COMPANY RESEARCH AND ANALYSIS REPORT

System Support Inc.

4396

Tokyo Stock Exchange Prime Market

10-Apr.-2023

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Index

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Summary

Double-digit increases in sales and profit continue on high growth in Cloud Integration Business

System Support Inc. <4396> (hereinafter, "the Company") is an independent IT company that continues to grow, centered on supporting the introduction and use of various cloud infrastructure-related services, ERP, databases, etc., using its strength of industry-leading technological capabilities. The Company is headquartered in Ishikawa Prefecture, Japan. However, Tokyo, Nagoya, and Osaka are the primary hubs of the Company's business activities. Also, the Company has a subsidiary in Silicon Valley in the US. The Company is also focused on recurring-revenue businesses, including data center services and the Product Business, which mainly consists of providing cloud (SaaS) services.

1. Outline of results for 1H FY6/23

In 1H FY6/23 (July 2022 to December 2022), the Company set record highs for consolidated results. Net sales increased 18.2% YoY (year-on-year) to ¥9,211mn and operating profit rose 26.4% to ¥743mn, as both figures exceeded the Company's forecasts (net sales of ¥8,765mn, operating profit of ¥722mn). Net sales increased in all the Company's business segments, particularly in the Cloud Integration Business. On the profit front, personnel investment costs increased but they were more than offset by the increase in sales. The operating margin continued its upward trend, rising to 8.1% thanks primarily to growth in the highly profitable Cloud Integration Business. Overall, the Company's consolidated results were very positive. In the Cloud Integration Business, net sales of ServiceNow*-related services increased 27.5% to ¥922mn, continuing their high growth, and Google Cloud-related services also grew rapidly, rising by 201.5% to ¥261mn. The Company's focus on training engineers in data analysis, an area where Google Cloud excels, proved successful.

* "ServiceNow" is a cloud platform that standardizes and automates business processes and supports improved productivity by employees and organizations. It is provided by ServiceNow, Inc. of the US. Over the past few years, it has started to rapidly become widely used as a DX solution not only in the US and Europe, but also in Japan. The Company was one of the first Japanese companies to enter into a partner agreement with ServiceNow in 2015, and has a top-tier track record for deploying the service in Japan.

2. Outlook for FY6/23

For FY6/23 consolidated results, the Company's initial forecasts are kept unchanged for net sales to increase 11.7% YoY to ¥18,093mn and operating profit to increase 21.7% to ¥1,456mn. The economic outlook is increasingly uncertain, but recent orders have been strong, and the Company is handling them by hiring and strengthening human resources. At the same time, demand continues to outstrip supply capacity, so the Company is expected to continue to operate at full capacity in the second half. Recurring-revenue businesses, the Outsourcing Business centered on data services and the Product Business, continue their strong performance and are projected to steadily grow in the second half as more customers are added. There is therefore a high likelihood that the Company will achieve its full-year forecasts. The Company is currently strengthening its personnel systems. In January 2023, it introduced a remote work program for employees out of commuting distance as a way to increase the employee retention rate.

3. Medium-term management plan

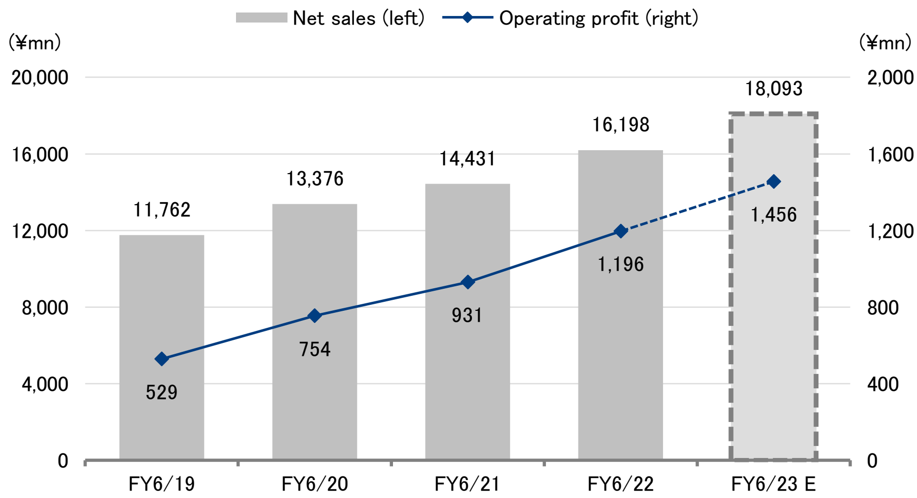
The Company started a three-year medium-term management plan that began in FY6/23. Its main theme is stated as "Growth and creation of further innovation." Under the plan, the Company will expand services that form the foundation of DX promotion for customers and society, promote the growth and success of diverse human resources, and strengthen ESG management. For FY6/25, it is targeting net sales of ¥21.89bn or higher, operating profit of ¥2.18bn or higher, and an operating margin of 10% or higher. In terms of average annual growth over three years, growth in net sales will exceed 10.6% and growth in operating profit will exceed 22.3%. Driving this will be the Cloud Integration Business. With the domestic cloud market continuing to experience double-digit annual growth rates going forward, along with its existing cloud integration services, the Company will take up promising solutions where future growth is expected in order to secure an annual growth rate of 25% for the business, expanding it at a pace beyond the industry average. One solution drawing attention is the Celonis Execution Management System (Celonis EMS)*, a platform for managing business process execution the Company began handling in 2022. The platform also links with ServiceNow, which the Company has ample experience implementing, so it is possible that sales will be increased relatively smoothly. It is already beginning to be deployed for customers. The Company's strategy is the same as before: to increase orders by actively training engineers. The Company also plans to steadily increase earnings from the System Integration Business, Outsourcing Business, Product Business and other areas. The Company further intends to continue investing in human resources, a source of growth, and plans to increase employees at a pace of almost 9% per year. It will also take a positive stance to possible M&A opportunities where synergies can be expected. Regarding its policy on shareholder returns, the Company plans to pay dividends with a payout ratio at the 30-35% level. The per-share dividend for FY6/23 is expected to be ¥30.0 (payout ratio of 31.6%), an increase of ¥5.0 from the previous fiscal year.

* A cloud platform developed and provided by Celonis SE of Germany, a global leader in process mining. Celonis EMS is a tool that helps increase productivity by visualizing and analyzing event log data from all systems using a process mining engine to identify inefficient business processes and suggest improvements. The Company entered into a sales partner agreement with Celonis K.K., the company's Japanese affiliate, in June 2022.

Key Points

- Double-digit growth in sales and profits in 1H FY6/23, exceeding company forecasts
- Recent orders remain buoyant; sales and profits expected to continue double-digit growth
- Smooth start to first year of medium-term plan, with the Company targeting annual growth in profit of 22% or higher, which will be driven by the Cloud Integration Business

Results trends



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

Company profile

An independent IT company that continues to grow by undertaking many projects involving mainstay cloud infrastructure-related services, ServiceNow, SAP and Oracle

1. History

The Company was founded in 1980 in Kanazawa, Ishikawa Prefecture to provide data entry services and system development services. In the 1980s, business performance continued to grow steadily against the backdrop of favorable economic conditions. However, business results started to deteriorate following the collapse of Japan's bubble economy in the 1990s, momentarily putting the Company's survival at risk. However, in 1994, the Company worked to rationalize management under the strong leadership of the current Representative Director Ryoji Koshimizu who took over management from the Company's founder. As a result, four years later, its business results had recovered to the point where profitability was restored. Subsequently, the Company developed its technological capabilities, which are said to be at the highest level of the industry for an independent enterprise, into a core strength, and has continuously increased its business performance by using the expansion of the domestic cloud market as a tailwind.

