COMPANY RESEARCH AND ANALYSIS REPORT

System Integrator

3826

Tokyo Stock Exchange Standard Market

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Index

Summary

Focused in FY2/24 on training engineers and developing a new revenue pillar to further strengthen the management foundation

System Integrator <3826> (hereafter, also "the Company") is an independent software developer that develops and sells software for improvement of corporate productivity with a slogan of "We consistently create software that creates time rather than consumes time." The Company operates the Object Browser Business, including the database development support tool SI Object Browser and integrated project management tool SI Object Browser PM (below, OBPM Neo), the E-Commerce Business, the ERP Business, and the AI Business respectively. Also, the Company actively promotes working style reforms, child-raising support and more, earning it high recognition outside of the Company.

1. FY2/23 results

Regarding business performance in FY2/23, net sales decreased by 6.9% year on year (YoY) to ¥4,486mn and ordinary profit declined by 29.3% to ¥416mn, so both sales and profits decreased. Net sales was negatively impacted by special demand for large projects being recorded in the previous period in the E-Commerce Business and the Company having difficulty obtaining new orders this term in the E-Commerce and ERP Businesses. Profits were negatively affected as a large-scale development project was canceled due to circumstances on the customer side, an increase in SG&A expenses from an increase in personnel and spending on education and training for engineers, and a lower utilization rate. To strengthen its development structure, the Company opened the Fukuoka Office in May 2022, started fully remote work for isolated locations, and established a new subsidiary in Vietnam in October 2022. Personnel recruitment is apparently proceeding according to schedule at both the Fukuoka Office and Vietnamese subsidiary, so the Company's order-receiving capacity is expected to increase going forward in the ERP Business and other businesses.

2. FY2/24 forecasts

In FY2/24, the Company forecasts net sales to increase by 11.5% YoY to ¥5,000mn and ordinary profit to decrease by 4.4% to ¥398mn. Net sales is expected to increase in all businesses, centering on the ERP Business, which has seen a major influx in inquiries related to projects to comply with the government's new invoicing system. At the same time, operating profit is expected to decline due to approximately ¥100mn being spent on research and development to create a new revenue pillar. By business, the ERP Business is expected to return to profitability and the AI Business is also projected to be in black ink, but profits in the Object Browser Business and E-Commerce Business are expected to decline. In the Object Browser Business, profit will be negatively impacted by an increase in personnel expenses and fully recording costs associated with withdrawing from the Object Browser Designer (OBDZ), an application design tool. In the E-Commerce Business, the profit margin is expected to come down due to increased sales of other companies' products. The Company intends to record a gain on sale of investment securities in extraordinary income, so net profit is expected to reverse the recent trend and increase by 20.0% to ¥336mn.

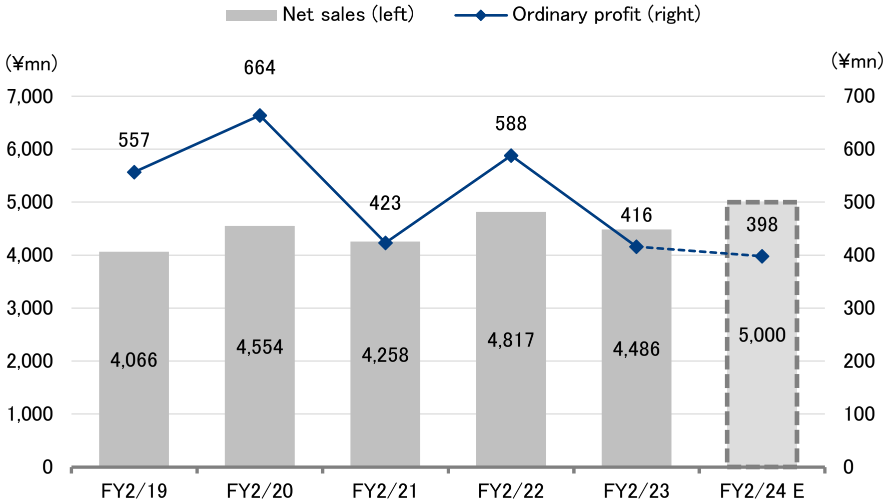
3. Medium-term business plan

The Company announced a new medium-term business plan in April 2023. It previously created medium-term plans with a span of three years, but because the lead time for large projects in the E-Commerce and ERP Businesses tends frequently to be around two years, from now on, the Company's medium-term plans will cover a period of two years, and the most recent plan is net sales of ¥5,500mn and ordinary profit of ¥536mn in FY2/25. The plan's basic strategies include expanding existing businesses by acquiring new customers, developing new businesses and making them profitable, and increasing productivity and order-receiving capacity by hiring and training engineers. From FY2/25, the Company plans to build a management foundation that allows double-digit annual growth to be sustained. The plan's long-term targets are net sales of ¥12,000mn and operating profit of ¥3,000mn in FY2/33 ten years from now. While increasing the size of its E-Commerce Business, ERP Business, AI Business and other businesses, the Company aims to achieve high growth by developing new businesses on the SaaS model (subscription model) targeting mid-sized and larger companies. Through improved productivity and sales growth from SaaS businesses, the Company is aiming to increase its operating profit margin significantly, from 9.1% in FY2/23 to 25%. In FISCO's view, the key to achieving these goals will be hiring and training engineers, which the Company has struggled to do over the past several years, and making new businesses profitable.

Key Points

- In FY2/23, revenue increased in the Object Browser and AI Businesses, but decreased in the mainstay E-Commerce and ERP Businesses
- For FY2/24, forecasting a decrease in operating profit from new development investment but a return to double-digit gains in net sales
- Announced a new two-year medium-term business plan and medium- to long-term performance targets; aiming for net sales of ¥12.0bn in ten years

Results trends



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

Business overview

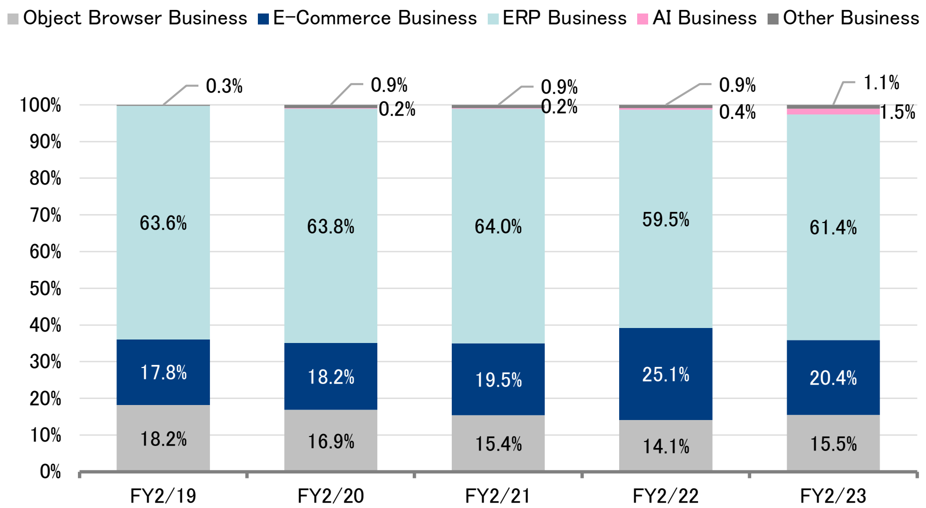
An independent software developer that "consistently creates software that creates time rather than consumes time"

Founded in 1995, System Integrator is an independent software developer. In addition to the sales of packaged software developed in-house, the Company also provides maintenance service and cloud services (SaaS). The Company is mainly looking to develop new products that can be offered as a SaaS model. Mainstay existing products include database development support tool SI Object Browser and integrated project management tool OBPM Neo, and package software such as SI Web Shopping for constructing EC websites and GRANDIT Web-ERP package. Business segments are Object Browser Business, E-Commerce Business, ERP Business, AI Business,* and Other Business for reporting the results of new businesses.

* The AI Business has been split off from the ERP/AI Business and disclosed as a separate segment since FY2/23.

Looking at results by business segment for the most recent five fiscal years, the ERP Business accounted for approximately 60% of total net sales, with the remainder equally divided between the Object Brower Business and E-Commerce Business. There has been no major change in these percentages. The Company has worked over the past several years to develop the AI Business and other new businesses, but they continue to account for less than 3% of the total, so it can be said that the Company has struggled to establish a new revenue pillar. Detailed explanations of each segment are as follows.

