Ltd.) in April 2010, and started providing cloud computing services. Furthermore, in systems integration services, it has started working on introducing package systems and developing add-ons as package-based SI services.

In April 2020, it carried out organizational restructuring in response to accelerating trends in DX. It established the DX Promotion Headquarters and made it directly responsible for the Salesforce Promotional Office (Now "Salesforce Business Promotional Office") and the newly established Cloud Strategy Office (Now "DX Technology Center"). Currently, the new DX Promotion Headquarters is central to efforts to strengthen the Company's pool of employees proficient in new digital technologies, such as low-code and agile development, and the Company is shifting toward cloud-based business.

The Company was listed on the Tokyo Stock Exchange (TSE) Second Section in December 2015, and subsequently upgraded to the TSE First Section in May 2018. It then moved to the Prime Market following the TSE's restructuring of its market segments in April 2022.

In April 2021, in the Company's first-ever M&A acquisition, it acquired all the shares of infree Corp., which handles the enterprise resource planning (ERP) of German-based SAP <SAP>, and made it a wholly-owned subsidiary. In April 2022, the Company acquired NESCO SUPER SOLUTION Co., Ltd. (now "Technigate Co., Ltd."), a specialist company of the SuperStream accounting package, and made it a wholly-owned subsidiary. These subsidiaries are included in the consolidation of the financial statements and have been part of the consolidated financial statements since FY3/22.

3. Business description

The Company operates the three service lines of systems integration services, infrastructure solutions services, and package-base SI services, and is structured to provide total system support to resolve business issues. According to the composition of consolidated net sales by service line in FY3/24 1H, systems integration services provided 56.6%, infrastructure solutions services 10.0%, and package-based SI services 33.4%.

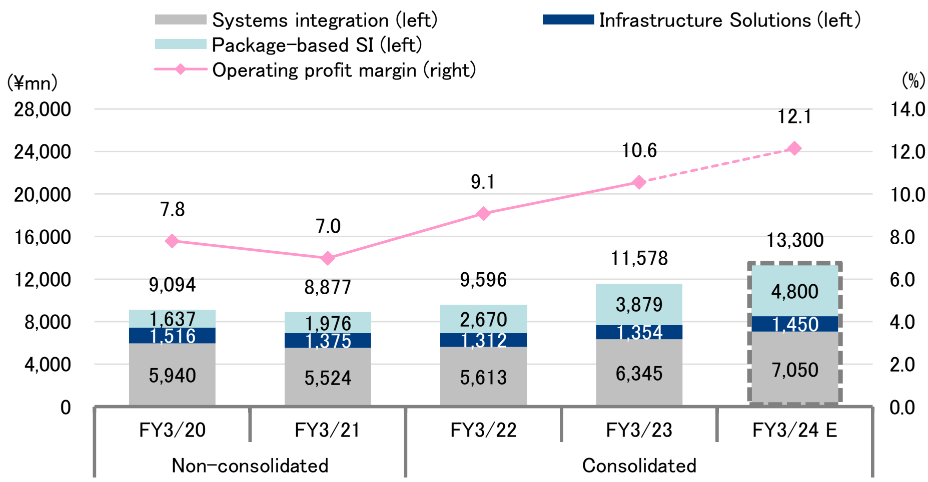
Regarding annual average sales growth rates for the three fiscal years up to FY3/23, the overall rate was 9.3%, the rate for systems integration services was 4.7%, the rate for infrastructure solutions services was -0.5%, and the rate for package-based SI services was 25.2%.

In FY3/21, sales and profits decreased due to the impact of the COVID-19 pandemic, with net sales decreasing 2.4% YoY and operating profit decreasing 12.6%. Looking at net sales changes by service line, systems integration services decreased by 7.0% YoY and infrastructure solutions services decreased by 9.3% YoY, while package-based SI services showed a clearly distinct trend, increasing 20.7% YoY. Infrastructure solution services experienced the strongest impacts of a reactionary decrease from Windows 10 upgrade-related business in FY3/20 and the COVID-19 pandemic. In FY3/22, both net sales and operating profit exceeded pre-pandemic levels, successfully overcoming changes in the business environment in a single fiscal year.

With respect to Company's results, sales are concentrated mainly in 2Q (July-September) and 4Q (January-March) due to the balance between the timing of budget execution by client companies and work periods on development systems, and operating profit tends to be weighted mainly towards the fiscal year-end in the fourth quarter. The 1Q operating profit margin was extremely low at between 1 and 2%; however, from FY3/22 onward, profitability has improved significantly, partly due to the increase in net sales of package-based SI services, and the seasonality of the Company's revenues appears to be easing somewhat.

The Company has positioned systems integration services and infrastructure solutions services as steady growth businesses and package-based SI services as a high growth business. In April 2020, the Company established the Salesforce Business Promotional Office to expand Salesforce-related business throughout the entire Company. The results appeared as early as FY3/21. infree, which was made a subsidiary in April 2021, has an excellent internal education system, and the Company has also utilized employees who are involved with its SAP-related business. As a result, net sales of the SAP-related business have realized sustainable growth. Furthermore, having a subsidiary that is high level and provides highly paid services has also had a beneficial impact on the Company's corporate culture, such as inspiring employee motivation to take on higher-added-value work. With the added impact of a difference in sales composition due to the expansion of package-based SI services, the operating profit ratio increased from 7.8% in FY3/20 before the COVID-19 pandemic to 10.6% in FY3/23. The Company forecasts a margin of 12.1% for FY3/24.

Trends in net sales and operating profit margin by service line



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

Business profile

Growth of package-based SI services greater than forecast

1. Systems integration services

Systems integration services are a mainstay business, with a share of total net sales of 56.6% in FY3/24 1H. Breaking down the services by industry type, services for finance account for 43.8% (*including 26.4% for banks, 14.2% for credit card companies, and 3.2% for financial and other), services for industry and logistics account for 42.3%, public sector 6.5%, and medicine 7.4%.