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

Moreover, in 2009, the Company founded STS Medic Inc., a subsidiary engaged in the development and sales of specialized software for the medical industry. Thereafter, the Company built a solid business foundation by making use of M&As. For example, T4C Co., Ltd., a service partner of the major ERP provider SAP, and ACROSS Solutions, Inc., which had been providing system solutions to the distribution industry, were successively converted into subsidiaries of the Company in 2010 and 2012, respectively. The Company has also entered overseas markets. Additionally, in 2013, the Company established a subsidiary in the US for the purpose of gathering information and supplying IT services in the country. In 2016, it set up a subsidiary in Canada to provide outsourcing services (such as accounting services) to Japanese companies in North America. More recently, B-ROCK, Inc., which provides online marketing services, was made a subsidiary of ACROSS Solutions in April 2022 and was then absorbed by it in July 2022. The Company was listed on the Tokyo Stock Exchange Mothers Market in August 2018 and was elevated to the Tokyo Stock Exchange First Section one year later in August 2019. The Company has since been transferred to the Prime Market in conjunction with the TSE's reorganization of its market segments in April 2022.

History

Date	Major event
January 1980	Founded in Kanazawa, Ishikawa Prefecture, providing data entry and system development services.
November 2000	Financed and founded eNet Solutions Co., Ltd.
January 2004	Entered into an Oracle EBS Technical Partner contract with Oracle Corporation Japan <4716>
February 2005	Commenced sales of "Tate Yakusha," a construction work information management system
March 2009	Financed and founded STS Medic Inc.
May 2010	Acquired shares of T4C Co., Ltd. and made it a subsidiary
June 2011	Entered into an SAP Service Partner contract with SAP Japan Co., Ltd.
March 2012	Acquired shares of ACROSS Solutions, Inc. and made it a subsidiary
April 2012	Began providing services for Cloud Koubou powered by Amazon Web Services, a cloud support service
July 2013	Financed and founded STS Innovation, Inc. in the United States
August 2013	Began providing services for PinMap, a customer data mapping service
October 2013	Entered into an APN Consulting Partner contract with Amazon Japan K.K.
March 2015	Acquired additional shares of T4C Co., Ltd. and ACROSS Solutions, Inc. and made them wholly owned subsidiaries STS Innovation financed and founded FrontLine International, Inc. in the United States (absorbed through a merger in April 2017)
September 2015	Entered into a PartnerNow Master Terms with ServiceNow Nederland B.V.
January 2016	Financed and founded STS Innovation Canada, Inc. in Canada
February 2016	Commenced sales of the cloud-based shift management system "SHIFTEE"
August 2018	Listed on the Tokyo Stock Exchange Mothers Market
August 2018	Commenced sales of the attendance/work management system "Shugyo Yakusha"
August 2019	Listed market changed to the Tokyo Stock Exchange First Section
April 2020	Entered into a Google Cloud & Google for Education Commercial Partner Program Agreement with Google Cloud Japan G.K.
January 2021	Entered into a Subcontractor Agreement with Automation Anywhere, Inc.
June 2021	Commenced provision of ADDPLAT, a next-generation data analysis platform
March 2022	Entered into a Celonis Partner Program Agreement with CELONIS K.K.
April 2022	Listed market changed to the Tokyo Stock Exchange Prime Market ACROSS Solutions, Inc. acquired all shares in B-ROCK, Inc. and made it a subsidiary (absorbed in July 2022)

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

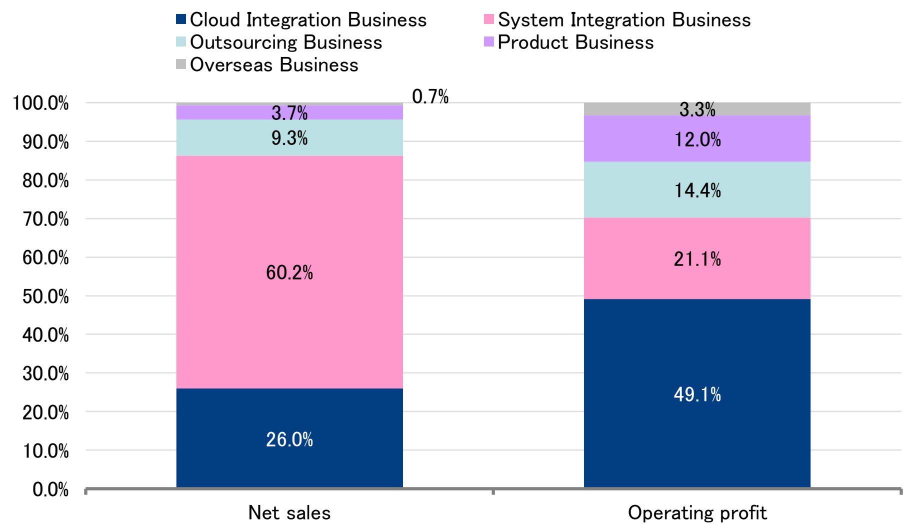
Five businesses centering on the Cloud Integration Business

2. Business description

The System Support Group comprises the Company and its six consolidated subsidiaries. The Group reorganized its business segments to more clearly present the progress of cloud integration, an area it will focus on over the medium term. The previous segments were the Solutions Business, Outsourcing Business, Product Business, and Others. In the new classification scheme, the Solutions Business was split into the Cloud Integration Business (implementation and support for the use of cloud services, including ServiceNow, Microsoft Azure, AWS and Google Cloud, and resale of their licenses, etc.) and the System Integration Business (implementation and support for the use of ERP packages, infrastructure construction for Oracle Database, etc. and IT system development). Non-nearshore operation and maintenance services, which had been included in the Outsourcing Business, were transferred to the System Integration Business. Accounting process outsourcing services provided by a Canadian subsidiary were moved to the Overseas Business, a new segment, and sales from overseas subsidiaries (recruitment services and marketing support services, etc. for local Japan-affiliated companies), which had been in the Others segment, are now recorded as part of the Overseas Business. The Product Business remains unchanged.

Looking at the share of each business segment in 1H FY6/23, the System Integration Business accounted for over half of net sales, 60.2%, followed by the Cloud Integration Business, which accounted for 26.0%, the Outsourcing Business, for 9.3%, and the Product Business, for 3.7%. With regard to operating profit, on the other hand, the share of the Cloud Integration Business was highest, at 49.1%, followed by the System Integration Business at 21.1%, the Outsourcing Business at 14.4%, and the Product Business at 12.0%. The Overseas Business was minimal. The reason the System Integration Business accounts for a lower share of profit is that the shared portion of SG&A expenses are allocated to each business segment are allocated to each segment in proportion to cost of sales, so because the System Integration Business has a large amount of sales, the proportion of shared expenses allocated to the segment is also high. Looking at gross profit levels, the Cloud Integration Business is 28.0% and the System Integration Business is 24.0%, so the gap between the two is not large.

Composition by business segment (1H FY6/23)



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

(1) Cloud Integration Business

In the Cloud Integration Business, the Company implements and supports the use of various types of cloud infrastructure-related services including ServiceNow, AWS, Microsoft Azure, Google Cloud and Oracle Cloud Infrastructure, and also resells the licenses for them. Looking at the sales composition in 1H FY6/23, ServiceNow-related services were highest at 38.5%, followed by AWS at 34.5%, Microsoft Azure at 12.1% and Google Cloud at 10.9%. License resales accounted for 33.6% of sales in this segment.

Orders for cloud-related services are often via referrals from cloud providers, so an important element in increasing orders is training large numbers of engineers certified on each of the cloud infrastructure-related services and gaining a track record of development projects with high customer satisfaction. For this reason, the Company is focused on hiring and training certified engineers, and as a result of its efforts, it has received many awards related to Microsoft Azure, AWS, Google Cloud and Oracle. Profitability is relatively stable, and with regard to ServiceNow services in particular, the Company has amassed a substantial development track record, being the first company in Japan to get involved in the platform. In part because of this, its ServiceNow business has the highest profitability of all its cloud services.

Regarding resales, which are cloud service usage fees, invoices denominated in dollars are sent to the Company from cloud service provider like AWS, and the Company converts them to yen and bills customers denominated in yen. For this reason, if the yen depreciates on currency markets, the amount of services companies use could be reduced because of the increased burden on customer payments, which increase the Company's sales, but the gross profit margin is fixed, so it does not change. There are also cases in which the rapid depreciation of the yen can create a foreign exchange loss related to dollar-denominated debt.