Sales results by business segment



Note: Percentages of the ERP Business and AI Business for FY2/20 and FY2/21 are calculated from results briefing materials
Source: Prepared by FISCO from the Company's financial results and results briefing materials

1. Object Browser Business

In the Object Browser Business, the Company is engaged with the development and sales of software products, comprising the four products of the database development support tool SI Object Browser, the database design support tool SI Object Browser ER (hereafter, the Object Browser series), the integrated project management tool OBPM Neo, and the application design tool OBDZ.*

* OBDZ, which the Company launched in 2019, struggled to meet sales expectations and the Company determined that profitability would be difficult to achieve, so it decided to discontinue the service. Support for existing customers will also end in FY2/24.

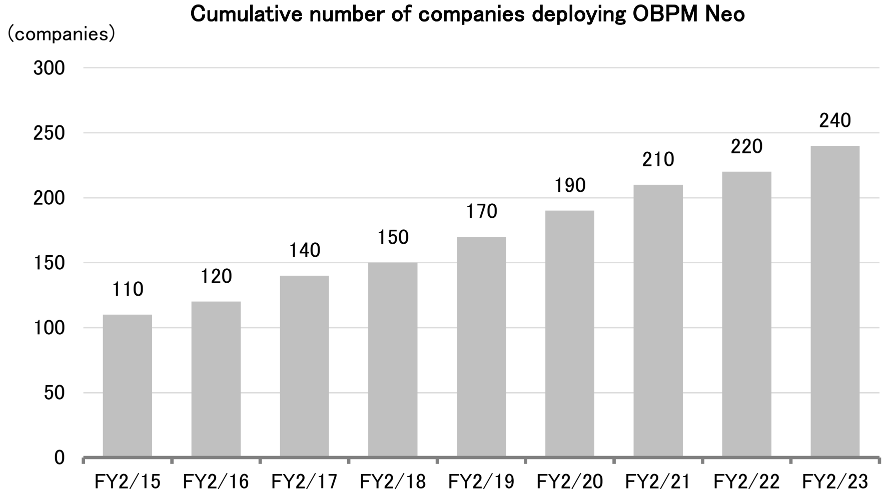
In the percentages of total net sales, the Object Browser series provides around 40% and OBPM Neo around 60%. Since the launch of the Object Browser series in 1997, it has a deployment track record of roughly 20,000 companies and 480,000 licenses, and it is the de-facto standard within Japan for its applicability to almost all main data bases. The prominent brand strength of the products makes them highly profitable with almost no sales costs and gross profit margins of over 80%. Competing freeware is available, but does not impact the products because of the difference in functionality. Previously, only package sales (license sales + maintenance services) were available, but from February 2021, SaaS-type sales* will also be launched. More than 30% of its net sales are accounted for through recurring income, such as from maintenance support, and its sales are also comparatively stable.

* The contract term ranges from one year to two years or three years (includes maintenance fees). Upgrades to the latest versions are free. For Oracle only.

At the same time, OBPM Neo is a tool that helps development divisions increase their productivity by enabling the comprehensive management of development project progress (including management of schedules, costs, personnel, quality and profitability) in order to prevent the occurrence of unprofitable projects in advance. The Company began developing and selling OBPM, the on-premises version, in 2008, and it updated the product in March 2021 to create OBPM Neo*1, the SaaS version. It is the only product in Japan that complies with PMBOK*2, and it is being increasingly deployed primarily by mid-sized IT companies. It has been deployed by around 240 companies as of the end of February 2023. Major IT companies develop their own project management tools in-house, but in recent years, the name recognition of OBPM Neo has increased and its high quality has come to be recognized, so more and more companies are considering deploying it within their divisions. At the same time, there are many cases of small and medium-sized companies using off-the-shelf software like Excel or free software tools. Switching to the SaaS version is expected to temporarily depress revenue for a period of around three years, but once the impact of this runs its course, the gross profit margin is expected to be around 70%, equivalent to the on-premises version (customers of the on-premises version account for less than 40% of the total as of FY2/23). In addition, the Company launched Self Plan in June 2022, an OBPM New Basic Edition plan that waives initial charges, and the Remote PMO Service*3 in July 2022, a service for quickly detecting problems and making improvements by monitoring customer projects online.

*1 Monthly usage fees (excluding tax) for 20 licenses are ¥75,000 for the Basic Edition, ¥112,500 for the Limited Edition and ¥150,000 for the Enterprise Edition. There are also optional services for connecting with various types of systems.
*2 PMBOK (Project Management Body of Knowledge): A systematic compilation of know-how and methods related to project management. “A Guide to the Project Management Body of Knowledge” was first published in 1987 by the non-profit Project Management Institute (PMI) and has gradually become well known. PMBOK has evolved over time and is now accepted as the industry standard for project management around the world.
*3 Regarding monthly fees (excluding tax), there are three plans, ¥300,000, ¥550,000 and ¥950,000, depending on the number of projects supported.

Cumulative number of companies deploying OBPM Neo



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

2. E-Commerce Business

The E-Commerce Business mainly develops and sells the Company's mainstay product of SI Web Shopping, which is Japan's first EC sites construction package. A feature of SI Web Shopping is its strength in large-scale EC sites. More specifically, it possesses scalability, being able to process large-volume transactions for sales amounts of several tens of billions of yen; high-level security functionalities; mobile-compliance functionalities, and is also compliant with multiple languages, while it is also possible to customize it by adding functionalities to meet the needs of other customers, and to connect to existing systems such as ERP. The Company has built EC sites at more than 1,100 companies since the release in 1996 (active sites are just under 10%). It possesses a wealth of expertise on building EC sites and customizable advanced technology capabilities as strengths.

Looking at the positions in the EC website-building package industry, if it is limited to large-scale B-to-C businesses, three companies – the Company, ecbeing Corp. (with a building track record for over 1,500 companies), which is a subsidiary of SOFTCREATE HOLDINGS CORP.<3371>, and Commerce21 Corporation (with a building track record for over 300 companies) which is a subsidiary of Estore Corporation <4304>– have basically become an oligopoly. In the past few years, large business demand for new EC sites has run its course, but there has been an increasing number of cases of replacement projects from other companies and building of reservation sites for rental/leasing companies and lodging companies.

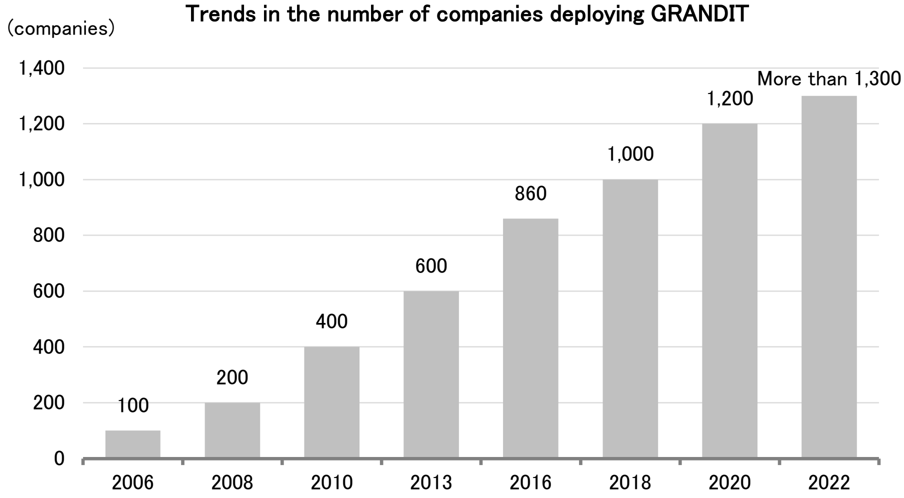
In addition, the Company signed a solution partner agreement with Adobe KK in May 2022 related to domestic sales of Adobe Commerce, a digital commerce platform, and has commenced related sales activities. Abode Commerce is characterized by its high level of convenience; it allows borderless EC and management of multiple sites and brands to be smoothly conducted on a single platform, and it is used overseas by a large number of global BtoB and BtoC companies. The Company's strategy is to expand its customer base and thereby increase the size of its business by proposing SI Web Shopping for development projects with customization requirements and Adobe Commerce for projects that can be handled with standard functions alone.

In addition, in July 2022, it began providing EC & Retail DX Support in support of EC businesses and retail companies with DX goals. Drawing on the Company's accumulated development know-how, the service not only helps launch high-quality EC sites quickly, it also provides support for subsequently building internal development structures. In this way, the service is closely aligned with the customer's needs. In the future, the Company will seek to provide support for customers' in-house development by having them enter into lab-type development contacts with its Vietnamese subsidiary, which is its offshore development site.