The systems integration services cover a wide range of fields, including finance, industry and distribution, public sector, and medical care. It mainly conducts outsourced development for customers such as end users, domestic manufacturers, and major systems integrators. The Company has in place a system to provide total services covering all processes, from planning and system construction through to system management. Banks are investing in IT in order to reduce workloads and to save labor, and demand is expected to be at a high level in the medium to long term. There are also many projects for online banks and distribution-related financial subsidiaries.

Financial institutions are the biggest customers for the IT services industry. In the case of the Company, it serves prime contractors include FUJITSU and Hitachi, Ltd. <6501> as a collaborating company. For many years, it has maintained excellent business relations with major systems integrators including FUJITSU at the top of the list, followed by the Hitachi Group centered on Hitachi, Ltd. and Hitachi Solutions, Ltd., the NTT DATA Group <9613>, and NS Solutions Corporation <2327>. The Company's strategy for growing transactions with manufacturing-based systems integrators, which are its largest customer base, is to expand package orders and pursue quality.

Close business relations with the FUJITSU Group formed immediately after founding, and it has become a core partner. In FY3/23, the degree of dependency on FUJITSU for sales was 27.0%. In FUJITSU's FY2022 PQI (Partner Quality Improvement) skill level certification, the Company ranked GOLD for all three steps of the skill levels, including the first step (quality records), second step (quality evaluation), and third step (quality plan), for the seventh consecutive year. In fiscal 2021, in the Fujitsu Software Master Award 2022, which recognizes the efforts of companies that are cultivating large numbers of engineers, the Company was the recipient of first place in the Top Technology Company category due to its cultivation of high-level engineers. FUJITSU is advancing DX business and the Company is actively working to cultivate DX personnel.

Direct user transactions have been positioned as a high growth area, even within systems integration services. The Company is leveraging its customer base to win repeat orders and using package-based SI services as a hook to cultivate new customers. It is advancing highly productive development by focusing on fields where it has expertise and new strategic fields. Main users include Mitsubishi Research Institute DCS Co., Ltd., Sumitomo Mitsui Trust Systems & Services Co., Ltd., Idemitsu Kosan Co., Ltd. <5019>, OPTAGE Inc., and NOMURA HOLDINGS, INC. <8604>. This customer base can be said to be the result of high evaluations from customers of the Company's technological capabilities, its business knowledge in areas such as finance and distribution, and its track record in terms of quality.

2. Infrastructure solutions services

Infrastructure solutions services covers an array of services including installing the hardware, such as servers, that form customers' IT system infrastructure; constructing networks and systems infrastructure, including databases and application infrastructure; and performing subsequent management and maintenance. It has also recently established a new office for cloud business, and focuses on cloud-related services. After surveying and analyzing the IT systems infrastructure environments of various customers, including general companies, universities and other educational facilities, hospitals, and government ministries and agencies, it provides infrastructure solutions services that are tailored to meet their needs. Specifically, in addition to infrastructure solutions services such as network construction, it provides total, one-stop services by combining systems integration services.

3. Package-based SI services

As the main pillar of the growth fields, the Company forms alliances with system and package vendors and in some cases is provided with packages, and offers a total service to customers, from support for introducing software package products (Salesforce, SAP, SuperStream, COMPANY, etc.) to customization, add-on development, maintenance, and management. Net sales of package-based SI services in FY3/24 1H were ¥2,160mn. The ratio of net sales by business type was 39.8% for Salesforce, 18.4% for SAP, 26.9% for accounting packages, 9.6% for personnel salary packages, and 5.2% for other types.

(1) Salesforce – cloud-based SFA/CRM applications

US-based Salesforce, Inc. <CRM> provides a platform that enables users to access combinations of multiple functions, with a focus on the cloud-based business applications Sales Force Automation (SFA) and Customer Relationship Management (CRM). It is the world's biggest platform in its field and has been introduced by over 150,000 companies globally. It established a Japanese subsidiary in 2000. The Company started a business with Salesforce in April 2010 and concluded a sales partner agreement in November 2016. In June 2023, the Company acquired the highest position of "Expert" in the Experience Cloud domain of the Salesforce Navigator Program. Under the Salesforce Navigator Program, the expert capabilities of Salesforce partners in their products, industries, and services are evaluated by Salesforce from the three aspects of knowledge, experience, and quality, and their level is certified on a three-step scale. Experts are partners who possess the highest level of experience and technology in a specific field.

It is currently a Salesforce certified consulting partner (Gold) and application partner, with a track record of more than 2,000 projects for around 500 companies. It uses its business findings in many industries and many types of businesses and knowledge of a wide range of products to propose optimal solutions. In terms of industries, it has a track record of projects including for non-life insurance, insurance agencies, universities, vocational schools and cram and preparatory schools, the manufacturing industry (food, equipment, parts, software, etc.), restaurants, wholesale businesses, retail businesses, specialty trading companies, apparel, print and publishing businesses, real estate, dispatches of human resources, internet services, legal offices, and facility management. It established the Salesforce Business Promotional Office to launch Salesforce cloud services not only for business divisions, but also for Company-wide applications, and this is leading to sustainable growth for the business. It is also used in information systems for financial institutions.

(2) SAP – enterprise resource planning package

German-based SAP was established in 1972 and is the world's largest market share holder in the enterprise resource planning (ERP) systems package field. In April 2021, in the Company's first ever M&A acquisition, it acquired all shares of infree Corp. and made it a wholly-owned subsidiary. Since its foundation in 2001, infree has wielded strengths both in consulting to facilitate adoption of the SAP R/3 package of SAP enterprise resource planning solutions and in developing add-on software. It was certified as an SAP PartnerEdge Service partner in January 2022. The Group's SAP sales were ¥69mn in FY3/21 and the M&A contributed to a substantial increase to ¥483mn in FY3/22. In FY3/23, the second year after the M&A, performance was still strong with sales of ¥667mn. Seeking to leverage synergies, the Company carried out reforms that include integration of offices and having its executives serve as representative directors of infree. Moreover, the Company has successfully grown sales in SAP-related business on a Group-wide basis by sharing resources, such as education tools developed by infree, within the Group.