Track record of main certifications and awards

<table>
<tr><th>Microsoft Azure</th><th>AWS</th></tr>
<tr><td rowspan="5">• Obtained Gold Cloud Platform Competency Certification (March 2018)
Certified as a partner with an outstanding track record in expanding Microsoft Azure
• Obtained Advanced Specialization (November 2020)*1
Obtained certification as a partner with sophisticated expertise in specific solution fields
• Received five consecutive MVP awards
Received consecutive awards in the data platform field since 2017*2</td><td>• Obtained Oracle Competency in the AWS Competency Program*3 (November 2014)
• Received the APN Partner Award "Rising Star of the Year" (FY2014)</td></tr>
<tr><th>Google Cloud</th></tr>
<tr><td>• Acquired Data Analytics Specialization in the Partner Advantage Program (September 2022)</td></tr>
<tr><th>Oracle</th></tr>
<tr><td>• Received Oracle Database-related awards for 14 consecutive years*4
Received Oracle Certification Award 2020 and other awards from Oracle Corporation Japan</td></tr>
</table>

*1 Obtained in the field of migrating Windows Servers and SQL Servers to Microsoft Azure.
*2 Award received by the Company's employees.
*3 A program to identify, validate, and promote Advanced and Premier tier partners in the AWS Partner Network (APN) that have demonstrated technical expertise and proven customer success pertaining to AWS.
*4 Awards received from 2007 to 2020.

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

(2) System Integration Business

The System Integration Business includes consulting, design, development, and operation and maintenance for corporate IT systems and also technical support for the deployment and use of ERP packages, and infrastructure construction for Oracle Database and other systems (Oracle Cloud Infrastructure services are included in the Cloud Integration Business). Regarding the sales composition in 1H FY6/23, IT system development accounted for 53.1%, followed by ERP-related services at 28.2% and database-related services at 18.7%.

For major projects such as systems for financial institutions and ERP construction, the Company does not receive orders directly; rather, they are undertaken on a subcontracted basis in order to prevent the risk of unprofitability caused by delivery delays and other such trouble. Profitability is lower, but major projects contribute to sales over the long term, so they play a role in maintaining the utilization rates of engineers at fixed levels.

(3) Outsourcing Business

In the Outsourcing Business, management services at data centers in three locations in Japan (Tokyo and Kanazawa) managed by subsidiary eNet Solutions Co., Ltd. account for 82.5% of net sales. The remaining 17.5% is taken up by data analysis and entry and system operation and maintenance on a nearshore basis.

The Company's data centers are primarily used as infrastructure for companies' private clouds or for business continuity planning (BCP) and data backup management. The Company also provides added-value services as a strategy for acquiring data center customers. Specifically, in 2006, it began providing Safetylink24, an emergency notification and safety confirmation service that automatically distributes safety confirmation messages for employees linked to earthquake information. Additionally, in 2010, the Company began offering ActionPassport, an electronic work flow system, and in 2017, the Company began providing Magic Insight, a service that allows customers to easily use IBM Japan, Ltd.'s IBM Watson Explorer (an AI-driven search and analysis platform) with a monthly charge plan. The data center service is characterized by a recurring-revenue structure in which monthly sales increase as contracted data increases, but when capacity is augmented, depreciation expense increases, and this can temporarily affect profits. As of December 2022, the number of customers using the Company's data centers amounted to approximately 1,000 companies.

(4) Product Business

In the Product Business, the Group is engaged in the development and sales of products (software) and the provision of services. It also customizes products according to customer needs. It currently has four main products. Tate Yakusha, a construction work information management system for the construction industry, and MOS, a mobile order receipt and placement system primarily for the wholesale and retail industries, respectively account for over 30% of sales, while SHIFTEE, a cloud-based shift management system, and Shugyo Yakusha, an attendance and work management system, respectively account for over 10% of sales. While the Company does receive orders for custom development projects from time to time, the majority of sales in the Product Business are generated through monthly fees from cloud (SaaS) services. Therefore, this business has a recurring-revenue business model where revenue increases in line with growth in the number of subscribers. Most sales are direct sales (Tate Yakusha is often sold through the OEM channel), but sales agencies are also used.

Outline of major products

Name	Provider	Description	Number of subscribing companies*
Tate Yakusha	System Support Inc.	A construction work information management system. The monthly charge for the standard version starts at ¥40,000 per 5 licenses (initial cost: ¥350,000). The monthly charge for the premium version starts at ¥80,000 per 5 licenses (initial cost: ¥580,000).	696
MOS	ACROSS Solutions, Inc.	A mobile order receipt and placement system. For the full version, the initial cost starts at ¥350,000, options at ¥100,000, and the monthly charge at ¥20,000 (with actual figures depending on the number of accounts needed by the party placing the order).	677
SHIFTEE	System Support Inc.	A cloud-based shift management system. The monthly charge for the light version is ¥200 per user (separate charges apply for customization).	110
Shugyo Yakusha	System Support Inc.	An attendance/work management system. The monthly charge for the cloud version is ¥200 per user (separate charges apply for the on-premise version).	160

* As of December 31, 2022, on a result basis
Source: Prepared by FISCO from the Company's website and supplemental results briefing materials

(5) Overseas Business

The Overseas Business consists of system integration services and recruitment services provided by a US subsidiary to Japan-affiliated companies doing business in North America and payroll and accounting outsourcing services provided by a Canadian subsidiary.

(6) Group companies and the number of employees

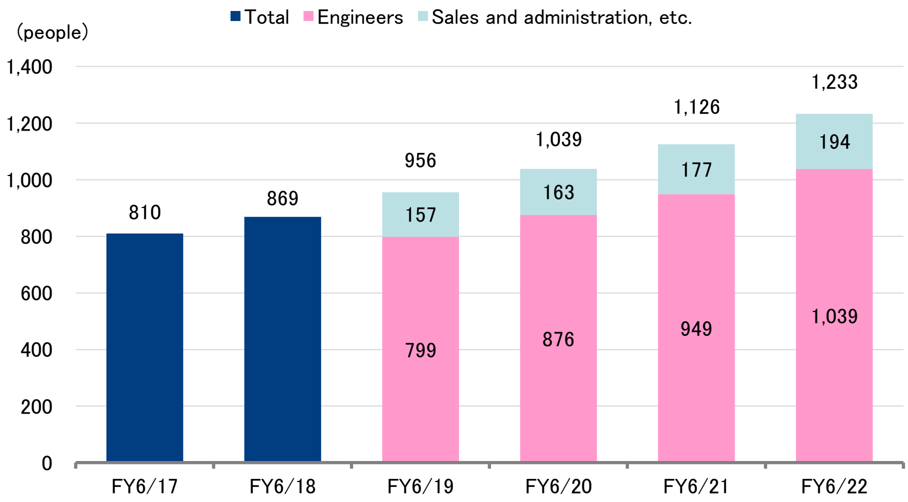
The Company's subsidiaries specialize in different functions and business sectors so that they can constantly provide new solutions to customers with proactivity and speed in each company's specialty area. The number of employees was 1,233 on a consolidated basis at the end of June 2022, an increase of 107 people from the end of the previous fiscal year. Engineers account for 84% of employees. By region, 52% of employees are in the Tokyo metropolitan area, 20% in the Hokuriku region, 14% in Kansai, 12% in Tokai, and 0.8% overseas. The Company carries out hiring with a good balance between regions.