3. ERP Business

The ERP/AI Business develops and sells (installs) the GRANDIT Web-ERP package. This software is sold by a consortium of 13 IT companies. Since this consortium was established in 2004, the Company has been involved in planning and developing GRANDIT and has contributed to the market diffusion of this product. The GRANDIT Web-ERP package is targeted to mid-sized companies with several tens of billions of yen in annual sales, but recently deployments for major companies have also started to increase, and it has been sold to more than 1,300 companies by the entire consortium. Distinctive features of the GRANDIT software include the points that it is an ERP that is completely based on the web, therefore customers can easily upgrade their software without maintenance work on the client side, and as the software is independent of hardware, it can be used anywhere in the environment where the web operates. Furthermore, the GRANDIT software can be applied to a wide range of industries because the technological expertise of each of the 13 companies is utilized in product development, and it is highly competitive in terms of functionality, being one of the few domestically produced ERPs that include production management. In the immediate past, the Company released the GRANDIT miraimil ERP service for small- and medium-sized enterprises and done more, continuing to evolve day-by-day.

Trends in the number of companies deploying GRANDIT



Source: Prepared by FISCO from the GRANDIT CORPORATION's materials

The Company has the leading track record of deployments among the members of the consortium, having deployed it into hundreds of companies, and it received the GRANDIT AWARD Prime Partner of the Year, as the leading sales company, six times in the past. Its strengths include its in-house developments, including the "production management add-on module" and the "construction management add-on module" as an add-on module to supplement GRANDIT's basic functionalities for the manufacturing industry, and the "project management template (IT template)" that coordinates with OBPM Neo for the software industry, and also that it has development capabilities enabling it to respond with a wide range of solutions. Moreover, its other strengths include that it is able to provide proposals for business automation through combining RPA and AI, and that it can provide integrated services based on the public cloud, such as AWS and Microsoft Azure.

The size of the domestic ERP market has been steadily growing with the widespread trend for digital transformation (DX) of management, which was further accelerated by the COVID-19 pandemic. SAP <SAP>, which is the largest ERP company, has announced that it will end its support for the maintenance of existing systems in FY2027, and companies, particularly major companies, are shifting from their existing systems to next-generation ERP. In addition, it appears that the trend to switch to other ERP will continue and annual growth of approximately 10% in this market is expected to continue.

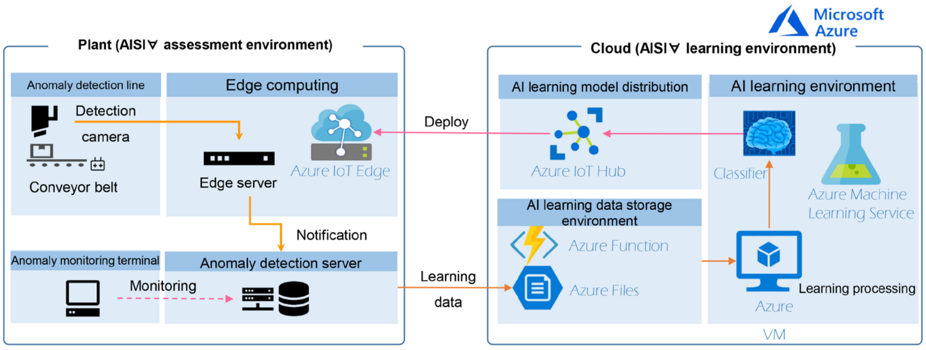
ERP vendors are classified by their customer size, and foreign companies such as SAP and Oracle <ORCL> are players for major companies. The Company's target customers are mainly mid-sized companies, which means that its competing products include GLOVIA by Fujitsu <6702> and OBIC7 by OBIC <4684>. However, recently, the Company has increasingly received orders from large companies, and accordingly, the prices of ordered projects are getting higher, to approximately ¥300mn to ¥500mn per project. It is difficult to calculate on a generalized basis, since the gross profit margin varies depending on each product configuration and specifications, but on average, the gross margin ranges from 25% to 29%. On the other hand, there is the risk that the profit margin will decrease, and a project will become unprofitable in the event that the project term is prolonged or the renovation work occurs.

4. AI Business

As for the AI Business, the Company released the AISIA-AD, deep-learning visual inspection system that uses state-of-the-art image recognition technologies, in October 2018. This system automates the visual inspection process on the production line using deep learning technology, resulting in significant labor savings. AISIA-AD's deep-learning technology creates an AI model that can distinguish between normal and anomalies through a learning environment that uses Microsoft Azure. In the anomaly detection process, using a camera, it photographs the products passing along the manufacturing line and uses an edge computer to make judgements at a high speed and in real time. The object of detection and the required precision differ from customer to customer, so it is necessary to develop an AI model for each individual project and to set specifications while implementing proof of concept (PoC).

The initial costs to implement PoC are approximately ¥4mn. Deploying AISI∀-AD in an actual manufacturing line requires a license fee of ¥4.8mn and development costs (from requirement definitions through to implementation support, and training) of ¥10mn, as well as approximately ¥4mn for hardware devices, and standard development and implementation term ranges from four to six months, and a PoC validation period of two to three months. In many cases, the customers of the Company's ERP business are in the manufacturing industry, and its strategy is to progress customer acquisition by capitalizing on the expertise and network it has accumulated through ERP deployments.

Image of AISI∀-Anomaly Detection in use



Source: The Company's results briefing materials

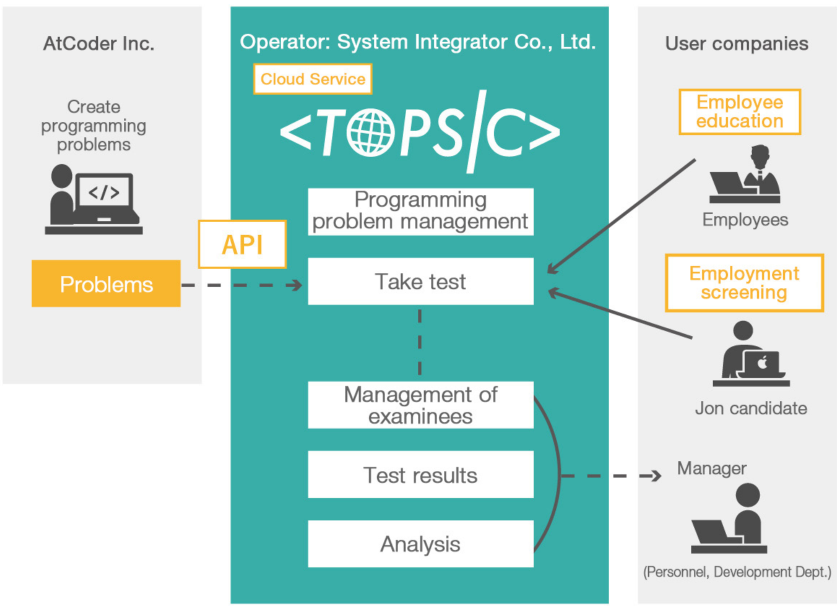
5. Other Business

In Other Business, the Company has three new services: TOPSIC, a programming skills evaluation service started in January 2018, VOICE TICKETS, a customer success support tool released in fall 2021, and IDEA GARDEN, an idea creation platform. Of these, the Company has decided to withdraw from VOICE TICKETS because it determined that profitability would be difficult to achieve.

(1) TOPSIC

TOPSIC started from TOPSIC-PG, a service that checks examinees' skill level by issuing problems and evaluating the ability of the algorithm, a common programming skill that does not rely on a programming language, in an online format with a combination of six difficulty stages. In February 2021, the Company released TOPSIC-SQL as a skill check service for SQL, which is a database-related language frequently used in operating systems. It is expected to be used as a tool in the screening process for the hiring of engineers, in the educational training of employees, and in the skill check process for selecting outsourcing companies. Also, since it supports multiple languages, its advantages include that it is applicable to foreign engineer hiring and offshore companies' selection.

TOPSIC service



Source: The Company's website

There are two kinds of fee-charging plans, which are the pay-for-usage system (billing per the frequency of use) and the fixed-fee system (billing per the number of people). In the pay-for-usage system, the standard plan (for general companies) is an annual basic fee of ¥38,000 plus a fee per exam taken of ¥19,000. In the fixed-fee system, the standard plan is an annual basic fee of ¥300,000, plus additional annual usage fees per the number of persons using it (offered for schools at 10% of the standard plan). As of the end of February 2023, the service is being deployed by 103 companies, a number that has been growing steadily. The profit margin for TOPSIC-SQL, which is created in-house, is higher than for TOPSIC-PG, whose exam questions are contracted out.