(3) SuperStream – accounting package

SuperStream Inc. was established in 1986, when it launched GL, a mainframe compatible general accounting system. In March 2022, the cumulative number of companies that had installed its SuperStream accounting package passed the 10,000 mark. In April 2022, the Company acquired the specialist company NESCO SUPER SOLUTION Co., Ltd. and made it a wholly-owned subsidiary. NESCO SUPER SOLUTION was founded in 2008 when NESCO Co., Ltd split off its SuperStream business and established it as a new company. The Company changed the subsidiary's trade name to Technigate Co., Ltd. in January 2023. In December 2022, it integrated its Tokyo and Osaka offices to quickly realize synergies through the unification of parent company and subsidiary and the sharing of business resources. It recorded net sales of ¥586mn in FY3/21 prior to becoming a subsidiary of the Company. The Group's consolidated sales of accounting packages, including SuperStream, were ¥269mn in FY3/21 and ¥295mn in FY3/22, and the effects of the acquisition led to a substantial increase to ¥837mn in FY3/23. Technigate has been taking action in response to the adoption of electronic invoice systems in accordance with Japan's Electronic Books Preservation Act, with FY3/23 serving as a transitional phase. Demand for software packages compatible with the new requirements is forecast in FY3/24.

Looking at the situation concerning taxpayers complying with the Electronic Books Preservation Act, as of October 2020 it was 72.7% of 33,000 major companies, 4.8% of 3,099,000 small to medium enterprises, and 1.2% of 5,251,000 sole proprietors. Revisions to the act in January 2022 forbid the saving of information from electronic transactions in hard format, making the preservation of electronic data mandatory for all businesses. A two-year grace period has been enacted up to December 2023, but from January 2024, electronic records must be preserved. The main purposes of the revisions are to promote paperless accounting operations, strengthen security, and encourage workstyle reforms and DX. Points covered by the revisions other than the mandatory preservation of electronic transaction information include the abolition of the pre-approval system, relaxation of timestamp and search function requirements, abolition of appropriate administrative processing requirements, and stronger penalties for falsification. While the relaxation of requirements will make it easier to introduce electronic book preservation, penalties for falsification are more severe.

4. IT-related and business-related qualifications

(1) Number of employees holding qualifications

One of the Company's strengths is that it is a group of excellent engineers. It actively progresses employees' acquisitions of qualifications not only for IT-related qualifications but also for business-related to deepen their understanding of customers' businesses, such as finance, industry and distribution, and medical care. At the end of September 2023, a total of 2,235 employees held IT-related and business-related qualifications (breaking this down, 1,972 employees held IT-related qualifications and 263 employees held business-related qualifications) and the average number of qualifications held per employee was 3.97. Compared to three years' ago, the number of employees holding qualifications has grown by 45.1%, and the average number of qualifications held per employee has increased by 0.91.

By actively promoting acquisitions of business-related qualifications, the Company's engineers are able to provide systems integration services from the customer's viewpoint. As a result, customer satisfaction is increasing, which becomes the driving force behind building strong relations of trust.

(2) New employee training

The Company also focuses on educating new employees. Prior to joining the Company, employees complete an e-learning course to prepare for the basic information processing test, and after joining spend three months receiving training to become members of society and on basic technologies. During this training period, trainees learn basic program development knowledge, programming languages, and systems design. The curriculum includes an introduction to Java programming, Java programming fundamentals, Java programming applications (DB access), Java application development fundamentals, introduction to Java DB access application development, web application development fundamentals, web application building practice, and a results presentation. It is high level training that not only teaches simple program building, but also challenges trainees to acquire two vendor certifications during the new employee training period. The pass rate for 'Oracle MASTER Bronze Oracle Database 12c' has achieved 100%. Employees from core collaborating companies can also join the training, and in 2023, 50 people participated, including 30 employees from the Company. Following the new employee training, new employees then transition to OJT for their assigned positions. There, they receive support from senior colleagues who are their trainers.

When recruiting, the Company seeks graduates and postgraduates from both the sciences and humanities. The ratio of men to women entering in 2022 was almost equal at 1:1.2. The Company aims to create a workplace where women can play an active role, as evidenced by the 100% return to work rate from parental leave in the same year. In addition, the ratio of new graduates in the humanities to those in the sciences is 70% for humanities and 30% for sciences. Employees in their 20s and 30s make up half of the Company's workforce, with 31.9% in their 20s, 22.6% in their 30s, 28.0% in their 40s, and 17.5% in their 50s or older. As it has in place a complete education system, it seems that it prioritizes recruits with "the ability to think logically," "a willingness to learn" and "a passion for the IT industry and SE," and recruits people who have the aptitude to use its system positively and want to grow. In April 2023, 30 people, including recent graduates looking to change jobs, joined the Company, and it plans to recruit 35-40 new graduates in the spring of 2024.