Description of main businesses of Group companies

Name of company	Cloud Integration Business	System Integration Business	Outsourcing Business	Product Business	Overseas Business
System Support Inc.	Cloud infrastructure-related services and implementation, usage support and license resales	System development, operation and maintenance, and infrastructure construction and support for databases, etc.	Data entry services, nearshore operation and maintenance	Development and sales of Tate Yakusha, a construction work information management system, and other products	-
eNet Solutions Co., Ltd.	-	Deployment of various solutions	Data centers and related platform services	-	-
T4C Co., Ltd.	-	ERP product deployment and usage support services	-	-	-
STS Medic Inc.	-	Sale and installation of medical devices and other items	-	Sales and deployment support for T-File, a medical image filing system	-
ACROSS Solutions, Inc.	-	Web marketing services	-	Development and sale of MOS mobile order receipt and placement system	-
STS Innovation, Inc.	-	-	-	-	Solution services, recruitment services, etc.
STS Innovation Canada Inc.	-	-	-	-	Outsourcing service for management operations

Source: Prepared by FISCO from the Company's website

Trend in the number of consolidated employees



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

Results trends

Double-digit growth in sales and profits in 1H FY6/23, exceeding company forecasts

1. Outline of results for 1H FY6/23

In 1H FY6/23 consolidated results, net sales increased 18.2% YoY to ¥9,211mn, operating profit rose 26.4% to ¥743mn, ordinary profit was up 27.8% to ¥757mn and profit attributable to owners of parent was up 29.4% to ¥508mn. All these results surpassed the Company's initial forecasts, and the Company set a consecutive new record high for the first half.

Results for 1H FY6/23

(¥mn)

	1H FY6/22		1H FY6/23				
	Results	% of net sales	Company forecast	Results	% of net sales	YoY	Achievement rate
Net sales	7,790	-	8,765	9,211	-	18.2%	5.1%
Cost of sales	5,740	73.7%	-	6,711	72.9%	16.9%	-
Gross profit	2,049	26.3%	-	2,499	27.1%	22.0%	-
SG&A expenses	1,461	18.8%	-	1,756	19.1%	20.2%	-
Operating profit	587	7.5%	722	743	8.1%	26.4%	2.9%
Ordinary profit	592	7.6%	721	757	8.2%	27.8%	5.0%
Profit attributable to owners of parent	393	5.0%	487	508	5.5%	29.4%	4.4%

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

The domestic economic outlook is becoming increasingly uncertain due to rising prices triggered by the Ukraine crisis and the ongoing depreciation of the yen, but companies remain highly engaged in DX initiatives, and demand continued to be strong for migrating information systems to clouds. Under such market conditions, all five of the Company's business segments recorded higher net sales, led by the Cloud Integration Business, and overall, the Company continued to perform well.

On the profit front, the cost-of-sales ratio declined from 73.7% in the same period of the previous fiscal year to 72.9% due to changes in the sales mix (increased sales share of the highly profitable Cloud Integration Business) and the effects of increased sales, and gross profit increased 22.0% YoY to ¥2,499mn. SG&A expenses increased 20.2% due to increases in personnel, recruiting, training, and other personnel-related costs and operating costs, but this increase was absorbed by the increase in gross profit, so the operating margin increased from 7.5% in the same period of the previous fiscal year to 8.1%, setting an all-time high for the first half.

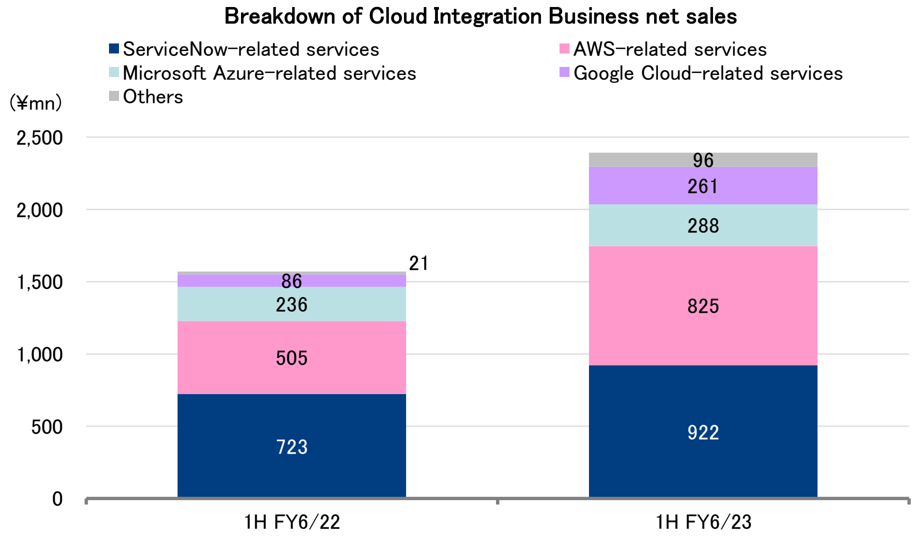
In the Cloud Integration Business, sharp growth in net sales of Google Cloud-related services

2. Trends by business segment

(1) Cloud Integration Business

Net sales from the Cloud Integration Business increased 52.2% YoY to ¥2,394mn and operating profit increased 58.1% to ¥374mn, so there were large increases in both sales and profits. Despite the major increase in sales, the gross profit margin only increased 0.2 percentage points YoY to 28.0%. This is partially attributable to the share of sales of ServiceNow, which is highly profitable, declining from 46.0% in the same period of the previous fiscal year to 38.5%.

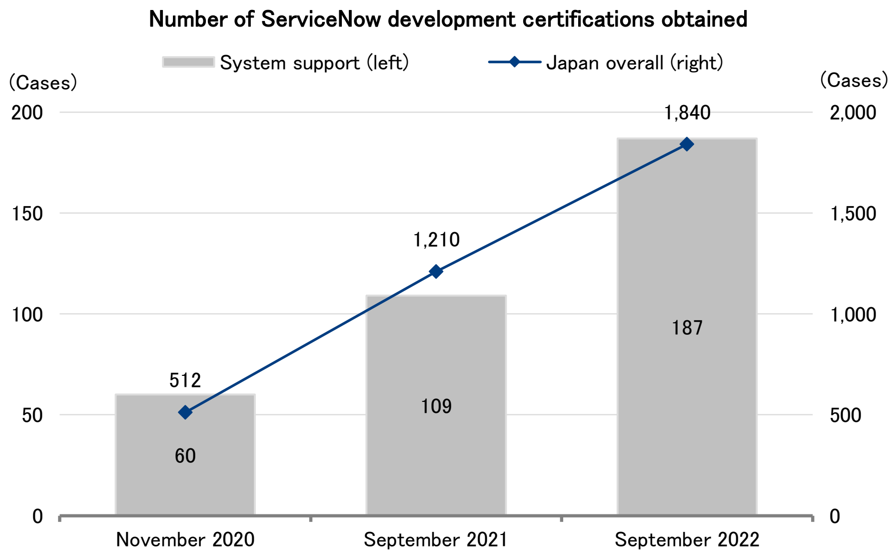
Looking at a breakdown of sales, ServiceNow-related services continued to be strong, increasing by 27.5% YoY to ¥922mn, while AWS-related services increased 63.4% to ¥825mn, Microsoft Azure-related services increased 22.2% to ¥288mn, Google Cloud-related services rose 201.5% to ¥261mn, and other services went up 340.9% to ¥96mn. There was sales growth in all cloud infrastructure-related services.



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

Regarding ServiceNow-related services, training engineers and expanding outside partnerships in order to meet robust demand is fueling high growth. According to documents released by ServiceNow Japan, the number of ServiceNow development certifications obtained has risen approximately three times over two years, from 60 in November 2020 to 109 in September 2021 to 187 most recently at the end of September 2022, as the Company has maintained its No. 2 spot in the industry*. In response to growth in the market, ServiceNow partner companies increased from 30 to 58 over the past three years, and the total number of certifications has increased approximately three times to 1,840, but the Company has maintained a just over 10% share of these certifications, and it can be inferred that it continues to remain in the top class as an Elite Partner, the highest rank. The customers for these services are major companies, and orders are increasing not only in Tokyo and Osaka but at other offices as well, including Nagoya and the Ishikawa area. It appears that even now demand continues to exceed capacity.

* Covers Certified Implementation Specialist / Certified Application Developer / Certified Application Specialist. Accenture Japan Ltd. was ranked first place with 199 projects.