The competitor to this programming skills evaluation service is Track Test from Givery Inc. It has been adopted by over 200 companies, from startups to major corporations, and ranks at the top of the industry in both the number of test-takers and number of problems. In addition, paiza from Paiza Inc., which provides job seeking and job changing services linked to skill checks, had approximately 500,000 registered members as of the end of March 2022 and can be deemed to be a competitor despite having a different business model.

In part to improve the name awareness of TOPSIC, since 2018 the Company has held PG Battle around once a year, a tournament in which companies and schools compete against each other in programming contests using TOPSIC. In July 2022, it also began TOPSIC SQL CONTEST, an event that tests SQL coding abilities. The fifth PG Battle held in October 2022 has grown to attract 378 teams and 1,134 participants on a combined school and company basis. TOPSIC SQL CONTEST has been held five times as well, and the number of registered members has grown to 1,314 as of the end of February 2023.

(2) IDEA GARDEN

The Company launched sales of IDEA GARDEN, an idea creation platform, in November 2021. It provides a framework in which each employee can create ideas for new businesses and new products, and these ideas are shared, accumulated and managed within the company and then completed in the form of a plan. It is a tool to realize the goal of "utilizing employees' ideas for company management," and is applicable to all industries. The annual usage fees are ¥600,000, ¥1.20mn or ¥3.60mn depending on the number of ideas that can be registered and the number of "gardens" (idea-management boards). A free trial version can be used for one month. In addition, in March 2023, the Company equipped the platform with a new function, AI brainstorming function (*β*), that uses ChatGPT, which is drawing attention as a dialogue-based AI tool. The function allows users to brush up their ideas in a short amount of time and in a simple way while brainstorming with AI in a chat format. Interest in IDEA GARDEN is high, and it has been attracting seminar participation and use of the free trial, but there are still not many customers paying for the fee-based version, which is an issue going forward.

Results trends

In FY2/23, sales and profits declined due to slowing in new orders and the burden of upfront investment

1. Overview of FY2/23 results

In FY2/23 results, net sales decreased by 6.9% YoY to ¥4,486mn, operating profit decreased by 30.7% to ¥406mn, ordinary profit decreased by 29.3% to ¥416mn, and net profit decreased by 28.4% to ¥280mn, so both sales and profits decreased. However, these figures came in above the Company's forecasts, which were downwardly revised in January 2023.

FY2/23 results

(¥mn)

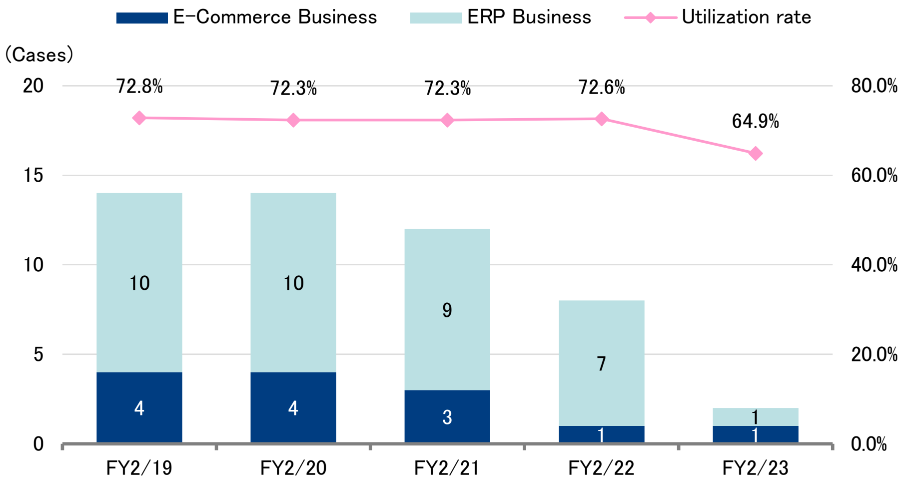
	FY2/22		FY2/23					
	Result	% of sales	Initial forecasts	Revised forecasts	Result	% of sales	YoY	Vs. revised forecasts
Net sales	4,817	-	5,000	4,400	4,486	-	-6.9%	2.0%
Gross profit	1,684	35.0%	-	-	1,576	35.1%	-6.4%	-
SG&A expenses	1,097	22.8%	-	-	1,169	26.1%	6.6%	-
Operating profit	587	12.2%	600	340	406	9.1%	-30.7%	19.7%
Ordinary profit	588	12.2%	603	345	416	9.3%	-29.3%	20.6%
Net profit	391	8.1%	426	239	280	6.2%	-28.4%	17.2%

* Figures announced by the Company in January 2023
* The company has applied the Accounting Standard for Revenue Recognition and other standards since FY2/23, which led to a ¥32mn decrease in net sales and ¥19mn increase in operating profit and ordinary profit, respectively.
Source: Prepared by FISCO from the Company's financial results

Net sales was negatively affected by special demand for large projects being recorded the previous fiscal year in the E-Commerce Business and by difficulty in acquiring new orders in the E-Commerce and ERP Businesses. In the E-Commerce Business, there was a large project in excess of ¥1.0bn (which was canceled when the customer changed its strategy), which is why the Company held back on activities to obtain new orders. This also had an effect. A high level of demand continued in the ERP Business, but projects are becoming increasingly complex, and their requirements do not always match the skill sets of engineers the Company has in-house, which has led to cases of turning down orders. This has also been a factor behind the Company's struggles.

At the same time, the engineer utilization rate dropped significantly, from 72.6% the previous term to 64.9%, due in part to actively hiring new graduates and mid-career employees with less experience, but an increase in development efficiency resulted in the gross profit margin rising by 0.2 percentage points YoY to 35.1%. SG&A expenses increased 6.6%, largely due to personnel expenses and education and training expenses, and the SG&A expenses ratio went up 3.3 percentage points to 26.1%. The operating profit margin declined 3.1 percentage points to 9.1%.

New projects and engineer utilization rate

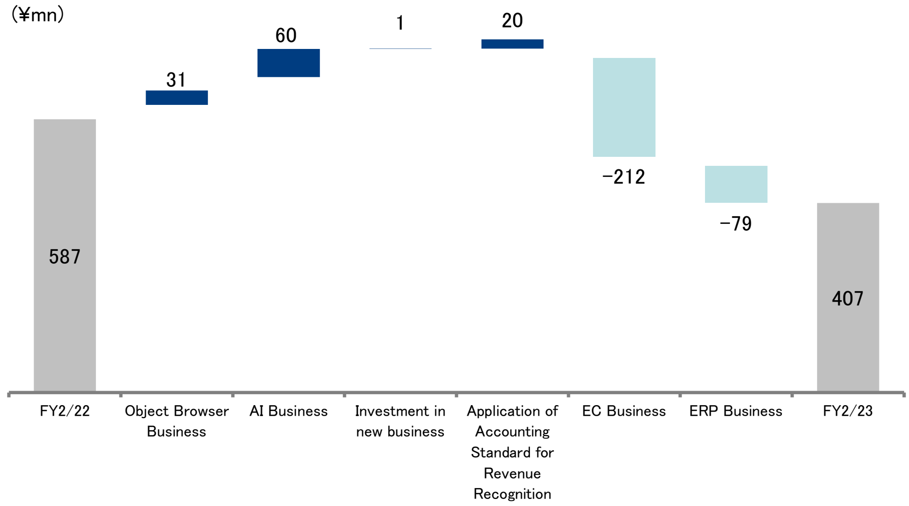


Source: Prepared by FISCO from the Company's financial results briefing materials

Looking at the factors behind the change in operating profit, positive factors included profit in the Object Browser Business increasing by ¥31mn, the loss in the AI Business contracting by ¥60mn, and application of the Accounting Standard for Revenue Recognition having an impact of ¥20mn*. Negative factors included the cancellation of a large project in the E-Commerce business having a negative impact of ¥173mn, the decline in the utilization rate having an impact of ¥39mn, an increase of ¥16mn in engineer training and education expenses in the ERP Business, and an increase of ¥63mn in SG&A expenses from adding personnel.

* The main increases were ¥8mn in the ERP Business, ¥7mn in the E-Commerce Business, ¥1mn in the AI Business, and ¥2mn in Other Business.