Results trends

FY3/24 1H net sales and all profit levels achieved new record highs

1. Outline of consolidated results for FY3/24 1H

In FY3/24 1H consolidated results, the Company achieved new record highs in net sales and all profit levels, with net sales increasing 19.6% YoY to ¥6,465mn, operating profit increasing 72.1% to ¥761mn, ordinary profit increasing 71.6% to ¥775mn, and profit attributable to owners of parent increasing 95.1% to ¥525mn. Net sales exceeded the initial plan by 12.2% and operating profit by 29.8%. Net sales was higher YoY in all three service lines. Systems integration and package-based SI net sales each exceeded the initial plan by more than 20%, at 21.1% and 21.3%, respectively. The operating profit margin rose by 1.9 points YoY to 22.1% due to progress on high-value-added business. Package-based SI services share of total net sales rose by 0.5 points YoY to 33.4%. The SG&A expense ratio decreased by 1.8 points YoY to 10.3%, mainly reflecting the strong increase in sales, despite a rise in personnel expenses associated with revised employee conditions and expense associated with human capital investment, such as expenses for training human resources in new digital fields. As a result, each level of profit increased significantly, and the 1H operating profit margin increased by 3.6 points to 11.8%, exceeding 10% for the first time

FY3/24 1H consolidated results

(¥mn)

	FY3/23 1H		FY3/23 1H			Change		vs plan
	Results	% of net sales	Plan	Results	% of net sales	Amount	%	
Net sales	5,404	-	5,760	6,465	-	1,061	19.6%	12.2%
Systems integration	3,020	55.9%	-	3,657	56.6%	636	21.1%	-
Infrastructure solutions	603	11.2%	-	648	10.0%	44	7.4%	-
Package-based SI	1,780	32.9%	-	2,160	33.4%	379	21.3%	-
Gross profit	1,094	20.2%	-	1,429	22.1%	335	30.7%	-
SG&A expenses	651	12.1%	-	668	10.3%	16	2.6%	-
Operating profit	442	8.2%	587	761	11.8%	319	72.1%	29.8%
Ordinary profit	452	8.4%	587	775	12.0%	323	71.6%	32.2%
Profit attributable to owners of parent	269	5.0%	360	525	8.1%	256	95.1%	45.9%

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

Package-based SI saw favorable performance in SAP and accounting packages-related businesses, which the Company acquired by M&A

2. Trends by service line

Net sales for the three service lines all grew, but growth was most prominent in package-based SI services, where the Company aggressively conducted M&As, lifting the share of total net sales to 32.9%, or one third, and contributing to profit expansion.

(1) Systems integration services

Net sales in systems integration services were ¥3,657mn, up 21.1% YoY. By industry, sales rose 23.1% to ¥1,602mn in the finance field, which saw favorable activity in contracted development projects for Internet banks and trust banks. In the industry and distribution field, sales for telecommunications providers where solid, while the public sector saw growth in sales driven by the continuation of a large-scale project from the previous fiscal year and the receipt of orders for system development projects for government organizations.

Systems integration services net sales by industry

(¥mn)

	FY3/23 1H		FY3/24 1H		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Finance	1,303	43.1%	1,602	43.8%	299	23.0%
(of which, banks)	707	23.4%	965	26.4%	257	36.4%
(of which, credit cards)	483	16.0%	519	14.2%	36	7.5%
(of which, insurance and securities)	111	3.7%	117	3.2%	6	4.6%
Industry and distribution	1,357	44.9%	1,547	42.3%	189	13.9%
Public sector	125	4.1%	236	6.5%	111	88.8%
Medical care	233	7.7%	270	7.4%	37	15.8%
Total	3,020	100.0%	3,657	100.0%	636	21.1%

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

(2) Infrastructure solutions services

Net sales in infrastructure solutions services rose 7.4% YoY to ¥648mn. The Company strengthened human resource training in the field of cloud development centered on DX promotion, and increased orders for cloud projects for the public sector. Furthermore, the semiconductor shortage eased and the receipt of orders for infrastructure design and deployment projects increased.

Infrastructure solutions services net sales by industry

(¥mn)

	FY3/23 1H		FY3/24 1H		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Finance	88	14.6%	82	12.7%	-5	-6.8%
Industry and distribution	347	57.5%	351	54.2%	4	1.2%
Public sector	156	25.9%	210	32.4%	54	34.9%
Medical care	11	1.8%	3	0.5%	-7	-68.8%
Total	603	100.0%	648	100.0%	44	7.4%

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

(3) Package-based SI services

Net sales of package-based SI services climbed 21.3% YoY to ¥2,160mn, for a share of total net sales of 33.4%. Growth in this service line has been driven thus far by Salesforce-related business, which saw a slowdown in growth with net sales of ¥860mn, up 4.3% YoY. On the other hand, SAP, which continued to experience M&A effects, recorded growth of 24.8% to ¥397mn, and accounting packages performed favorably, growing 54.9% to ¥580mn. For Technigate, which handles the SuperStream accounting package, FY3/23 was a transitional phase in preparation for the revision of Japan's Electronic Books Preservation Act. In FY3/24 1H net sales increased significantly with the start of the invoicing system as the method for input tax deduction for consumption tax in October 2023.

Package-based SI services net sales by industry

(¥mn)

	FY3/23 1H		FY3/24 1H		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Salesforce-related business	825	46.3%	860	39.8%	35	4.3%
SAP	318	17.9%	397	18.4%	78	24.8%
Accounting packages (SuperStream, Bugyo)	375	21.1%	580	26.9%	205	54.9%
Personnel salary packages (COMPANY, SuperStream)	204	11.5%	207	9.6%	2	1.4%
Other (DynamicsCRM, others)	56	3.1%	113	5.2%	56	54.9%
Total	1,780	100.0%	2,160	100.0%	379	21.3%

Note: Accounting packages (SuperStream, Bugyo), personnel salary packages (COMPANY, SuperStream), and other (DynamicsCRM, others)
Source: Prepared by FISCO from the Company's results briefing materials

3. Financial condition

At the end of FY3/24 1H, total assets were up ¥290mn from the end of FY3/23 to ¥7,793mn. Looking at the main factors in the change, current assets were up ¥371mn to ¥6,511mn, and non-current assets were down ¥81mn to ¥1,281mn. Accounts receivable – trade and contract assets increased ¥298mn, while cash and deposits decreased by ¥67mn. In intangible assets, goodwill decreased by ¥35mn to ¥309mn. The Company practices debt-free management, and has a current ratio of 330.8% and an equity ratio of 66.6%, so its financial stability is extremely high. As it has ample liquidity on hand, we at FISCO believe that it can take an agile approach to M&A.