Source: Prepared by FISCO from documents released by ServiceNow Japan

Among cloud infrastructure-related migration and usage support services other than ServiceNow, the rapid growth of Google Cloud-related services was prominent. The Company has focused these past one to two years on training engineers in data analytics, where Google Cloud excels, and this has been one reason it has acquired large numbers of orders in this area (The Company has over 80 engineers involved in Google Cloud as of October 2022 and over 155 hold certifications). In September 2022, in recognition of these achievements, the Company acquired Partner Specialization, the highest rank of technical certification in data analytics within the Google Cloud Partner Advantage program*. In addition, in October 2022, the Company developed and began providing three new solution packages using Google Cloud services (Windows File Server Migration, Data Analysis Platform, and Autoscaling Application Platform). Each package optimally combines Google Cloud functions based on its objectives, so the companies that implement them are able to use them at low cost, with low risk, and in a short period of time (around three to five weeks from the service application). In particular, companies utilizing big data analysis services are expected to continue to increase, so this area will be watched as one where high growth is expected.

* There are two Japanese companies other than the Company that have acquired Google Cloud Specialization in data analytics, Deloitte Tohmatsu Consulting LLC and SCSK <9719> (as of February 2023).

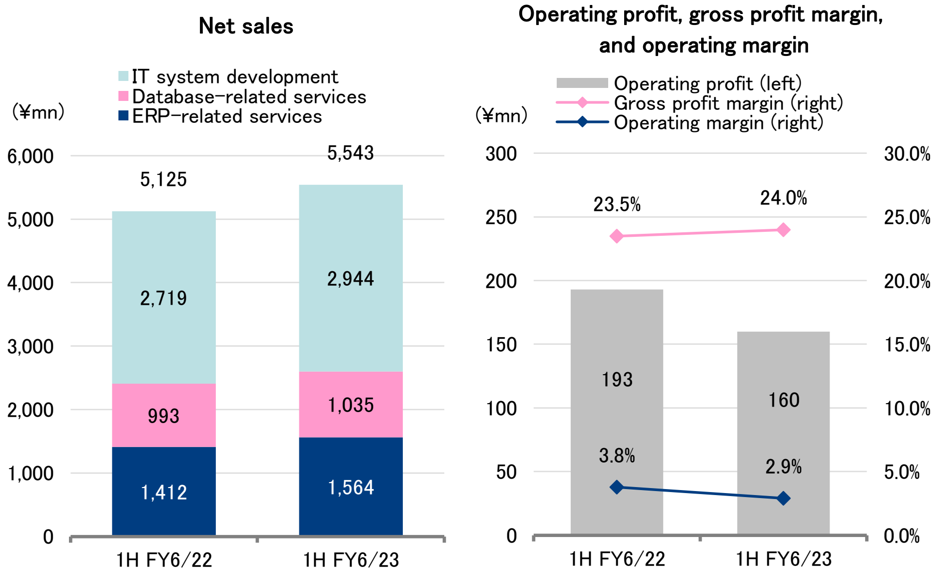
In other cloud-related services, along with Oracle Cloud Infrastructure, the Company has handled Celonis EMS since 2022, and it is beginning to gradually generate sales results. For Celonis EMS, the Company is currently at the stage of training engineers, and like Google Cloud, it is expected to contribute to sales growth on a full-fledged basis in one to two years going forward.

License resales is a recurring-revenue business in which cloud service usage fees are collected from customer accounts, so net sales increase as more customers deploy the services, but in 1H FY6/23, the yen depreciated further on foreign exchange markets compared to the same period of the previous fiscal year, and this also provided a boost to sales. The profit margin is low, but sales can be expected on an ongoing basis, so it is a stable revenue source.

(2) System Integration Business

Net sales from the System Integration Business increased 8.2% YoY to ¥5,543mn and operating profit decreased 16.8% to ¥160mn. The decrease in profit despite the increase in sales was mainly due to an increase in SG&A expenses. As was discussed previously, the shared portion of SG&A expenses are allocated to each business segment in proportion to cost of sales, so when SG&A expenses increase, the burden falls heavily on the System Integration Business because it has a large amount of sales. Looking on a gross profit basis, it increased, rising by 10.5% to ¥1,330mn, so the actual earnings situation can be seen as positive.

System Integration Business net sales breakdown and profit margin



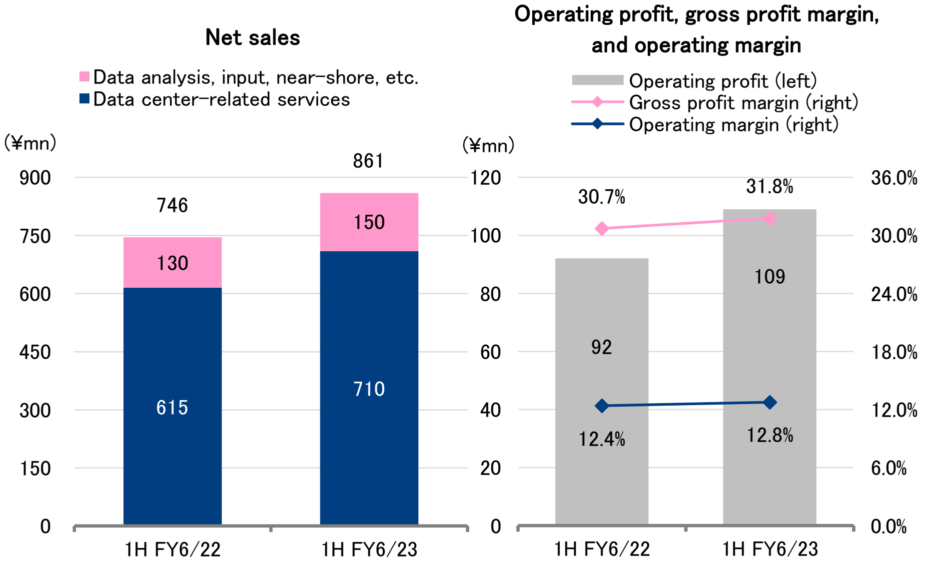
Source: Prepared by FISCO from the Company's supplemental results materials

Looking at a breakdown of net sales, IT system development increased 8.3% YoY to ¥2,944mn, ERP-related services increased 10.7% to ¥1,564mn, and database-related services increased 4.2% to ¥1,035mn, so results were solid in each area. In ERP-related services in particular, companies continue to migrate to SAP S/4 HANA in anticipation of the end of maintenance support for SAP's existing product (in 2027), and business continues to be brisk. Also, database-related services performed well centering on mainstay Oracle products.

(3) Outsourcing Business

Net sales from the Outsourcing Business increased 15.4% YoY to ¥861mn, and operating profit rose 18.9% to ¥109mn, as both sales and profits continue double-digit growth. Looking at a breakdown of net sales, data center services, which include AI-related services, increased 15.4% to ¥710mn, and data analysis and input and near-shore operation and maintenance services rose 15.5% to ¥150mn, so results were strong in both areas. A key factor is that companies are reinforcing BCP measures for their information systems and they are continuing to make increasing use of the Company's data center in Kanazawa, where earthquakes are rare. The gross profit margin increased from 30.7% in the same period of the previous fiscal year to 31.8% as a result of the increase in sales. Investment to augment capacity at data centers made in the first half of the previous fiscal year ran its course, and this also is thought to have contributed to the increase in the profit margin. Recurring monthly revenue from data centers has steadily risen and has recently topped the ¥100mn level.