Factors changing operating income



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

As a result of actively hiring new graduates and mid-career professionals in order to strengthen its development structure, the Company's employees increased by 14 YoY to 233. The Company hired 23 new graduates in April 2022, 16 more than the previous year. It also hired 15 mid-career professionals, a record-high number that was due partially to having opened its new Fukuoka Office in May and hiring for remote work. In addition, the Company established a Vietnamese subsidiary in October 2022 as its offshore site, and as of February 2023 it had a workforce of 15 employees (including one person transferred from Japan).

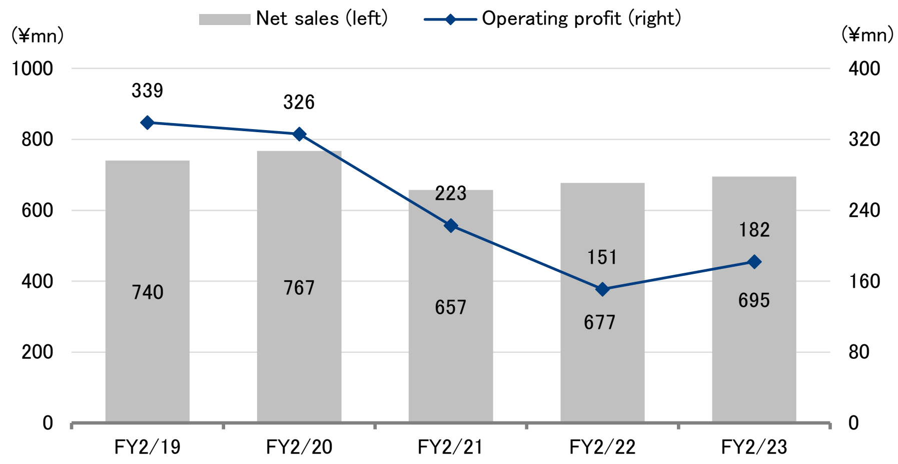
In FY2/23, revenue increased in the Object Browser and AI Businesses, but decreased in the mainstay E-Commerce and ERP Businesses

2. Results by business segment

(1) Object Browser Business

In the Object Browser Business, net sales increased by 2.6% YoY to ¥695mn and operating profit increased by 20.1% to ¥182mn, which slightly exceeded the Company's forecasts* (net sales of ¥690mn and operating profit of ¥172mn). Net sales increased for the second consecutive term thanks to an increase in OBPM Neo contracts, although sales of the Object Brower series were slow. Regarding profit as well, the figure returned to positive territory for the first time in four fiscal years thanks to an increase in the profit margin for OBPM Neo, which was upgraded in March 2021 from a purchase model to an SaaS model (monthly fee model).

Object Browser Business



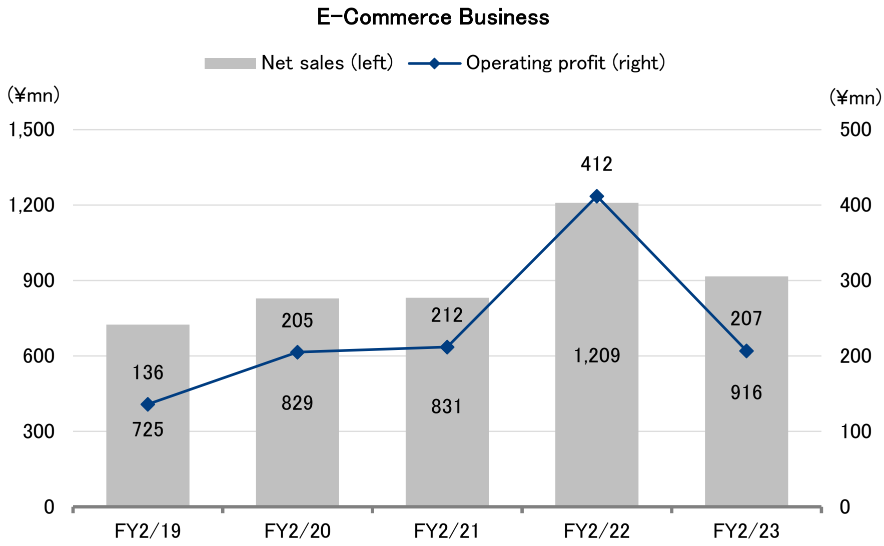
Source: Prepared by FISCO from the Company's financial results

The Object Browser series, which are used across a wide range of industries and well-positioned as reliable tools to improve the productivity of software development, are a stable source of revenue for the Company. The Company released SI Object Browser for SQL Server 22, which is the newest version, in July 2022, and maintained sales by proactively incorporating customer requests and enhancing convenience, such as by supporting the latest databases other than "Oracle" and various platforms.

OBPM Neo is being switched to an SaaS model for existing customers (on-premises contracts), and the number of new contracts is also increasing. As a result, the cumulative number of companies using the product increased to 240 from 220 at the end of the previous fiscal year, and the percentage of on-premises contracts declined from around 50% the previous term to under 40%. With regard to switching over major customers, some of whom are provided with additional customized functions, the plan is to migrate them after the equivalent functions are added to OBPM Neo. For this reason, the timing for the complete switchover to the cloud service is set for March 2025 or later. New initiatives included providing Self Plan in June 2022, which waives initial usage fees, and launching Remote PMO Service in July 2022, a service for quickly detecting problems and making improvements by monitoring customer projects online. While not yet used extensively, the IT industry faces the problem of shortages in not only engineers but also project managers, so the service will be watched as a solution for this issue.

(2) E-Commerce Business

In the E-Commerce Business, net sales decreased by 24.2% YoY to ¥916mn and operating profit decreased by 49.8% to ¥207mn. Both figures slightly exceeded the Company's forecasts (net sales of ¥900mn and operating profit of ¥173mn). As discussed above, sales of large projects were recorded in the previous term, and a large project that had been ordered was canceled for reasons attributable to the customer, which slowed activities to acquire new orders and caused orders to stagnate. These were the factors responsible for the declines in sales and profits.



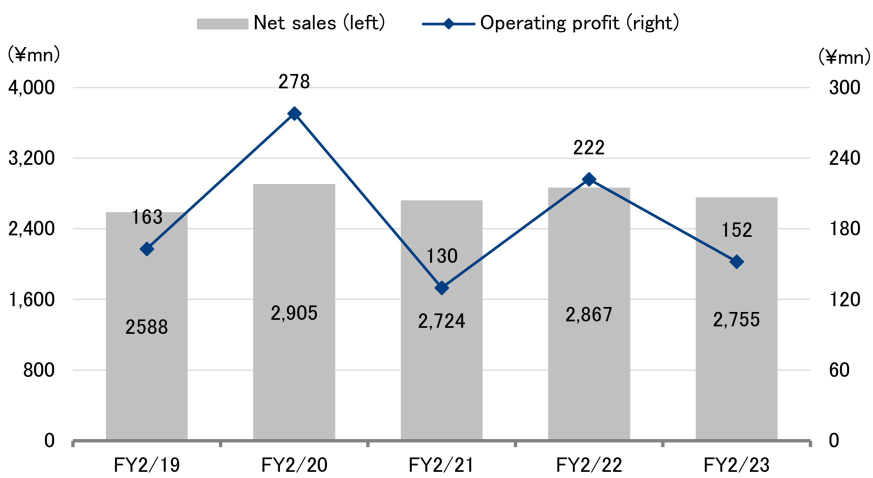
Source: Prepared by FISCO from the Company's financial results

New initiatives included starting sales of Adobe Commerce, a digital commerce platform from Adobe, and launching EC & Retail DX Support, a service in support of in-house development. The Company worked to cross-sell these products with SI Web Shopping. There were many inquiries related to Adobe Commerce, but few companies are launching new EC sites and there are many cases of customers wanting customization, so it was only deployed by one customer. However, inquiries increased from new customer segments, companies like rental and leasing companies and hotel operators interested in setting up reservation sites, for example. In some cases, these inquiries have led to sales talks for SI Web Shopping, so Adobe Commerce is helping the Company acquire prospective customers in this business.

(3) ERP Business

In the ERP Business, net sales decreased by 3.9% YoY to ¥2,755mn and operating profit declined by 31.5% to ¥152mn, slightly exceeding the Company's forecasts (net sales of ¥2,700mn and operating profit of ¥131mn). ERP demand continued to be buoyant against a backdrop of rampant DX investment by companies, but the Company did not have enough internal engineer resources to accommodate the scale and specifications of new projects and so failed to acquire orders, and some projects under development were canceled, which were factors negatively affecting revenue. Profit was negatively impacted by a decrease in gross profit caused by lower revenue and an increase in personnel and education expenses from the establishment of the Fukuoka Office to strengthen the development structure and new engineer hirings. The Company finds that it is necessary for new graduate hires to gain around three years of experience before they are able to generate a profit on average. This is because in ERP development projects, requirements differ with the customer, so a certain amount of development experience is needed.