Consolidated balance sheet and financial ratios

(¥mn)

	FY3/20 (non-consolidated)	FY3/21 (consolidated)	FY3/22 (consolidated)	FY3/23 (consolidated)	FY3/24 1H (consolidated)	Change
Current assets	4,969	5,187	5,823	6,139	6,511	371
(Cash and deposits)	2,167	2,384	2,906	3,062	2,995	-67
(Accounts receivable – trade and contract assets)	2,339	2,321	2,428	2,649	2,948	298
Non-current assets	528	559	676	1,362	1,281	-81
Property, plant and equipment	85	75	64	113	103	-9
Intangible assets	9	6	121	727	690	-36
Goodwill			114	345	309	-35
Investments and other assets	433	476	489	522	486	-35
Total assets	5,498	5,746	6,500	7,502	7,793	290
Current liabilities	1,404	1,317	1,625	2,013	1,968	-45
Non-current liabilities	466	482	508	623	620	-3
Total liabilities	1,871	1,800	2,133	2,637	2,588	-48
Total net assets	3,626	3,946	4,366	4,865	5,204	338
[Stability]						
Current ratio	353.9%	393.8%	358.3%	305.0%	330.8%	25.8pt
Equity ratio	66.0%	68.7%	67.2%	64.7%	66.6%	1.9pt

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

Outlook

FY3/24 forecast appears conservative, despite upward revision

In its FY3/24 consolidated results, the Company forecasts net sales to increase 14.9% YoY to ¥13,300mn, operating profit to increase 32.1% to ¥1,615mn, ordinary profit to increase 32.2% to ¥1,636mn, and profit attributable to owners of parent to increase 38.6% to ¥1,070mn. Compared to the initial plan, net sales are forecast to be 7.2% higher and operating profit 13.0% higher. Operating profit will approach the target of ¥1,620mn for FY3/25, the second year of the medium-term management plan, VISION 2025, discussed below.

Consolidated outlook for FY3/24

(¥mn)

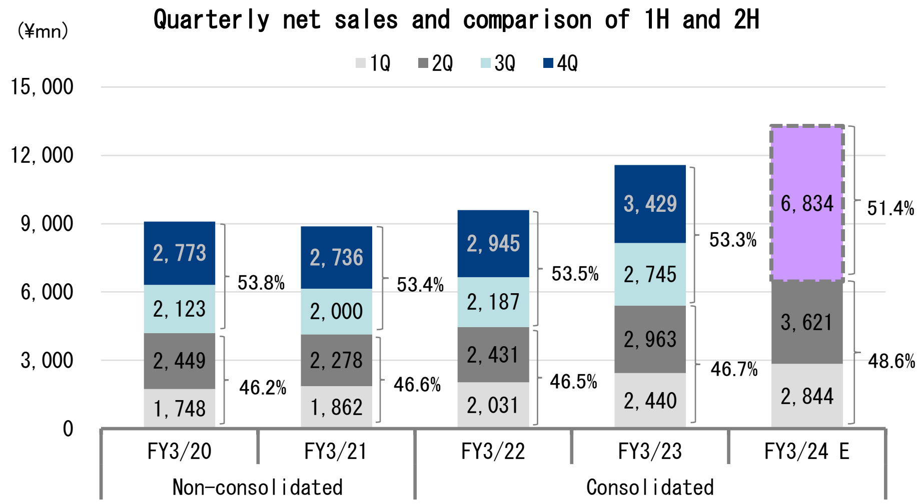
	FY3/23		FY3/24			YoY		Change vs. plan
	Results	% of net sales	Initial plan	Revised forecast	% of net sales	Change	Change (%)	
Net sales	11,578	-	12,400	13,300	-	1,722	14.9%	7.2%
Systems integration	6,345	54.8%	6,550	7,050	53.0%	705	11.1%	7.6%
Infrastructure solutions	1,354	11.7%	1,450	1,450	10.9%	96	7.1%	0.0%
Package-based SI	3,879	33.5%	4,400	4,800	36.1%	921	23.7%	9.1%
Operating profit	1,222	10.6%	1,429	1,615	12.1%	393	32.1%	13.0%
Ordinary profit	1,238	10.7%	1,447	1,636	12.3%	398	32.2%	13.1%
Profit attributable to owners of parent	772	6.7%	900	1,070	8.0%	298	38.6%	18.9%

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

Looking at net sales by service line, net sales are expected to increase by 11.1% YoY to ¥7,050mn in systems integration services, 7.1% to ¥1,450mn in infrastructure solutions services, and 23.7% to ¥4,800mn in package-based SI services. The sales forecast was revised upward by ¥900mn from the initial forecast, of which the breakdown is ¥500mn for systems integration services and ¥400mn for package-based SI services. This will increase the portion of total net sales accounted for by package-based SI services to 36.1%.