Outsourcing Business net sales breakdown and profit margin

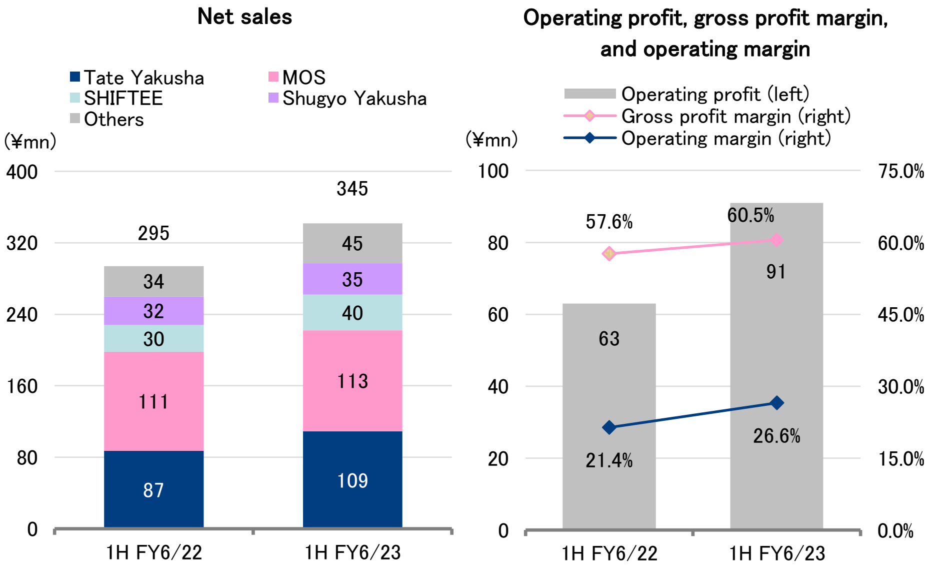


Source: Prepared by FISCO from the Company's supplemental results materials

(4) Product Business

Net sales from the Product Business increased 16.8% YoY to ¥345mn and operating profit increased 44.9% to ¥91mn, setting consecutive record highs for a half fiscal year. Looking at a breakdown of net sales, Tate Yakusha increased 25.1% to ¥109mn, SHIFTEE rose 35.3% to ¥40mn, so both products performed well. Also, MOS increased 1.8% to ¥113mn and Shugyo Yakusha increased 9.4% to ¥35mn, as sales grew steadily. On the profit front, the operating margin rose significantly, from 21.4% in the same period of the previous fiscal year to 26.6%, thanks in part to an improved profit margin in recurring sales, including monthly usage fees, and reductions in SG&A expenses.

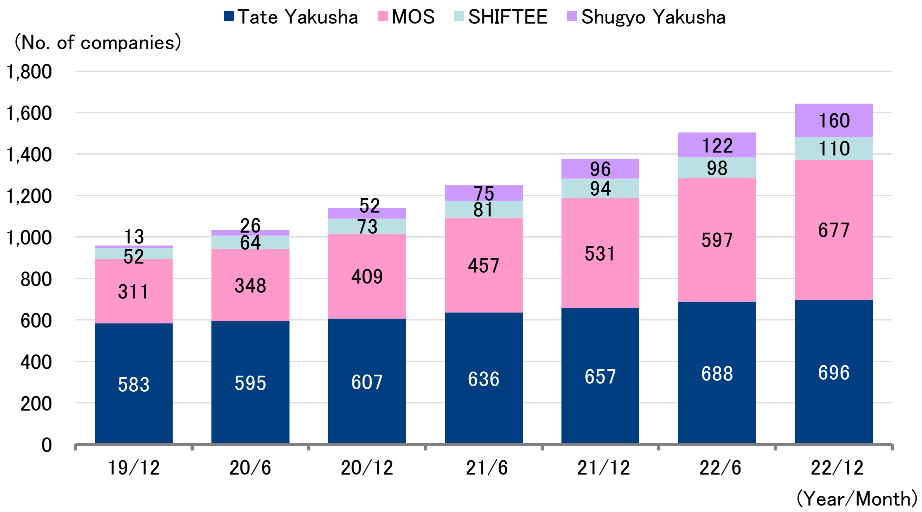
Product Business net sales breakdown and profit margin



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

Regarding Tate Yakusha, the impact of the COVID-19 pandemic has nearly run its course, and it has become possible to hold face-to-face sales talks, so the lead time from negotiations to contracting improved, and the Company was able to acquire prospective customers by starting to participate again in trade shows. These factors were behind the strong sales. Also, with respect to SHIFTEE, more companies are working to increase the efficiency of shift management, especially in the service industry, which is leading to increased inquiries about SHIFTEE, which enables shift creation and management to be conducted simply and at a low cost. The percent increase in sales of MOS and Shugyo Yakusha appears low compared to the increase in the number of companies implementing them, but this is attributable to many customers having a small number of users (equivalent to sales) per company.

Number of companies deploying each product



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

(5) Overseas Business

Net sales from the Overseas Business increased 35.8% YoY to ¥67mn and operating profit increased 22.6% to ¥25mn. The continued depreciation of the yen provided a boost to results and payroll and accounting outsourcing services performed well, which led to the increased sales and profits. The operating margin fell from 42.0% in the same period of the previous fiscal year to 37.9%, but this was affected by the situation with system integration projects.

The equity ratio continues to increase; financial condition is sound

3. Financial condition and business indicators

Looking at the Company's financial condition as of the end of 1H FY6/23, total assets were ¥8,164mn, an increase of ¥348mn from the end of FY6/22. In terms of the main factors behind this change, in current assets, cash and deposits decreased by ¥89mn and notes and accounts receivable – trade and contract assets increased by ¥431mn. In non-current assets, goodwill decreased by ¥14mn, and property, plant and equipment increased by ¥54mn.

Total liabilities decreased ¥25mn YoY to ¥4,368mn. Interest-bearing debt increased by ¥482mn, income taxes payable decreased by ¥47mn. Total net assets were ¥3,796mn, an increase of ¥374mn from the end of the previous fiscal year. This was primarily caused by an increase of ¥373mn in retained earnings as a result of recording profit attributable to owners of parent and the payment of dividends.

Looking at business indicators, the equity ratio increased from 43.8% at the end of FY6/22 to 46.5%, a new record high, owing to an increase in shareholders' equity. The interest-bearing debt ratio increased from 33.6% to 43.0%, but in a normal year the ratio tends to increase at the end of the first half due to an increase in working capital and tends to decrease toward the end of the fiscal year, so there is no particular problem with the current level. Net cash (cash and deposits less interest-bearing debt) continues to be positive, and the Company's financial condition can be judged to be sound.

Consolidated balance sheet

(¥mn)

	End of FY6/20	End of FY6/21	End of FY6/22	End of 1H FY6/23	vs. prior fiscal year-end
Current assets	4,631	5,319	6,303	6,625	321
(Cash and deposits)	2,387	2,697	3,254	3,164	-89
Non-current assets	1,316	1,342	1,511	1,538	27
Total assets	5,947	6,662	7,815	8,164	348
Total liabilities	3,540	3,669	4,393	4,368	-25
(Interest-bearing debt)	1,015	952	1,149	1,631	482
Total net assets	2,407	2,993	3,421	3,796	374
(Security)					
Equity ratio	40.5%	44.9%	43.8%	46.5%	2.7pt
Interest-bearing debt ratio	42.2%	31.8%	33.6%	43.0%	9.4pt

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

Outlook

Recent orders remain buoyant; sales and profits expected to continue double-digit growth

1. Outlook for FY6/23

For its consolidated results in FY6/23, the Company's initial forecasts are kept unchanged for net sales to increase 11.7% YoY to ¥18,093mn, operating profit to increase 21.7% to ¥1,456mn, ordinary profit to rise 22.0% to ¥1,452mn, and profit attributable to owners of parent to go up 25.1% to ¥982mn. The rate of progress through the first half is 50.9% for net sales and 51.0% for operating profit, which is nearly equivalent to the average progress rate for the three most recent years (48.4% for net sales, 52.1% for operating profit). While there is some concern that corporate earnings will deteriorate due to rising prices and higher personnel costs, even recently the appetite for investment in DX is rampant, and orders, especially in the Cloud Integration Business, show no signs of slowing. FISCO therefore believes there is a strong likelihood that performance will be steady in the second half as well and that the Company will meet its forecasts. Data center operation costs are expected to increase due to higher electricity rates going into effect in spring 2023, but FISCO thinks that this increase will be within a range that can be absorbed by sales growth.