ERP Business

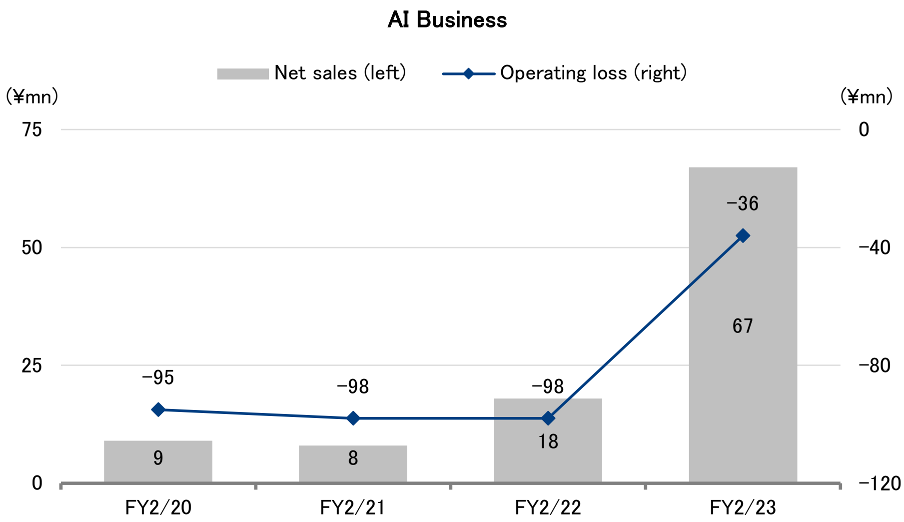


Source: Prepared by FISCO from the Company's financial results and results briefing materials

New initiatives included launching GRANDIT miraimil, a cloud-based ERP service for SMEs that is geared specifically to trading companies, the wholesale industry, and the IT and information services industry, and also commencing provision of an electronic data saving option to comply with the amended Electronic Books Preservation Act, which goes into effect in January 2024. The government's new invoicing system starts in October 2023, so inquiries for projects to comply with the system have picked up, and the Company is working to restore revenue while also taking orders for small and medium-sized projects.

(4) AI Business

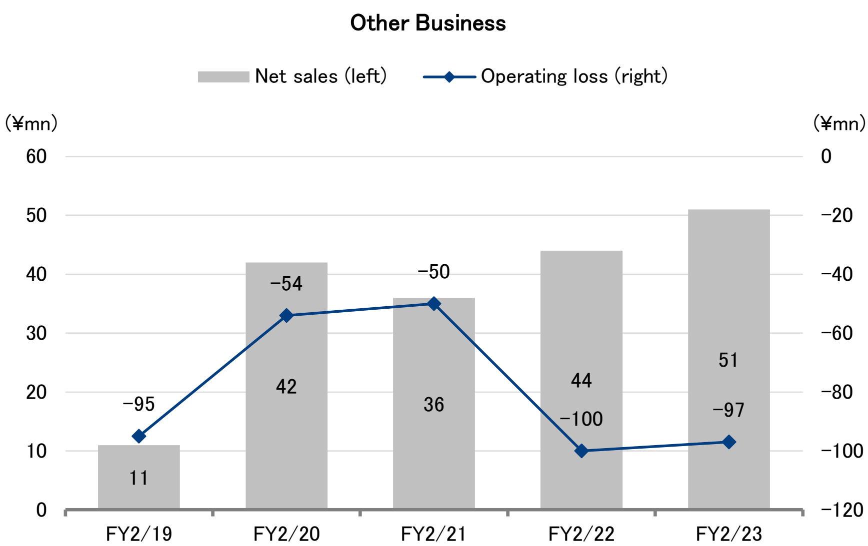
In the AI business, net sales increased by 254.9% YoY to ¥67mn, and there was an operating loss of ¥36mn (loss of ¥98mn the previous year), figures that are slightly above the Company's forecasts (net sales of ¥60mn and operating profit of ¥40mn). There was an increase in verification and study projects (including for proof of concept (PoC)) using AISIA-AD, a deep-learning visual inspection system, and the system was deployed on one manufacturing line, which was a factor increasing revenue. The range of targets for inspection that have been inquired about is very broad, having including film products, transport device components, plastic bottle caps, and electricity materials, so the Company will work to make the business profitable as soon as possible.



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

(5) Other Business

In the Other Business segment, net sales increased by 15.1% YoY to ¥51mn, and there was an operating loss of ¥97mn (a loss of ¥100mn in the previous fiscal period). The results were generally in line with the Company's forecasts (net sales of ¥50mn and an operating loss of ¥96mn). TOPSIC, a programming skills evaluation service, saw a steady increase in the number of contracted companies and revenue increased. This was owing in part to the Company launching TOPSIC-SQL, an evaluation service for SQL skills, a database language, in February 2021, to go along with TOPSIC-PG, which tests algorithm skills. In addition, with regard to IDEA GARDEN, which was launched in November 2021, a small amount of sales was recorded. In terms of profit, a loss continued to be posted due to the burden of development costs.



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

Has an excellent financial position with debt-free management

3. Financial position and management indicators

Total assets at the end of FY2/23 amounted to ¥3,780mn, up ¥199mn from the end of the previous fiscal year. Looking at the main factors behind this change, in current assets, work in process decreased by ¥159mn, due in part to the impact of applying the Accounting Standard for Revenue Recognition, but cash and deposits increased by ¥332mn. In non-current assets, software (including software in progress) decreased by ¥145mn, while investment securities increased ¥25mn and investments in capital of subsidiaries and associates of ¥24mn was recorded in connection with establishment of the Company's Vietnamese subsidiary.

Total liabilities at the end of FY2/23 totaled ¥910mn, up ¥44mn from the end of the previous fiscal year. Accounts payable – trade increased by ¥30mn and income taxes payable increased by ¥69mn. Total net assets amounted to ¥2,869mn, up ¥154mn from the end of the previous fiscal year. Retained earnings increased by ¥202mn, but treasury stock increased by ¥47mn (a decrease factor).

Looking at management indicators, the equity ratio edged up by 0.1 percentage points, from 75.8% at the end of the previous fiscal year to 75.9%. The Company can be determined to be highly financially sound, with its debt-free management and accumulation of record high cash and deposits, which is over ¥1.9bn. For the indicators of profitability, ROE decreased by 5.2 percentage points YoY to 10.0% and the operating profit margin declined by 3.1 percentage points to 9.1%, worsening for the first time in two fiscal periods, but this was largely impacted by upfront investment to strengthen the development structure, etc., and this investment is expected to bear fruit going forward.

Balance sheet and management indicators

(¥mn)

	FY2/20	FY2/21	FY2/22	FY2/23	Change
Current assets	2,589	2,544	2,801	3,105	303
(Cash and deposits)	1,296	1,473	1,631	1,964	332
(Work in process)	134	329	169	10	-159
Non-current assets	698	953	778	687	-91
Total assets	3,288	3,498	3,580	3,780	199
Total liabilities	1,024	1,066	866	910	44
(Provision for loss on order received)	0	231	-	-	-
(Interest-bearing debt)	-	-	-	-	-
Total net assets	2,264	2,431	2,714	2,869	154
(Retained earnings)	1,536	1,686	1,988	2,959	202
[Management indicators]					
(Stability)					
Equity ratio	68.9%	69.5%	75.8%	75.9%	0.1pt
(Profitability)					
ROE	21.3%	12.5%	15.2%	10.0%	-5.2pt
Operating profit margin	14.5%	9.8%	12.2%	9.1%	-3.1pt

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

Outlook

For FY2/24, forecasting a decrease in operating profit from new development investment but a return to double-digit gains in net sales

1. Forecasts for FY2/24

In its forecasts for FY2/24 results, the Company is expecting net sales to increase by 11.5% YoY to ¥5,000mn, operating profit to decrease by 3.6% to ¥392mn, ordinary profit to decrease by 4.4% to ¥398mn, and net profit to increase by 20.0% to ¥336mn. Net sales are being projected to increase in all business segments. The expected decrease in operating profit is primarily because the Company will record over ¥100mn in R&D expenses for the development of new products (¥28mn in R&D expenses the previous fiscal year). In addition, with regard to net profit, the Company is planning to record a gain on sale of investment securities, so net profit is projected to increase, reversing the recent trend.

Forecasts for FY2/24

(¥mn)

	FY2/23		FY2/24		
	Result	% of sales	forecast	% of sales	YoY
Net sales	4,486	-	5,000	-	11.5%
Operating profit	406	9.1%	392	7.8%	-3.6%
Ordinary profit	416	9.3%	398	8.0%	-4.4%
Net profit	280	6.2%	336	6.7%	20.0%
Earnings per share (¥)	25.62		30.78		

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

The Company has identified four key themes for FY2/24: strengthening new customer acquisition, securing development engineers and enabling them to contribute quickly, making businesses being incubated profitable (AI Business and other new businesses), and creating a new mainstay business with the potential to be a future revenue pillar. With regard to personnel investment, in April 2023 the Company plans to hire 15 new graduates (down by eight YoY) and hire around 20 mid-career professionals. It will introduce an accelerated training program to get new personnel up to speed and ready to contribute in a shorter amount of time than before. Hiring also appears to be proceeding steadily at the Fukuoka Office and Vietnamese subsidiary.

New products under development are apparently services that will help companies increase their business efficiency, and the Company began development in 2022 and plans to provide them in phases on a function by function basis using the SaaS model starting in 2024. For this reason, R&D expenses are expected to peak in FY2/24.

In FY2/24, the ERP Business is expected to return to double-digit revenue and profit growth and the AI Business is projected to be profitable for the first time

2. Outlook by business segment

Outlook by business segment

(¥mn)

	FY2/23 Result	FY2/24 forecast	YoY
Net sales			
Object Browser Business	695	742	6.7%
E-Commerce Business	916	989	8.0%
ERP Business	2,755	3,106	12.7%
AI Business	67	97	44.0%
Other Business	51	66	28.6%
Core Business Profit			
Object Browser Business	286	270	-5.6%
E-Commerce Business	321	294	-8.4%
ERP Business	499	612	22.6%
AI Business	-13	2	-
Other BusinessResults target of medium-term business plan	-75	-73	-

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

(1) Object Browser Business

In the Object Browser Business, the Company is forecasting net sales to increase by 6.7% YoY to ¥742mn and core business profit* to decrease by 5.6% to ¥270mn. Net sales are projected to increase thanks to increases in contracts for both the Object Browser series and OBPM Neo. OBPM Neo is expected to contribute to higher revenue as the Company plans to take measures to reduce the cancellation rate, which rose in the previous year (from 6.5% in FY2/22 to 13.4% in FY2/23). Previously, the sales organization had two separate teams, one for acquiring new customers and one for providing installation and follow-up support for contracted customers, but this organization was unified in March 2023, and now enables the sales reps that acquired a customer continue to provide follow up for subsequent installation and other support. Through this change, the Company intends to raise customer satisfaction levels and lower the cancellation rate.

* The Company will disclose business segment profit on the basis of core business profit beginning in FY2/24. Previously, operating profit was disclosed after allocating shared expenses to each segment in proportion to its net sales, but core operating profit provides a more accurate picture of each business's earnings.

At the same time, core business profit is forecast to decline because personnel expenses will increase to strengthen the development structure and costs of around ¥10-20mn are expected from withdrawing from OBDZ, for which service will end in FY2/24. There are still a small number of customers using OBDZ, and there will be infrastructure maintenance costs until the service is ended.

In the Company's view, there are 2,200 to 2,300 IT industry companies with the potential to deploy OBPM Neo, so it believes there is still room to acquire more customers. Further, it sees the Remote PMO Service that started in FY2/23 as having adequate potential to increase contract numbers because of the continued chronic shortage of project managers. The Company's near-term target for OBPM Neo is installation at 400 companies, and it aims to further expand the business over the medium term. With regard to the profit margin, it is expected to increase further from FY2/25 when customers are fully switched over from the purchase model to the monthly fee model.

(2) E-Commerce Business

In the E-Commerce Business, the Company is forecasting net sales to increase by 8.0% YoY to ¥989mn and core business profit to decrease by 8.4% to ¥294mn. Along with increasing sales of Abode Commerce, inquires for EC & Retail DX Support, a service in support of in-house development, are also increasing, so the Company is projecting higher revenue. However, profit is expected to decline because of a shift to sales of other companies' products, like Adobe Commerce, which has a low profit margin.

(3) ERP Business

In the ERP Business, the Company is forecasting double-digit growth in revenue and profits, with net sales to increase by 12.7% to ¥3,106mn and core business profit to increase by 22.6% to ¥612mn. Orders recently have been strong mainly related to projects to comply with the government's new invoicing system, and there have been positive effects as well from strengthening the development structure in the previous term, which including opening the Fukuoka Office and establishing a Vietnamese subsidiary. As a result, the Company is projecting a new record high in net sales for the first time in four fiscal years. The core business profit margin is projected to rise from 18.1% to 19.7% thanks to the expected increase in sales and a higher engineer utilization rate.

(4) AI Business

In the AI Business, the Company is forecasting net sales to increase by 44.0% to ¥97mn and core business profit to be ¥2mn (a loss of ¥13mn the previous term), which will be the first time the business has turned a profit. A number of AISIA-AD projects are expected that will involve actually employing the system on manufacturing lines, and around ten PoC projects are expected as well. Interest in AI solutions has apparently been rekindled by the rise of ChatGPT, and the Company intends to capture some of this demand.

In April 2023, the Company released ImageCheck AI, a self-check tool for AI-based visual inspections that customers can use to conduct simple verifications of AI's utility and other issues related to its deployment. The Company previously provided a fee-based simple verification service (¥400,000, two-week verification period) that could be used to test AI models with images from the customer's manufacturing line at the stage prior to conducting PoC, but this involved the extra work of confidentiality agreements, image data, and data evaluations, so it did not result in increased productivity. The Company developed the new tool and began providing it free of charge because it believes that if customers can conduct simple verifications themselves, the process will progress smoothly to PoC. The reaction to the tool's release has been positive, but issues have emerged as well, as evidenced by an increase in questions related to how to operate the tool. The Company intends to make improvements to the tool's functions going forward in order to enhance its convenience.

(5) Other Business

In Other Business, the Company is forecasting net sales to increase by 28.6% to ¥66mn and a core business loss of ¥73mn (a loss of ¥75mn the previous fiscal year). Regarding TOPSIC, the Company plans to increase the number of companies using the service by further enhancing it. It will increase the number of questions to expand sales of TOPSIC-SQL, for which demand is rampant, and release a free assessment function, which is a new function for more objectively evaluating and assessing skills. The breakeven point is just under ¥100mn, so the Company will strive for profitability in three or four years.

Regarding IDEA GARDEN, the Company is at the stage of upfront investment to raise name recognition and acquire new prospective customers through holding seminars and other activities. In April 2023, the product was equipped with the AI Advisor Function (B), which utilizes GPT-4, the latest language learning model from Open AI, and with another new function, Idea Contribution Points, which visually renders the contribution level of employees to idea creation. It is thought that adding AI functions will increase the efficiency of idea creation activities on the platform. The reaction since the release has apparently been very good, so along with increasing name recognition the key to profitability going forward will likely be the extent to which free trial users can be switched over to fee-based contracts.

Announced two-year medium-term business plan and medium- to long-term performance targets; aiming for net sales of ¥12.0bn in ten years

3. Medium-term business plan

The Company announced a new medium-term business plan in April 2023. It previously created medium-term plans with a span of three years, but because large projects in the E-Commerce and ERP Businesses with project periods of around two years have been increasing, this most recent plan covers a period of two years. The previous medium-term business plan put forth five measures (expand existing businesses and increase brand power, develop overseas business, make new businesses profitable, enhance employee skills, and become a leading “streamlined company” in Asia), and these have been inherited by the new plan and reorganized into four perspectives (business, human capital and organization, mindset, and systems). The Company plans to conduct priority measures on this basis.

(1) Priority measures

a) Business perspective

From a business perspective, the Company intends to engage in the following priority measures. It will execute and stably grow sustainable businesses, create new core businesses with standalone net sales of around ¥2.0bn in ten years, make unprofitable businesses profitable and raise business earnings power, and strengthen marketing and sales capabilities.

Regarding new core businesses, along with a new product currently under development for mid-sized market and larger companies, the Company intends to develop a new product using AI technology and grow both of the products into around ¥2.0bn businesses. In addition, the Company established the Business Strategy Headquarters in March 2023 in order to strengthen its ability to acquire new customers and reduce cancellation rates. It has brought together sales reps in charge of new customer acquisition and marketing divisions that had been dispersed in different businesses. By unifying the organization, the Company hopes to improve coordination and enhance its comprehensive strengths.

b) Human capital and organization perspective

Based on the belief that human capital is the source of a company’s growth, the Company will introduce transparent HR systems and enhance its working environment to allow for the growth of both individual employees and the company itself. Specifically, it plans to increase employee engagement by implementing training aimed at getting engineers up to speed as quickly as possible and a voluntary personnel rotation program, by enhancing its program for helping employees acquire certifications, and by improving and enhancing programs for accommodating diverse working styles.

c) Mindset perspective

The Company will seek to instill learning from one's mistakes and taking on challenges as standard patterns of behavior and form its own unique corporate culture while cultivating a pioneering mindset.

d) System perspective

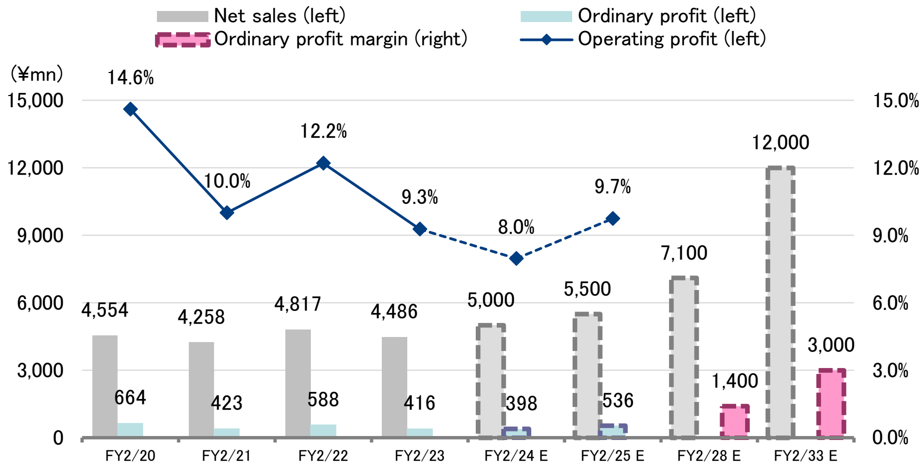
The Company will work for transparent management and to maximize results by building a management information platform and promoting numbers-based management, by building a sales information platform and promoting data-driven sales activities, and by optimizing information systems and recurrently utilizing information systems.

(2) Result target

The Company's results targets for FY2/25 are net sales of ¥5,500mn and ordinary profit of ¥536mn, so it is aiming for double-digit revenue and profit growth. Profit is expected to decline in FY2/24 due to the increased burden of development investment, but the Company is projecting a reversal to double-digit profit growth in FY2/25 thanks to higher revenue and an increased utilization rate resulting from newly hired engineers getting up to speed.

The Company has also set medium- to long-term targets. In FY2/28 in five years, the Company is aiming for net sales of ¥7,100mn and operating profit of ¥1,400mn, and in FY2/33 in ten years, it is targeting net sales of ¥12,000mn and operating profit of ¥3,000mn. Net sales is expected to grow at an annual rate of 10%, and the operating profit ratio is being projected to improve from 9.1% in FY2/23 to 25% as a result of raising profitability and growing high value-added SaaS businesses. The Company intends to achieve it targets by cultivating the AI Business and other new business while expanding its existing core businesses, the E-Commerce Business and ERP Business, by strengthening its development structure. Regarding the Company's Vietnamese subsidiary, it currently has a workforce of 15 people, but the Company plans to increase this number to 40 within FY2/24 and make it an offshore site mainly for the ERP and E-Commerce Businesses.

Results target of medium-term business plan



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

Shareholder return policy and SDGs initiatives

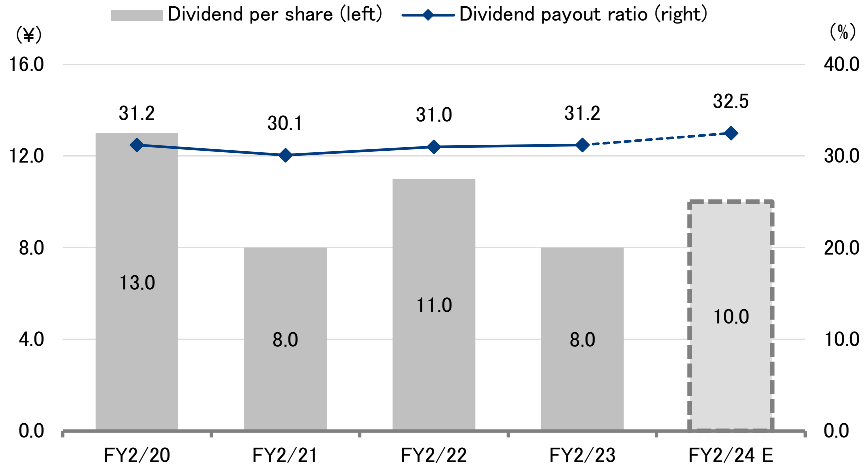
Standard dividend payout ratio is 30% based on performance and a gift of Koshihikari rice through shareholder rewards program

1. Shareholder return policy

The Company actively works to return profits to shareholders in order to enhance its corporate value. The Company's dividend policy is to link the dividend to performance results, with a standard dividend payout ratio of 30%. In FY2/23. the Company paid a dividend of ¥8.0 per share (dividend payout ratio 31.2%), ¥3.0 down YoY due to a reduction in profits, but FY2/24, the Company plans to pay a dividend of ¥10.0, an increase of ¥2.0 per share (dividend payout ratio 32.5%). The Company also conducts treasury share buybacks as needed, and most recently acquired 100,000 shares with a total acquisition value of ¥47mn in April-May 2022.

In addition, the Company has introduced a shareholder rewards program with the objective of cultivating stable shareholders who hold their shares for the mid-to long-term. The program is for shareholders who hold at least 200 shares and who are listed under the same shareholder number in the shareholder ledger at the end of August and end of February in each year. The Company rewards newly harvested Koshihikari rice grown in Niigata, using reduced levels of fertilizers and agrochemicals. Shareholders holding from 200 to 999 shares receive a 1kg bag, those holding 1,000 to 3,999 receive a 2kg bag, those holding 4,000 to 15,999 receive a 5kg bag, and those holding 16,000 shares or more receive a 10kg bag, with the gift being delivered each fall after the harvest.

Dividend per share and dividend payout ratio



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

Highly evaluated as a company actively working on SDGs

2. SDGs initiatives

The Company is actively promoting SDGs initiatives. Specifically, since August 2021, it has conducted an SDGs support program that provides the Company's SI Web Shopping license at a special price to EC providers aiming to help achieve the SDGs through their EC businesses. In addition, to support children's cafeterias in Saitama Prefecture, where the Company has its headquarters, it began activities in September 2021 to provide websites for the cafeterias free of charge, and it has created a total of 15 sites as of the end of February 2023.

Toward the enhancement of employees' work environments, the Company has been actively taking various measures to promote diversity, including building a system to enable women to work more easily, and recruiting people with disabilities and from overseas. In addition, in 2007, the Company introduced a work-from-home system for employees to conduct childcare or nursing care. It has also had a work-at-home program in place since 2007 for employees with childcare or nursing care responsibilities. One hundred percent of female employee take childcare leave and the return rate is also high at 93%. Male employees are also encouraged to take advantage of childcare leave and work from home for childcare. Further, by putting in place a remote work program that allows for fully remote work, the Company is striving to make its workplace environment even more attractive to employees.

The Company has been highly reputed for these initiatives and in 2012, it was awarded with the gold certification as "a company practicing diverse workstyles" from Saitama Prefecture and in 2021, it was registered as a "Saitama Prefecture SDGs Partner" and "Saitama City SDGs Certified Company." In 2017, the Company was certified by the Ministry of Health, Labour and Welfare as a "company realizing both work and nursing care (Tomonin)" and then in 2019 as a "company supporting parenting (Platinum Kurumin)." Also in 2017, the Company was selected as one of the "100 Teleworking Pioneers" by the Ministry of Internal Affairs and Communications, as a company that is actively promoting teleworking. These initiatives by the Company have also been highly evaluated by students and others, and even within the IT industry where the labor shortage has become a serious issue, the Company appears able to recruit excellent human resources comparatively smoothly and has a low level of turnover, 10% or lower.

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