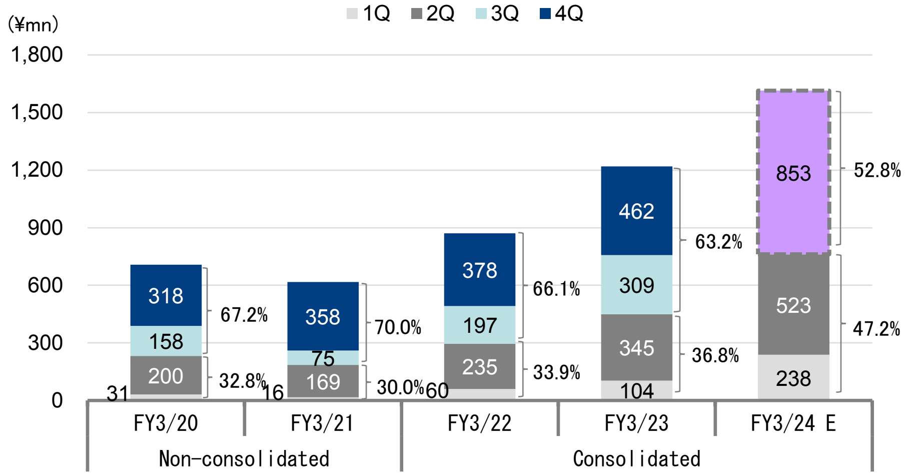
The average breakdown of net sales for 1H (April to September) and 2H (October to March) over the past five fiscal years was 46.4% and 53.6%, respectively, and the breakdown of operating profit was 33.4% and 66.6%, respectively. In contrast, projections for FY3/24 of net sales breakdown for 1H and 2H of 48.6% and 51.4%, respectively, and that of operating profit of 47.2% and 52.8%, respectively. The 2H ratio of 52.8% is low compared to the past level (66.6%), and we at FISCO consider the upwardly revised forecast to be on the conservative side.

Looking at 1H progress rates of net sales by service line for FY3/24 and the past five-year average (in parentheses), systems integration services was at 51.9% (47.6%), infrastructure solutions services was at 44.7% (43.5%), and package-based SI services was at 45.0% (45.2%). Since 2H net sales for systems integration services have not been lower than 1H sales even once in the past five years, there seems to be room for upward revision.



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

Quarterly operating profit and comparison of 1H and 2H



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

Medium- to long-term growth strategy

Better-than-planned progress on medium-term management plan VISION 2025 from the first fiscal year

1. Medium-term management plan (VISION 2025)

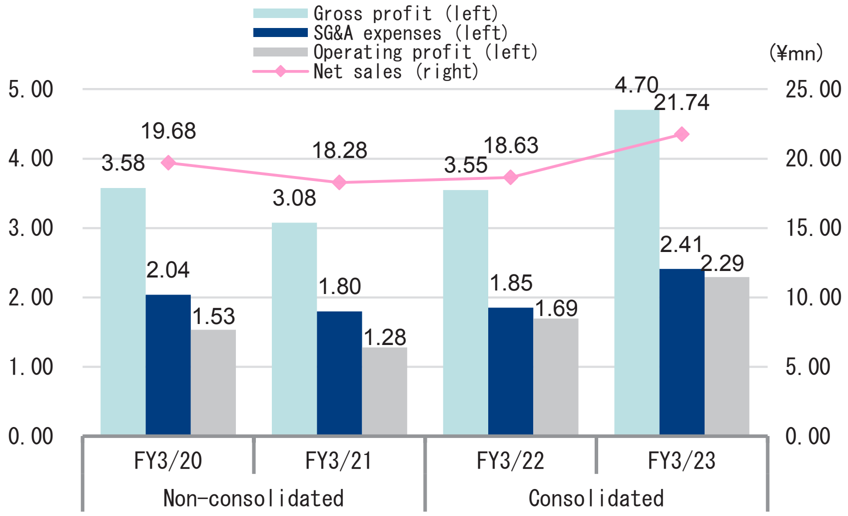
In VISION 2023, the Company's medium-term management plan covering the three years up to FY3/24, the key strategies are 1) proactively advance M&A, 2) further strengthen relationships with alliance partners, 3) promote DX business, 4) grow direct user transactions and strengthen in areas of expertise, and 5) further grow sales in existing SI fields. The Company's numerical targets for FY3/26 are net sales of ¥15,000mn and operating profit of ¥1,800mn. This would correspond to three-year CAGR of 9.3% for net sales and 13.8% for operating profit. By service line, projected net sales CAGR is 5.5% for systems integration services, 4.4% for infrastructure solutions services, and 15.6% for package-based SI services. The share of total net sales for package-based SI services, a high-value-added business, is projected to increase 6.5 points to 40%, contributing to an increase in the operating profit margin of 1.4 points to 12.0%.

Based on the favorable results for 1H, the full-year results forecast for FY3/24 has been revised upward to net sales of ¥13,300mn and operating profit of ¥1,615mn. Since the plan values for FY3/25, the second year of the medium-term management plan, are net sales of ¥13,700mn and operating profit of ¥1,620mn, the Company is virtually expecting to achieve the operating profit target one year ahead of schedule. The share of total net sales for package-based SI services has been revised upward from 35.5% in the initial plan to 36.1%. The forecast operating profit margin has also been revised upward from 11.5% under the initial plan to 12.1%, exceeding the target value for the final year of the medium-term management plan of 12.0%. If the share of total net sales of this service line reaches 40%, the profit margin has the potential to exceed the target.

Human capital is an important management resource, central to value creation for an IT services company; however, the Company faces a worsening shortage of engineers. In its DX Report of September 2018, the Ministry of Economy, Trade and Industry suggested that there is a risk of a shortage of between 400,000 to 800,000 engineers emerging by 2030 due to the '2025 Digital Cliff' and the low productivity of IT human resources in Japan, as it is a labor-intensive business model. In the determination of surplus and shortage of full-time employees and other workers by industry D.I. (Diffusion Index = "shortage" - "surplus") based on the Survey On Labor Economy Trend by the Ministry of Ministry of Health, Labour and Welfare, as of August 2023, the "total of surveyed industries" stood at 45, whereas the "information and communications industry" stood at 53 ("shortage" 54, "surplus" 1), indicating a strong sense of shortage. Only three industries had a more serious shortage of workers than the information and communications industry: the "construction industry" (D.I. 58), which will ramp up workstyle reforms from April 2024, as well as the "transport and postal activities industry," (D.I. 56), and the "medical health care and welfare industry" (D.I. 61).