Outlook for FY6/23 consolidated results

(¥mn)

	FY6/22		FY6/23			Achievement rate through 2Q	Average achievement rate for the past three years*
	Results	% of net sales	Company forecast	% of net sales	YoY		
Net sales	16,198	-	18,093	-	11.7%	50.9%	48.4%
Operating profit	1,196	7.4%	1,456	8.0%	21.7%	51.0%	52.1%
Ordinary profit	1,190	7.3%	1,452	8.0%	22.0%	52.2%	51.9%
Profit attributable to owners of parent	785	4.9%	982	5.4%	25.1%	51.8%	51.1%
Net profit per share (¥)	75.91		94.88				

* 1H result divided by full-year result for the past three years
Source: Prepared by FISCO from the Company's financial results

Some recent topics are as follows. In December 2022, the Company announced that it had been chosen by Google Cloud as a launch partner for the new fully managed database service AlloyDB*. The Company's extensive track record in high-quality development related to databases was recognized, and going forward this should lead to increased orders related to support for deployment of the service. In addition, in January 2023, the Company announced it had begun providing an implementation support service for Azure combined with Oracle Cloud Infrastructure (OCI). The service uses the Oracle Database Service for Microsoft Azure, a multi-cloud service jointly released by Microsoft and Oracle in July 2022. The Company will support the construction of multi-cloud environments that utilize the characteristics of both systems to deliver high performance and high cost efficiency.

* AlloyDB is a fully managed, PostgreSQL-compatible database service that accommodates enterprise-grade database workload. It offers exceptional performance on Google Cloud, high scalability and high availability. The preview version of the service was announced in May 2022, and it was officially released in December 2022.

Looking at personnel hiring, new graduate hires in spring 2023 numbered 85, a little less than the 91 people that were initially planned, but this represents a 15-person increase from the previous year, so hiring was steady. At the same time, for its mid-career hires, the Company is planning to hire 93 people in FY6/23, an increase of 10 from the previous year. Progress through the first half is a little behind plans, but the Company will continue to focus on hiring and training engineers, who are strongly felt to be in short supply. As a part of its measures for increasing engineers, the Company introduced a remote work program for employees outside of commuting distance in January 2023. A remote work program had already been instituted for employees within commuting distance and around 80% of employees utilized it, but expanding its scope to outside of commuting distance prevents employees from quitting because of having to move to an outlying region because of family circumstances, such as the need to providing nursing care. It also helps create a pleasant work environment, and this is expected to be a plus when it comes to hiring.

Smooth start to first year of medium-term plan; driven by the Cloud Integration Business, targeting profit growth of 22% or higher annually

2. Medium-term management plan

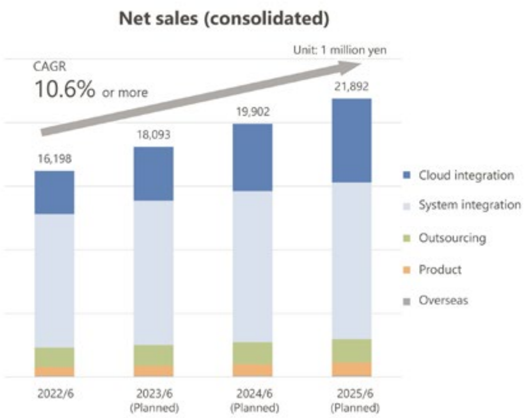
(1) Outline of medium-term plan

The Company started a three-year medium-term management plan from FY6/23. The main theme is stated as "Growth and creation of further innovation," and under the plan, the Company will expand services that form the foundation of DX promotion for customers and society, promote the growth and success of diverse human resources, and strengthen ESG management. For FY6/25, it has set targets of net sales of ¥21.89bn or higher, operating profit of ¥2.18bn or higher, and an operating margin of 10% or higher. This amounts to three-year annual growth in net sales of more than 10.6% and operating profit of more than 22.3%. As discussed previously, FY6/23, the first year of the plan, has gotten off to a smooth start.

Looking at average annual growth rates in net sales by business segment, the Cloud Integration Business is highest at 25.0%, and next is the Product Business at 15.0%. For the System Integration Business, Outsourcing Business and Overseas Business, the Company is projecting solid growth for each of between 5.5% and 7.0%. Over the next three years, the Company is expecting an increase in sales of over ¥5.7bn, but more than 50% of this will be generated by the Cloud Integration Business.

Net sales targets in the Company's medium-term management indicators (consolidated)

◆Aim for net sales of 21.89 billion yen or more in FY2025/6.



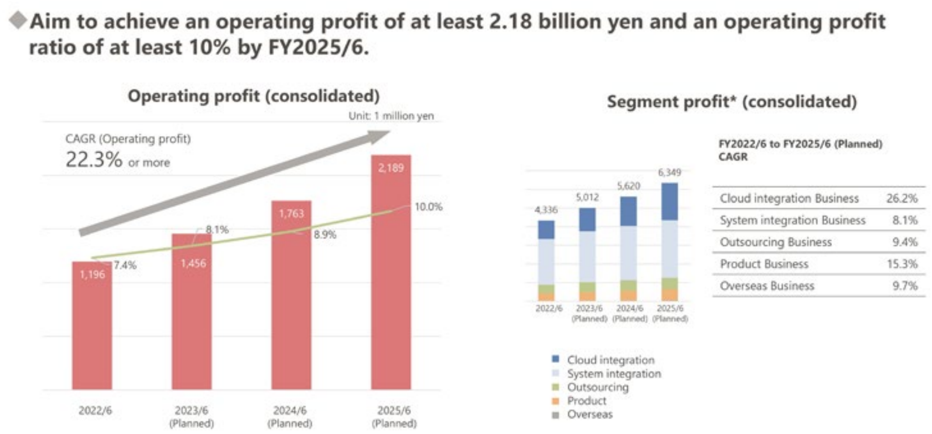
FY2022/6 to FY2025/6 (planned) CAGR

Cloud integration Business	25.0%
System integration Business	5.5%
Outsourcing Business	6.0%
Product Business	15.0%
Overseas Business	7.0%

Source: The Company's medium-term management plan materials

The trends are nearly the same for segment profit (operating profit). The Cloud Integration Business is highest at 26.2%, followed by the Product Business at 15.3% and the other three businesses at between 8.1% and 9.7%. The Company is also projecting profit margins to go up in nearly all its business segments. Only the Product Business is expected to have a generally flat profit margin, but this is because the Company is planning to continue investing in enhancements to the functions of existing products and development of new products, etc.

Profit targets in the Company's medium-term management indicators (consolidated)



Source: The Company's medium-term management plan materials

(2) Growth strategy by business segment

a) Cloud Integration Business

The key to the Company achieving the targets of its medium-term management plan is the growth of its Cloud Integration Business. Against the backdrop of the ongoing migration of IT systems to clouds, the cloud services market is projected to continue double-digit growth over the medium term, so the Company is planning sales growth of 25%, which exceeds the market average. To meet the goals of its plan, the Company intends to focus on the following three initiatives. It will 1) work to strengthen relationships with cloud vendors through engineer training and thereby increase customer referrals, 2) work to optimize cloud migration and post-migration ("lift & shift") and increase orders, centering on the three major cloud platforms (AWS, Microsoft Azure, Google Cloud) and ServiceNow, and 3) gather information on promising cloud services overseas, commercialize them in the Japanese market as soon as possible through engineer training and knowledge accumulation, and use them to acquire new customers.

Regarding initiatives for promising new services, the Company is currently making several arrangements. The first is Celonis EMS, an execution management platform provided by Celonis, a firm with which the Company entered into a sales partnership agreement in June 2022. It is already beginning to be deployed for customers. This tool collects and analyzes business process information and identifies portions that are inefficient in order to optimize business operations. Since its release in October 2020, it has been increasingly adopted by global corporations, and it is drawing attention in Japan as well, with the expectation that it will be widely used going forward.

Celonis has around 40 sales partners in Japan, but given the Company's extensive experience in deployment of ServiceNow, it is possible that it will quickly build up a track record of implementing Celonis EMS as well. This is because Celonis and ServiceNow entered into a strategic partnership in October 2021, have linked their products, and have agreed in principle on collaborating going forward in development, marketing and sales. In both cases, the products are tools for increasing productivity, and they are even more effective when used in combination, so companies that have implemented ServiceNow are strong prospects as customers for Celonis EMS. The Company continues to actively train and increase personnel with ServiceNow certification, and sales growth is expected going forward.

b) System Integration Business

In the System Integration Business, the Company will work to recruit and train engineers to expand its mainstay ERP-related, database-related and RPA-related services, and will increase sales by building close relationships with customer companies to expand existing customer projects and acquire recurring orders. In addition, the Company intends to maintain and strengthen project management from the perspectives of quality, duration, cost and risk control to increase service quality while preventing the occurrence of unprofitable orders, and in this way, it will work for steady growth.

c) Outsourcing Business

In the Outsourcing Business, the Company will target a different customer segment than major public cloud vendors for its data center services, acquiring customers by attracting them with unique services, including AI-related services, and building up data usage volume. Since 2022, with the rapid depreciation of the yen, the increased burden of service usage charges for public clouds has entered the awareness of companies and some have begun to move toward building private clouds. The Company intends to accommodate this demand. It also plans to increase quality and secure profitability by gradually adding capacity at data centers in line with their operating status. Moreover, with regard to maintenance for SAP's ERP products, demand is expected to rise ahead of 2027, so the Company will train nearshore staff in the Kanazawa region and further strengthen its systems.

d) Product Business

In the Product Business, the Company will expand sales channels through distributors and others and strengthen advertising to acquire new customers and will work to increase the number of users by expanding user divisions within existing customers. The Company also intends to continue strengthening the functions of existing products. It plans to increase the number of companies deploying the Company's four main existing products from 1,505 at the end of FY6/22 to 2,500 in FY6/25. There were 1,643 companies as of the end of December 2022, and they have been increasing at a generally steady pace.

Regarding MOS, a mainstay product, the Company's strategy is to utilize the online marketing business it has acquired through M&A to further promote sales through online marketing and also work for competitive differentiation by providing MOS and online marketing services to customers on a one-stop basis and thereby acquire new customers. Since the absorption-type merger in July 2022, progress had been made in building an organizational structure, and while the effects have yet to materialize, further development is expected going forward.

e) Overseas Business

In the Overseas Business, the Company, through its US subsidiary, will provide support services for IT infrastructure, HR recruitment, marketing and other areas for Japan-affiliated companies expanding into North America, and through its Canadian subsidiary, will provide remote monitoring services for Japanese companies that take advantage of the time difference with Japan and also strengthen outsourcing services for accounting processes.

(3) Investment in human resources

The Company positions human resources as a source of business growth and aims to create new corporate value by actively recruiting and promoting diverse human resources, providing training, and creating a pleasant work environment. With regard to recruitment, the Company will recruit functionally through hiring managers assigned to its various offices instead of solely hiring through the head office. It also plans to be active in conducting recruiting activities to prevent mismatches between job and applicant. New graduate hires are increasing each year, and the Company plans to hire 85 such individuals in FY6/23, which, combined with the 93 mid-career professionals it plans to hire, will bring the total number of hires to 178 for the year, which would be a record high. Many companies in the IT industry struggle to recruit personnel, but in the Company's case, its name recognition was raised when it became a publicly listed company, and it is involved in cloud infrastructure-related services, which continue to grow, so it is able to recruit and hire relatively smoothly. Also, with regard to its attrition rate, the rate has declined from 8.1% in FY6/19 to 4.9% in FY6/22, which is less than half the industry average. Employee engagement is also thought to be increasing. The Company is planning to increase the number of consolidated employees from 1,233 at the end of FY6/22 to 1,582 by the end of FY6/25.

Number of personnel hired (consolidated)

	FY6/19	FY6/20	FY6/21	FY6/22	FY6/23 plan
New graduates recruitment	55	58	60	70	85
Mid-career recruitment	93	97	89	83	93
Retirement rate	8.1%	7.7%	5.9%	4.9%	-

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

Regarding engineer training, the Company will continue to make investments to maintain or increase its competitiveness, including by acquiring vender certifications related to cloud services in particular. In addition, it will work to increase pay levels and will set targets for the proportion of female employees, reductions in total working hours and the proportion of employees taking childcare leave and will work to achieve them. Specifically, in FY6/24, on a non-consolidated basis, the Company is aiming for a proportion of female employees of 28% or higher (it was 28.3% in FY6/22), average total hours worked per employee of 2,000 hours or less per year (1,995 hours in FY6/22), and a proportion of male employees taking childcare leave of 40% or more (36.4% in FY6/22).

(4) Strengthening ESG management

Through ESG management based on its corporate philosophy (Contributing to Society, Advanced Customer Service, Sharing Value), the Company is engaged in solutions to social issues and will strengthen the following initiatives going forward.

In the area of the environment, to realize a decarbonized society, the Company is contributing to environmental preservation and increasing the efficiency of resource use through the provision of IT services and reducing the environmental impact of its business activities. Going forward, the Company aims to set CO_2 emissions targets and implement further reduction and absorption measures, establish a disclosure system in line with the Task Force on Climate-Related Financial Disclosures (TCFD), and respond to the Carbon Disclosure Project (CDP) survey and work to improve its score.

For society, the Company will seek to expand local business and stimulate the economy through training DX personnel. In terms of specific measures, it started Microsoft Base Kanazawa activities in August 2022 based on the concept of local IT urbanization in Hokuriku starting in Kanazawa. The Company is providing free DX education for industry-academia-government-private sector DX and also providing opportunities for communication pivoting on cloud systems that make possible the experience of the latest technology. These activities support the expansion of local businesses, the stimulation of economic activity and the creation of new business opportunities. Participants total 270 people from 48 organizations when including those scheduled to participate in the future.

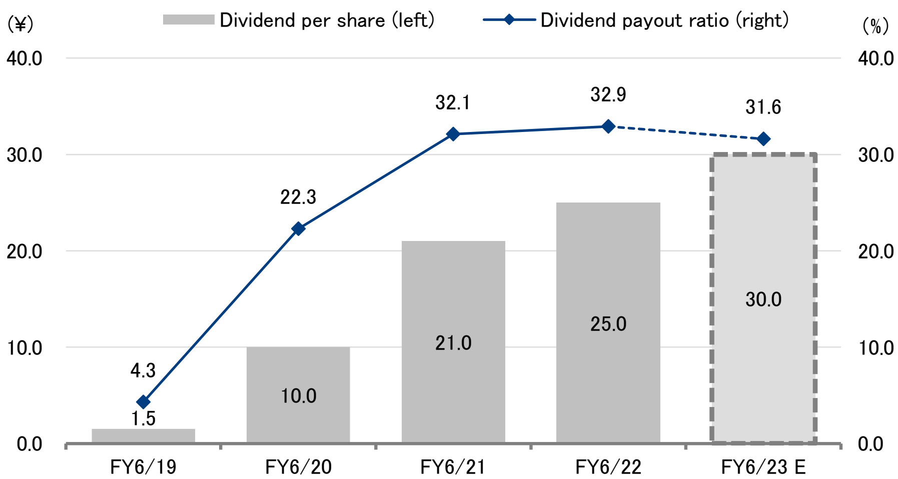
The Company established a new sustainability page on its website in February 2023 that introduces its policies on sustainability, EGS-related initiatives, and other such topics.

Shareholder return policy

Dividends to be paid with a target payout ratio of 30-35%

The Company regards the return of profits to shareholders as one of the important management issues. The Company has indicated that its basic policy on distributing profits is to strive to improve dividends according to business performance and profit levels, while providing stable dividends based on consideration of earnings conditions. Concurrently, the Company will ensure adequate internal reserves needed for future business expansion and strengthening the management structure. With respect to the dividend per share for FY6/23, the Company plans to increase the amount by ¥5.0 YoY to ¥30.0, which would mark the fourth consecutive year of dividend increases since its listing on the stock market. It targets a dividend payout ratio in the 30%-35% range, and intends to continue dividend increases alongside earnings growth.

Trends in dividend per share and dividend payout ratio



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

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