When the Company was primarily operating business based on systems integration services, its targets were to rigorously manage projects and eliminate unprofitable projects in order to lift the operating profit ratio above 10%. In FY3/24, the Company has reached a level where it can plan to achieve an operating profit ratio of 12.1% by expanding cloud services and package-based SI services. Comparing pre-COVID-19 non-consolidated financial results for FY3/20 and consolidated results for FY3/23 including package-based SI services subsidiaries, per-employee figures have risen in net sales from ¥19.68mn to ¥21.74mn, in gross profit from ¥3.58mn to ¥4.70mn, in SG&A expenses from ¥2.04mn to ¥2.41mn, and in operating profit from ¥1.53mn to ¥2.29mn. By increasing the weight of high-value-added business, the Group has adopted a growth strategy of increasing productivity by enhancing per-employee net sales and gross profit, raising employee compensation, and investing in R&D and human resource development for the future.

Per-employee net sales, gross profit, SG&A expenses, and operating profit



Note: Per-employee net sales, etc., are calculated using the average of the number of employees at the start and at the end of the fiscal year, with the number at the end of the fiscal year used for FY3/22 only
Source: Prepared by FISCO from the Company's securities report

2. Measures for realizing the medium-term management plan

The market environment in the medium-term management plan anticipates steady growth in the domestic IT market, while innovative new technologies such as agile development and generative AI are continuously emerging. The Company works to place the right person in the right position in order to meet customers' expectations. In anticipation of changes in user needs and to build a competitive position in the future, the Company is dynamically engaged in reskilling its employees to enhance agile development capabilities.

Measures for realizing the medium-term management plan

1. Promotion of proactive M&A Expand the Group's overall business scale by investing in companies with businesses that will create synergies with the Company
2. Further strengthen teamwork with business partners Expand the scope of solutions through package-based SI and services by deepening cooperation with companies possessing excellent IT products/services and proprietary technologies
3. Promote the DX business
(1) Cloud, package-based SI
1) Company-wide development of Salesforce-related business
2) Increase the ratio of package-based SI services, such as SAP and SuperStream
3) Expand direct user transactions through expansion of package-based SI services
4) Promote structural reform of the cloud business (AWS, Azure, etc.) in the infrastructure solutions field
(2) Low-code development, agile development
1) Develop low-code development personnel centered on GeneXus and Microsoft Power Platform
2) Make agile development the standard method for low-code and cloud native development
(3) Initiatives on generative AI
1) Start planning development of generative AI business from FY3/24 2H as a measure to strengthen the DX business
2) Promote investigative research on generative AI services, such as Salesforce "Einstein Copilot," ServiceNow "Now Assist," Microsoft "Azure Open AI Service" and examine necessary skills acquisition for formulation and implementation of a proposal model.
4. Investment in human resource development and strengthening of specialization fields
(1) Aggressive investment in human resource development
Accelerate promotion of acquisition of service and IT qualifications and focus on new digital engineer qualification acquisition, such as package-based SI services, cloud, and low-code development
(2) Bolster areas of strength
Promote high-productivity development, focusing on areas in which the Company possesses know-how and new growth areas
5. Further improve sales in existing SI areas
(1) Expand domain in the finance field
(2) Increase receipt of orders in the public sector
(3) Strengthen alliances with partners such as Fujitsu <6702> Group, Hitachi Group, NTT Data Group <9613>
(4) Promote modernization of existing systems

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

Conventional development requires systems to accurately and efficiently record, store and use large amounts of data, with an emphasis on quality. Existing systems are becoming outdated, complex, and black box, and modernization is required to avoid the '2025 Digital Cliff' that Japan's Ministry of Economy, Trade and Industry is warning about. Migrating COBOL assets to languages like Java requires engineers with many years of systems development experience who know older programming languages. For cost-focused customers, the Company provides combinations of package and cloud services. For customers who are focused on development speed, it proposes DX-based development. The Company will use order-made software development to overcome the '2025 Digital Cliff' and provide solutions for users aiming for management transformation through DX, so it is pursuing agile development methods as a standard for low-code development and cloud-native development.

Characteristics of conventional development and DX development

Type	Characteristics
Conventional development	System to accurately and efficiently record, store and use large amounts of data • Focus on cost and quality: Scratch development, waterfall development, packages, cloud, joint development
DX development	System to repeatedly provide and improve services in a short space of time • Focus on speed and flexibility: Agile development, low-code development, cloud, generative AI

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

In order to strengthen its agile development capabilities, the Company entered into a software development partnership agreement with GeneXus Japan Inc. in September 2022. The GeneXus low-code software development tool has been adopted by over 8,700 companies located in more than 50 countries worldwide and used by more than 130,000 technical experts. The GeneXus software development tool significantly shortens development timelines by as much as 80% by enabling developers to automatically generate applications and databases simply by entering task requirements. Once the requirements have been declared, developers are able to share a functional prototype of the application or database, thereby making it easier to pinpoint issues at the preliminary stage. In addition, the software development tool automatically generates software applications after requirements have been declared. This makes it possible for users to significantly reduce development costs and shorten timelines, while lowering the occurrence rate of coding bugs and curbing the likelihood of system obsolescence. The tool offers the distinctive advantage of enabling development of systems that are not prone to obsolescence because it provides for substantial maintainability and does not rely on infrastructure.

The Company is working to train low-code developers, mainly around GeneXus and Microsoft Power Platform. As of the end of FY3/23, the Company had 16 engineers holding low-code development qualifications, and this had increased to 18 by the end of FY3/24 1H. It plans to raise this to 50 by the end of FY3/24. The DX Promotion Headquarters is taking steps to establish standard approaches to low-code development and agile development with respect to cloud-native development.

The Company has been placing focus on its highly profitable package-based SI services offering hands-off solutions. The Company has achieved sustainable growth through strategic investment and inhouse education in the SAP business. As a SuperStream NX partner, Technigate has knowledge and strong technical capabilities concerning the SuperStream accounting package business. It cultivates direct user transactions with a focus on major companies and to date, it has installed the package at a total of 727 companies. The Company is sharing the knowledge possessed by its subsidiary and using it to grow its own direct user transaction business. It also plans to integrate subsidiaries' customer bases into its package-based SI services business so that it can provide them with next-generation services that offer even greater added value.

The Company has launched a new business handling ServiceNow. US-based ServiceNow, Inc.<NOW> was established in 2004 and provides a cloud-based operations platform for raising worker productivity in an SaaS format. It established a Japanese subsidiary in 2013. Its cloud services encourage workstyle reforms and greater productivity among employees by simplifying and automating a company's routine workflow processes in areas from IT asset management to security, human resources, and customer service.

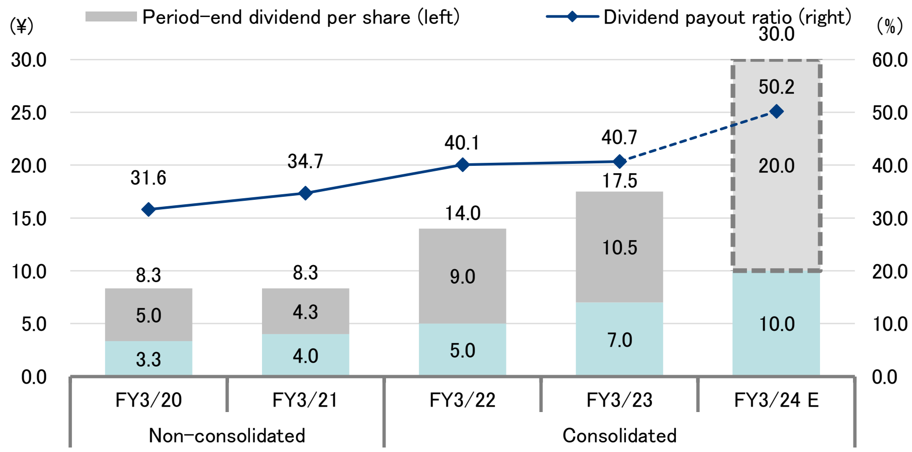
In its initiatives on generative AI, the Company will start planning business development in FY3/24 2H as a measure to strengthen the DX business. It will promote investigative research on generative AI services, such as Salesforce "Einstein Copilot", ServiceNow "Now Assist" Microsoft "Azure Open AI Service" and examine necessary skills acquisition for formulation and implementation of a proposal model.

Shareholder return policy

FY3/24 dividend expected to be ¥30.0, up ¥12.5 YoY due to increase in profit and raising of dividend payout ratio

The Company considers returning profits to shareholders to be one of its more important management issues, and its basic policy is to continuously and stably return profits to shareholders after considering supplementing internal reserves as necessary to strengthen the management structure and for business development in the future. In November 2021, the Company changed its dividend policy and raised the consolidated dividend payout ratio from 30% to at least 40%. Moreover, under VISION 2025, the Company has lifted the consolidated dividend payout ratio to at least 50% for the three years until FY3/26. On November 1, 2023, the Company conducted a two-for-one stock split of its common stock. The forecast dividend per share for FY3/24, adjusted for this stock split, has been significantly increased by ¥12.5 from ¥17.5 in the previous fiscal year to an annual dividend of ¥30.0 (expected dividend payout ratio of 50.2%), comprising an interim dividend of ¥10.0 and a year-end dividend of ¥20.0.

Dividend per share and dividend payout ratio



Notes: Retroactively revised following the 1.5 to 1 stock split conducted on October 1, 2021
Retroactively revised following the 2 to 1 stock split conducted on November 1, 2023
Source: Prepared by FISCO from the Company's results briefing materials

Sustainability management

The Company's value creation model is to promote corporate management with an emphasis on ESG towards reaching the United Nations Sustainable Development Goals (SDGs) in 2030, serving as an IT partner while continuously creating solutions. Its seven key targets for sustainability management are 1) human resource development, 2) response to climate change, 3) human rights and diversity, 4) health and productivity management, 5) business partners, 6) quality security, and 7) corporate governance. It has cited 10 of the SDGs to which it will contribute: 3. Good health and well-being, 4. Quality education, 5. Gender equality, 8. Decent work and economic growth, 9. Industry, innovation and infrastructure, 10. Reduced inequalities, 12. Responsible consumption and production, 13. Climate action, 16. Pease, justice and strong institutions, and 17. Partnerships for the goals. By promoting corporate management that emphasizes ESG, the Company aims to contribute to achieving the SDGs through the provision of system solutions that support high-quality, safe and secure social infrastructure by a group of excellent engineers, and to create workplaces that enable individual employees to enjoy a healthy and fulfilling relationship with their work.

Seven key indicators for sustainability management

The Group's key indicators	The SDGs
1. Human resource development	Contribute to the realization of sustainable social infrastructure through the provision of optimal system solutions by a group of excellent engineers.
2. Response to climate change	Recognize that initiatives in response to climate change are a common global issue and aim to conduct corporate activities that are considerate of the global environment.
3. Human rights and diversity	Respect the human rights and individual diversity of all people and aim to establish an environment where individuals can reach their full potential.
4. Health and productivity management	Aim to create a workplace where individual employees can be healthy mentally and physically and enjoy fulfilling relationships with their work.
5. Business partners	Contribute to the achievement of the SDGs through the building of long-term cooperative relationships with business partners.
6. Quality security	Aim to be a company that is trusted by stakeholders by providing high quality, safe and secure services.
7. Corporate governance	Further enhance corporate governance to realize management that can provide benefits to all stakeholders.

Source: The Company's results briefing materials

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■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp