

COMPANY RESEARCH AND ANALYSIS REPORT

VALTES CO., LTD.

4442

Tokyo Stock Exchange Growth Market

17-Jan.-2023

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FISCO Ltd.

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

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VALTES CO., LTD.

4442 Tokyo Stock Exchange Growth Market

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<https://www.valtes.co.jp/en/index.html>

Summary

Company specializes in software testing, features a unique education method, and has major potential for growth in expanding market

VALTES CO., LTD. <4442> (hereafter, also “the Company”) was established in 2004 by its current President and Representative Director Shinji Tanaka. Mr. Tanaka had been managing a general software house, but had concerns and misgivings that the test market in Japan for third-party evaluation of software was immature and leading to low quality, high cost software, and his desire to enhance the quality of software in the world inspired him to establish the Company. Since then, the Company has been involved in numerous software testing projects, while also focusing on in-house engineer training and establishing a unique education method. Since most software tests are often done internally by software vendors even now, and software testing by external companies is a developing market, it can be said the Company also has significant future growth potential.

1. 1H FY3/23 consolidated results

In the 1H FY3/23 consolidated results, net sales were ¥4,169mn (+38.7% YoY), operating profit was ¥478mn (+912.2%), ordinary profit was ¥483mn (+893.3%), and profit attributable to owners of parent was ¥310mn (+738.0%). In key performance indicators (hereafter, “KPIs”), the “average unit price” (monthly net sales per engineer) came to ¥729,000 (+¥63,000 YoY), the number of engineers in operation at the end of 1H FY3/23 was 1,122 (+257), and the number of projects during 1H FY3/23 was 1,860 (+306), all marking record highs for 1H. As a result, the gross profit margin improved to 28.9% (from 22.9% in the same period of the previous fiscal year), and gross profit grew on the back of higher sales to offset a 13.3% YoY increase in SG&A expenses, such that operating profit increased substantially.

2. FY3/23 consolidated forecasts

For the FY3/23 consolidated results, the Company is forecasting net sales of ¥8,847mn (+31.9% YoY), operating profit of ¥962mn (+68.8%), ordinary profit of ¥972mn (+67.6%), and profit attributable to owners of parent of ¥647mn (+56.6%). While the forecasts seem conservative in light of 1H results, that is because the Company is prioritizing an array of up-front investments with an eye to FY3/24 and beyond, including investments in hiring core personnel in FY3/24, reinforcing the organizational structure looking to the Group’s expansion, strengthening marketing, and establishing a comfortable work environment. As key measures, the Company will work in the mainstay software tests segment to further increase the size of projects and unit price by expanding enterprise projects. In the web/mobile app development segment, it aims to expand security business and actively introduce and develop new technologies. In the offshore segment, it aims to expand business by actively increasing engineer numbers to respond to post-lockdown economic normalization.

3. Growth strategy

In the Japanese software testing market, software vendors are still conducting a lot of tests in-house, but it is also true that there is a growing need for outsourcing. Therefore, outsourcing to specialized companies like the Company is expected to increase moving ahead. Against this backdrop, the Company plans to achieve both growth in scale and high profitability by controlling investments and implementing four basic strategies ((1) investment in human capital, (2) expansion of enterprise domain, (3) expansion of intellectual property, and (4) M&A and organizational strengthening). The Company has set net sales of ¥10bn in FY3/24 as a quantitative target, which is no doubt already within range. More than that, attention will be on what is in store for the next target.

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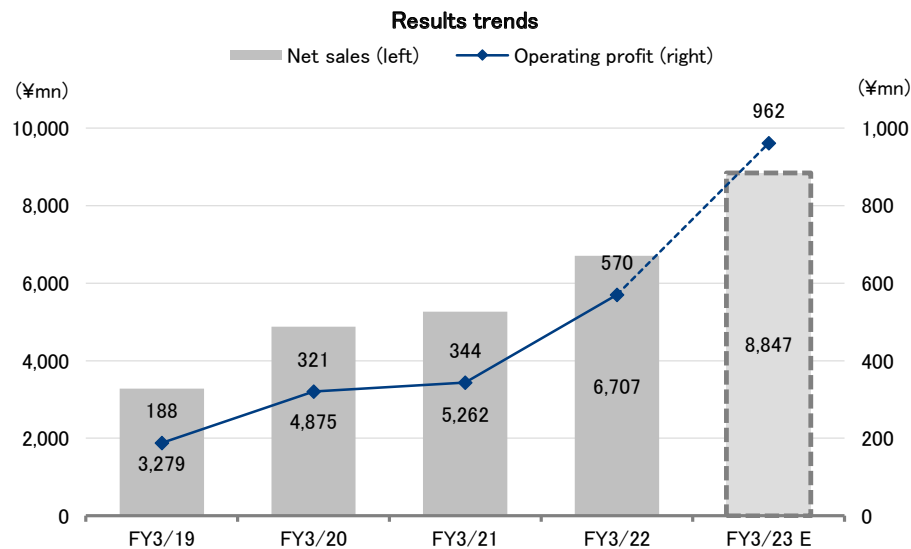
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Summary

Key Points

- Core business is software testing services. Targets growth in step with market expansion
- 1H FY3/23 profit rose sharply, targets operating profit growth of 68.8% YoY for the full fiscal year
- Medium-term strategic target of net sales of ¥10bn in FY3/24 is well within reach



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

Company overview

Software testing specialist, with unique employee education method among its strengths

The Company was established in 2004 by its current President and Representative Director Shinji Tanaka. Before that, Mr. Tanaka was managing a general software house. At the time, many software houses and IT vendors were conducting software tests in-house. Therefore, assessments inevitably tended to be lenient. As a result, the quality of the deliverables—software—was low, while the cost was high. Mr. Tanaka had concerns and misgivings about such things, and his desire to enhance the quality of software in the world inspired him to establish the Company for the purpose of specializing in software testing. The Company's name, VALTES, comes from "Value Created through Testing."

Company overview

Ever since, the Company has stayed on its path as a software testing specialist, taking part in numerous software testing projects, while also concentrating on in-house engineer education and establishing a unique education method. As a software testing specialist, the Company is currently handling lots of requests for testing from wide array of customers, including users and IT vendors. Although much of software testing is still conducted internally by software vendors and the like, and software testing by external companies is a developing market, there has recently been growing awareness of software testing conducted by external companies. It can therefore be said that the software testing market is developing, and the Company's growth potential is significant.

Regarding the stock, the Company listed on Tokyo Stock Exchange (hereafter, "TSE") Mothers Market in May 2019, and moved to the Growth Market accompanying the TSE's market reorganization in April 2022. The Company currently aims to move to the Prime Market.

History

Date	Major event
April 2004	VALTES CO., LTD. established
December 2008	Obtained ISO 27001 information security management system certification
October 2012	Group company VALTES Mobile Technology Co., Ltd. (VMT) established
February 2014	Group company VALTES Advanced Technology, Inc. (Philippines) established
December 2015	Certified as a "Platinum Partner" in the ISTQB Partner Program
December 2017	Certified as a "Global Partner" in the ISTQB Partner Program
May 2019	Listed on the Tokyo Stock Exchange Mothers Market.
August 2020	Made RSR Co., LTD. a subsidiary
November 2021	Released beta version of T-DASH test automation tool
February 2022	Released official version of T-DASH test automation tool
March 2022	Launched Prime WAF, a cloud-based WAF
April 2022	Moved to the Growth Market accompanying the Tokyo Stock Exchange's market reorganization Made Mint CO., LTD. a subsidiary
August 2022	Launched AnyTest capable of remotely controlling actual smartphones via a cloud platform

Source: Prepared by FISCO from the Company's website

Business description

Mainly engaged in software testing, but also develops web/mobile apps

1. Business description and segment overview

The Company's three reporting segments are software tests, web/mobile app development, and offshore.

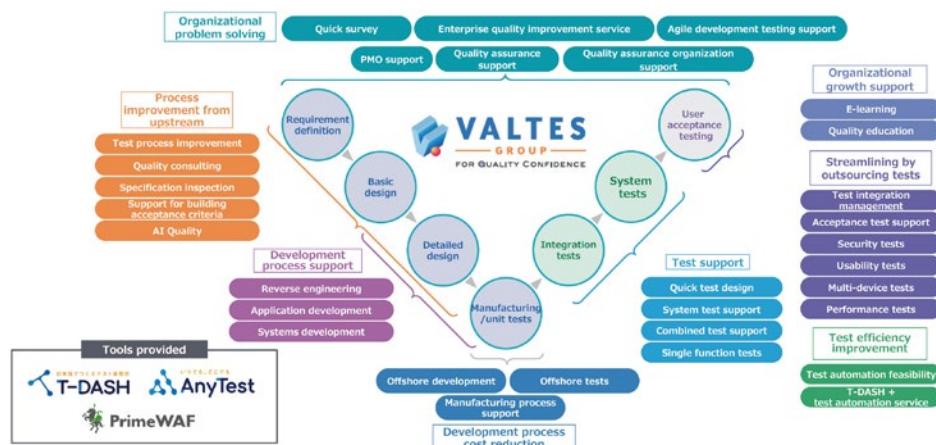
(1) Software tests segment (90.8% share of 1H FY3/23 net sales)

a) Business domain and workflow

The software tests segment provides a wide range of software testing services from an independent, third-party perspective so user companies, manufacturers, and software vendors can avoid risks by bringing to light any software problems. Its services extend from drafting quality plans in the development process to improving the development process, and discovering software issues. It also handles everything from planning tests, designing tests, preparing test cases, conducting tests, and preparing test summary reports to verify that there are no serious problems with software. A feature of the segment is that it covers extensive ground in software development, from the upstream to downstream.

Business description

The Company's service map



Source: The Company's results briefing materials

The Company's scope of service provision is extensive, from enterprise (business systems, core systems, etc.) to embedded (AV devices, consumer electronics, industrial equipment, etc.), web/smartphone (websites, mobile applications, etc.), and other domains. Among them, profit margins are relatively high for enterprise-related work, so the Company aims to expand in that field going forward.

Comparison matrix of test processes in peripheral markets

		Potential market scale	Market stage	Barriers to entry
Test Process market	Enterprise domain	Huge	Startup	High
	Embedded domain	Big	Startup	High
	Web/smartphone domain	Medium	Growth	Medium
	Entertainment domain	Small	Maturity	Low

Source: The Company's "Business Plan and Growth Potential Explanatory Material"

The Company's testing is also not limited to functionality and determining whether or not planned operations are carried out accurately. Rather, it meets an array of testing needs. For instance, tests of access based on the number of users assuming actual operation, tests concerning the accumulation, continuity, and durability of data from ongoing business activities, and tests to discover potential for things like the leakage of personal information due to software problems, and to discover software vulnerabilities.

b) Main services, forms of provision, and contract types

The Company's main services are diverse, and include software testing, quality consulting, software quality seminars, digital broadcasting testing, security and vulnerability assessment, reverse engineering, and publishing, information dissemination, and site operation.

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Business description

Major services provided

Software testing	From single function testing to system testing support, multiple device testing, test automation, and acceptance test support, the Company's engineers with specialist expertise conduct various software tests on behalf of customers, working out the best test patterns according to the objective, and providing testing services supporting the quality of applications, systems, and more to a wide assortment of industries.
Quality consulting	Whereas software testing services entail testing software that has already been developed, quality consulting services involve supporting quality management, such as by establishing and standardizing quality assurance processes for the entire software development process including upstream processes, as a project management office (hereafter, "PMO") for quality or quality management office (QMO).
Software quality seminars	The Company's engineers also provide software quality education seminars for customers' developers, quality managers, project leaders, project managers, and so forth. The Company currently offers 15 educational courses. It has also created English language versions of some content, and training in English is also possible.
Digital broadcasting testing	The Company provides a wide variety of digital broadcasting testing services, not just functional testing for receivers, but also services such as specification testing to determine if systems are in line with broadcasting standards, tests of abnormal conditions not specified in standards, and creation of data for testing.
Security and vulnerability assessment	This includes the provision of SaaS-based WAF services, and diagnostics to check if web systems, mobile applications, or IoT devices are susceptible to external intrusions (hacking). The Company and its subsidiary VALTES Mobile Technology Co., Ltd. both provide these services.
Reverse engineering	For software with no documentation, the Company creates documents from the software and tests the software according to those documents.
Publishing, information dissemination, and site operation	For everyone involved in software development, the Company operates a website conveying information that goes beyond software quality improvement to information on industry trends, management methods, and other valuable information needed by engineers. It also publishes books for engineers, including the new books "Ichiban Yasashii Sofutoea Tesuto No Hon" (rough translation: the easiest software book) and "Sofutoea Tesuto No Kyokasho" (software test textbook).

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

The Company provides software testing services in two ways, through "test center testing services" where it sets up a test center in the Group and establishes a test environment according to customer needs, and through "on-site testing services" where it provides (dispatches) personnel tailored to customer needs*.

* The Company has a general worker dispatch business license.

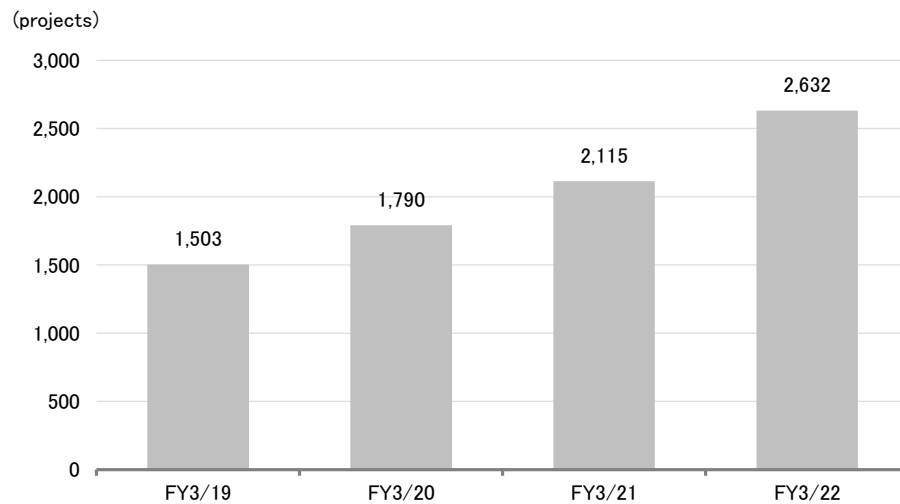
The Company offers three types of contracts: "dispatch contracts" where the Company's engineers are dispatched to provide services under the instruction of customers based on dispatch worker contracts, "quasi-consignment contracts" where services are provided under the instruction of the Company according to the content of agreements with customers, and "consignment contracts" where tests are mainly conducted at the Company's test center and test summary reports and other deliverables are delivered to customers. At present, the majority of contracts are quasi-consignment contracts.

c) KPIs

The Company handles most work under quasi-consignment contracts, and has few consignment contracts where there is a risk of projects becoming unprofitable. Fundamentally, contracts are concluded for each project. However, there are also lots of cases where requests from customers lead to continuing agreements, such as when there are a succession of development projects or development issues, and when there are updates of systems for which an order was received once. That can also be said to be a significant barrier to entry. The order amount varies by project, and its range is wide from several millions to several tens of millions of yen. When projects are continued, however, they sometimes end up generating sales in the hundreds of millions of yen from the customer. Since cumulative sales from those projects account for the bulk of the segment's net sales, it is fair to say that the number of projects is one KPI for the Company's earnings. There were 2,632 projects in FY3/22, and the number of projects has been steadily expanding over the past four years.

Business description

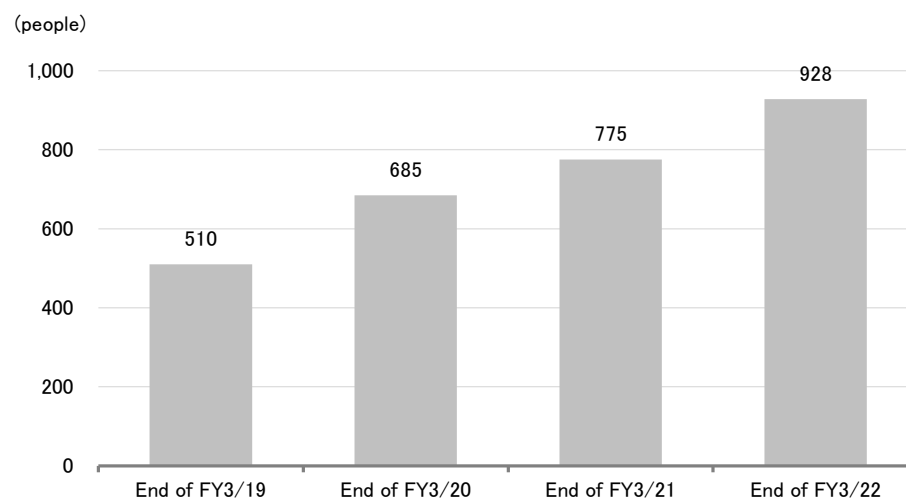
Trends in the number of projects



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

Also, the Company obviously needs engineers to work on the projects it has acquired, and its engineer numbers are an important factor for its business. The Company's engineer numbers are equivalent to manufacturers' production capacity. By increasing its engineers with a certain level of knowledge and experience, the Company increases its production capacity, which, as a result, leads to sales growth. In addition to regular employees and contract employees, the Company's engineers include what it refers to as business partners. At the end of FY3/22, the Company's engineers included 476 regular employees (51.3% of the total), 143 contract employees (15.4%), and 309 business partners (33.3%), and the total number of engineers has steadily grown over the past four years.

Trends in the number of engineers

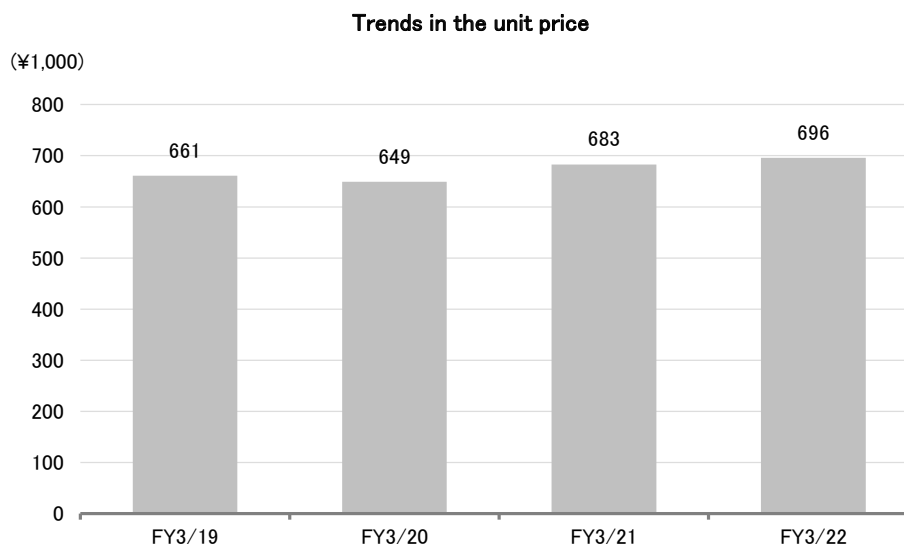


Note: The number of engineers is the total number of regular employees, contract employees, and business partners

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

Business description

Another important factor is net sales per engineer. The Company defines that figure as the “unit price (monthly),” which is “net sales in the software tests segment ÷ the number of engineers.” The unit price declined in FY3/20, partly due to impact from the COVID-19 pandemic, but rose steadily thereafter.



Note: Unit price = net sales in the software tests segment ÷ the number of engineers (regular employees + contract employees + business partners)

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

d) Reasons for outsourcing test process

One reason that customers ask (place orders with) outside companies like the Company to perform software tests is that general system engineers do not receive systematic education about testing and are not test professionals, so it is inefficient for them to do the work. In particular, subcontracted small-scale Sler tend to have the engineers that developed the software conduct testing. However, it is said to generally be difficult to objectively conduct tests on programs that you created yourself. It is like how magazine writers and reporters overlook more issues when editing and proofreading their own work. Furthermore, few developers know systematic and exhaustive testing methods, and developers don't like testing work itself, so having developers handle the testing process often ends up prolonging the testing process and reducing quality (launches with undiscovered bugs). To resolve those issues, outsourcing to external companies has been advancing in recent years.

Another reason for outsourcing is that there is currently a shortage of engineers in Japanese IT industry. The Japanese IT market is expected to continue to grow in the future, driven by digital transformation (DX) initiatives. On the other hand, it is also true that there is a shortage of engineers, and many Sler are often receiving inquiries but having difficulty accepting orders due to insufficient staffing. In this situation, if they were to outsource the testing process, which accounts for over 37% of the entire development process, the freed up resources would enable them to accept orders for new development projects. Also, it is true that major Sler, users, and others are increasingly outsourcing the testing process since in addition to things like shortening the process timeline and assuring quality, it enhances productivity by optimizing human resources.

It can be said that the shift to outsourcing software testing due to this situation is likely to continue to increase further going forward.

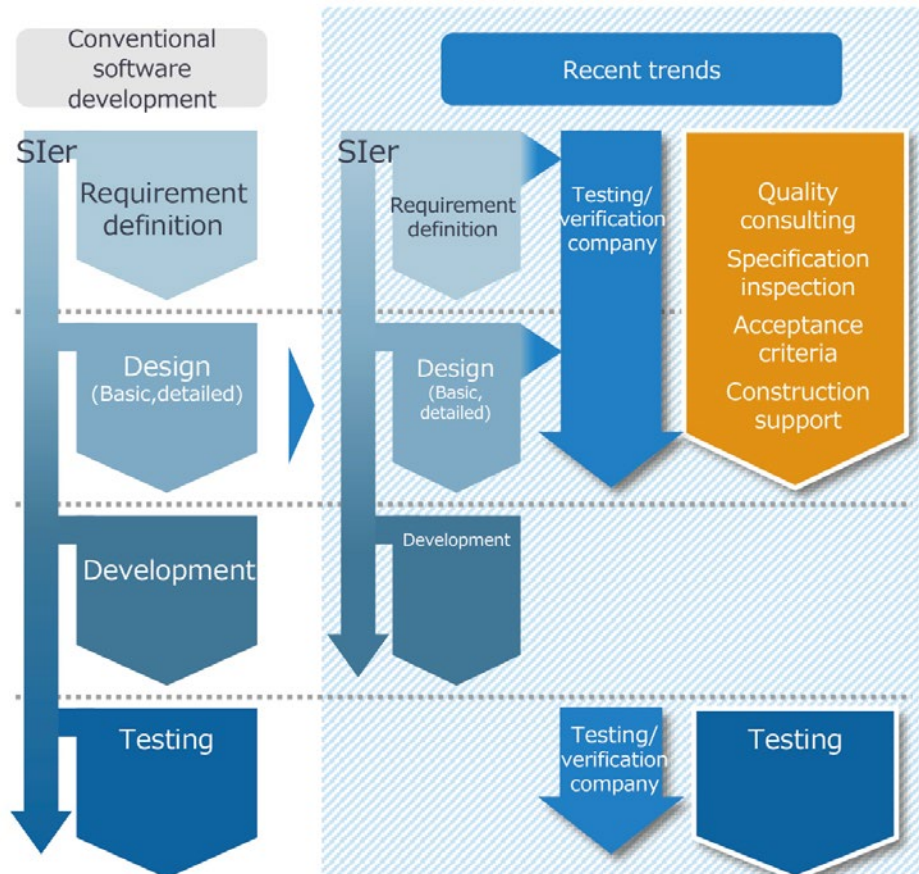
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Business description

Changes in software development workflow



Source: The Company's results briefing materials

(2) Web/mobile app development segment (8.9% share of 1H FY3/23 net sales)

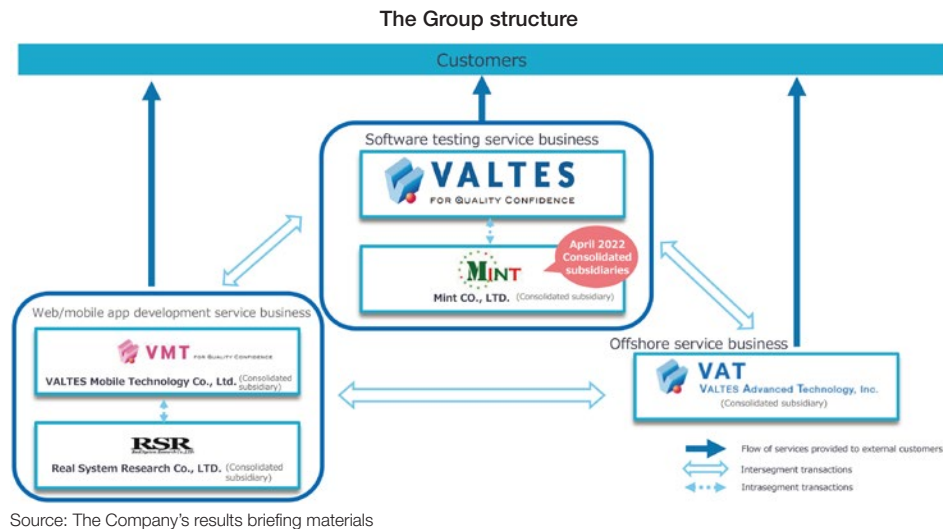
The consolidated subsidiary VALTES Mobile Technology Co., Ltd. develops web/mobile apps, and provides security diagnostics (vulnerability assessments). In web/mobile app development, it can provide one-stop services from planning to requirement definition, design, release, and operation. Also, the Group's management policy is to raise the quality of software, and secure coding based on education from the Company's software testing and security service teams is practiced in providing software development services. In web/mobile app security diagnostics, it provides safety investigations. Skilled engineers' diagnostics expertise is used to create procedures that can discover latent vulnerabilities. Additionally, the consolidated subsidiary Real System Research Co., LTD. undertakes operations such as developing computer software, developing systems on a consignment basis, and dispatching development personnel.

(3) Offshore segment (0.3% share of 1H FY3/23 net sales)

The consolidated subsidiary VALTES Advanced Technology, Inc., which mainly operates in the Philippines, shares know-how with Group companies to provide software testing and software development services to customers, including software vendors and manufacturers. With an inexpensive, ample local labor force, local engineers that have undergone training with the Company's educational content provide services to customers such as Japanese companies and Japanese companies in the Philippines with VALTES Advanced Technology as the point of contact.

Business description

The Group structure described above is summarized in the exhibit below.



(4) Main intellectual property investments

In addition to services for each project, the Company also offers subscription-based services. While the amount of those sales is not disclosed because it is yet small in scale, growth looks promising and conditions going forward will be under focus.

a) Qbook testing information platform

This platform is for improving software quality. The Company provides the testing and quality enhancement expertise it has amassed free of charge, with the aim of increasing its recognition, educating personnel contributing to ICT society, and so on.

b) T-DASH test automation software

This test automation tool enables even non-engineers to easily check and verify the operation of web applications.

c) PrimeWAF pay-as-you-go cloud-based WAF

This simple, low-cost cloud-based web application firewall (WAF) service protects websites from an array of cyberattacks.

d) AnyTest for testing actual equipment anytime, anywhere

This tool enables actual equipment to be operated remotely via a cloud platform. With an extensive model and OS lineup, it features remote yet lag-free operation.

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Business description

2. Features, strengths, and competition

The Company's core business is software testing, and its features and strengths are described below.

(1) Robust experience, knowledge, and insight as a specialized company

As previously mentioned, the Company has continued to engage in software testing business as a specialized company since it was established in 2004 for the purpose of providing software testing services. It has therefore accumulated a wealth of experience and specialist knowledge and insight during this time. Regarding its expertise, it is fair to say the Company has leading technological capabilities in Japan, including having been the first in Japan to obtain Global Partner status for the international certification ISTQB*. This high level of expertise as well as experience and knowledge are creating strong relationships of trust with customers, and that is no doubt one of the Company's strengths.

* Abbreviation for International Software Testing Qualifications Board, an organization for certifying software testing professionals in 130 countries around the world. Only 10 companies in the world are a Global Partner, and the Company is the first in Japan.

(2) Offers testing services for all software development processes

The Company provides testing services covering the entire software development process, from the upstream tasks of requirement definition, basic design, detailed design, manufacturing and unit tests, combined tests, and system tests to the downstream task of user acceptance tests. It can therefore provide one-stop solutions for customers, which is also no doubt one of its strengths.

(3) Unique education method

It goes without saying that number and quality of engineers are an important factor for the Company's business. The Company has therefore established a unique, systematic education method (training curriculum) leveraging the experience and insight gained since its founding to secure high-quality engineers. New graduates without experience undergo 320 hours of training per month and mid-career hires with experience 160 hours per month after joining the Company, concentrating only on training for the first two months after entering the Company and not conducting any regular business during that time. This unique education method aims to quickly turn engineers into competitive forces, while maintaining high skills. As a result, 92% of engineers that have been with the Company for two years or longer have JSTQB* certification. This kind of education method cannot be established in a short period of time, and is one of the Company's strengths as well as a barrier to entry.

* Abbreviation for Japan Software Testing Qualifications Board, a certification organization for software testing professionals in Japan.

(4) Competition

Competitors in the software testing market include SHIFT Inc. <3697>, Pole To Win, Inc., DIGITAL HEARTS HOLDINGS Co., Ltd. <3676>, and VeriServe Corporation (SCSK Corporation's <9719> subsidiary). While their respective market shares are unclear due to the lack of accurate data, the market itself is growing, so the Company apparently faces little direct competition from them. Rather, it can be said that the Company's biggest competition is from the in-house market (Sler, users conducting tests internally, etc.). Since the outsourcing ratio in the software testing market is still low, it appears that the market itself is expanding more than those companies are competing with each other.

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Business performance

Main KPIs improved in 1H FY3/23 and operating profit grew sharply to a record high

1. Overview of 1H FY3/23 results

(1) Profit and loss conditions

In the 1H FY3/23 consolidated results, net sales were ¥4,169mn (+38.7% YoY), operating profit was ¥478mn (+912.2%), ordinary profit was ¥483mn (+893.3%), and profit attributable to owners of parent was ¥310mn (+738.0%). Net sales and profit across the board reached record highs for the second quarter.

In the main KPIs, the “average unit price” (monthly net sales per engineer) was ¥729,000 (+¥63,000 YoY), the number of engineers in operation as of the end of 1H FY3/23 was 1,122 (+257), and the number of projects during 1H FY3/23 was 1,860 (+306), all marking record highs for 1H. As a result, net sales rose sharply and the gross profit margin improved to 28.9% (from 22.9% in the same period of the previous fiscal year). On the other hand, SG&A expenses increased 13.3% YoY, but that was neutralized by growth in gross profit, so operating profit rose sharply.

Analyzing the factors contributing to the change in operating profit shows higher sales boosted profit by ¥266mn (with boosts of ¥251mn in the software tests segment and ¥15mn in the web/mobile app development segment), improvement in the gross profit margin buoyed profit by ¥250mn (with boosts of ¥180mn in the software tests segment and ¥68mn in the web/mobile app development segment, but a drag of ¥6mn in the offshore segment), and a rise in SG&A expenses (with personnel expenses down ¥58mn, R&D expenses up ¥31mn, and other expenses down ¥59mn) depressed profit by ¥85mn.

1H FY3/23 consolidated results

(Unit: ¥mn)

	1H FY3/22		1H FY3/23		YoY
	Result	% of net sales	Result	% of net sales	
Net sales	3,005	100.0%	4,169	100.0%	38.7%
Gross profit	688	22.9%	1,204	28.9%	75.1%
SG&A expenses	640	21.3%	726	17.4%	13.3%
Operating profit	47	1.6%	478	11.5%	912.2%
Ordinary profit	48	1.6%	483	11.6%	893.3%
Profit attributable to owners of parent	37	1.2%	310	7.5%	738.0%

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

Equity ratio improved to 60.9%

(2) Financial condition

As for the Company's financial condition at the end of 1H FY3/23, current assets totaled ¥2,322mn (-¥23mn from the end of FY3/22). This mainly reflected a ¥176mn decrease in cash and deposits, and a ¥114mn increase in notes and accounts receivable - trade, and contract assets (including electronically recorded monetary claims - operating). Non-current assets came to ¥1,065mn (+¥480mn). Key factors were a ¥5mn decrease in property, plant and equipment, a ¥283mn increase in intangible assets mainly due to a rise in goodwill, and a ¥203mn increase in investments and other assets. As a result, total assets came to ¥3,388mn (+¥457mn).

Meanwhile, total liabilities were ¥1,323mn (+¥105mn from the end of FY3/22). This chiefly owes to an ¥83mn increase in accounts payable - trade, and a ¥15mn decrease in long-term and short-term borrowings. Total net assets were ¥2,064mn (+¥351mn), mainly due to a ¥310mn increase in retained earnings from the recording of profit attributable to owners of parent. As a result, the equity ratio was 60.9% (compared to 58.4% at the end of FY3/22).

Consolidated balance sheets

	End of FY3/22	End of 1H FY3/23	Change
(Unit: ¥mn)			
Cash and deposits	1,356	1,180	-176
Notes and accounts receivable - trade, and contract assets (including electronically recorded monetary claims - operating)	919	1,033	114
Total current assets	2,345	2,322	-23
Property, plant and equipment	89	83	-5
Intangible assets	197	480	283
Goodwill	64	360	296
Investments and other assets	298	501	203
Total non-current assets	585	1,065	480
Total assets	2,930	3,388	457
Accounts payable - trade	175	259	83
Short-term borrowings	141	136	-5
Accounts payable - other	387	395	8
Total current liabilities	1,159	1,278	118
Long-term borrowings	54	43	-10
Total non-current liabilities	58	45	-13
Total liabilities	1,217	1,323	105
Retained earnings	1,067	1,378	310
Total net assets	1,712	2,064	351

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

(3) Status of cash flows

In 1H FY3/23, net cash provided by operating activities was ¥322mn. The main inflows included ¥482mn in profit before income taxes, ¥29mn in depreciation, and an ¥84mn increase in trade payables. The main outflows included a ¥98mn increase in trade receivables and contract assets.

Net cash used in investing activities was ¥481mn. The main outflows included ¥100mn for the purchase of investment securities, and ¥296mn for the purchase of shares of subsidiaries resulting in change in scope of consolidation. Net cash used in financing activities was ¥18mn. The main outflows included ¥15mn for repayments of long-term and short-term borrowings. As a result, cash and cash equivalents declined ¥176mn to ¥1,160mn at the end of 1H FY3/23.

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Business performance

Consolidated statements of cash flows

	1H FY3/22	1H FY3/23
(Unit: ¥mn)		
Cash flows from operating activities	18	322
Profit before income taxes	48	482
Depreciation	24	29
Decrease (increase) in trade receivables and contract assets	-12	-98
Decrease (increase) in works in process	28	-
Increase (decrease) in trade payables	16	84
Cash flows from investing activities	-17	-481
Purchase of shares of subsidiaries resulting in change in scope of consolidation	-	-296
Cash flows from financing activities	-16	-18
(Net) increase in long-term and short-term borrowings	-10	-15
Net increase (decrease) in cash and cash equivalents	-16	-176
Cash and cash equivalents at end of period	1,154	1,160

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

2. 1H FY3/23 performance by segment

1H FY3/23 earnings by segment

	1H FY3/22		1H FY3/23		
	Result	% of net sales	Result	% of net sales	YoY
Net sales	3,005	100.0%	4,169	100.0%	38.7%
Software testing services	2,686	89.4%	3,784	90.8%	40.9%
Web/mobile app development	303	10.1%	370	8.9%	22.1%
Offshore	15	0.5%	14	0.3%	-9.2%
Operating profit	47	1.6%	478	11.5%	912.2%
Software testing services	98	3.7%	462	12.2%	368.2%
Web/mobile app development	-24	-8.0%	53	14.4%	-
Offshore	9	59.5%	0	6.6%	-90.0%
Adjustment amount	-36	-	-38	-	-

Note: Net sales do not include internal sales or transfer amounts

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

(1) Software tests segment

In the software tests segment, net sales increased 40.9% YoY to ¥3,784mn, and operating profit rose 368.2% to ¥462mn.

The number of projects steadily expanded to 1,442 (+17.7% YoY), with the acquisition of many large-scale projects in particular leading to sales growth. Key factors included participation in many upstream processes as PMO*1 and QMO*2, growth in acquisition of migration projects*3, and 54.5% YoY growth in the number of companies with annual sales of ¥100mn or more.

*1 Abbreviation for project management office, a department or structural system that supports management of individual projects across the organization.

*2 Abbreviation for quality management office, a department or structural system that supports management of individual aspects of quality across the organization.

*3 Migration means moving software, systems, data, and so forth to a different environment or switching to a new environment.

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Business performance

The “unit price” was ¥729,000 (+¥63,000). Key factors were growth in the share of sales accounted for by the enterprise domain, active hiring of PMO personnel, aggressive proposal of test automation, and existing customers’ ongoing strong performance. Also, the number of active personnel increased a solid 31.6% YoY, by 231 people to 963 people, owing to an increase in the number of applicants, strengthening of relationships with business partners, and steady collaboration with joining companies.

(2) Web/mobile app development

In the web/mobile app development segment, net sales rose 22.1% YoY to ¥370mn, and operating profit improved to ¥53mn from a ¥24mn loss in the same period of the previous fiscal year. In addition to growth in sales of app development and reverse engineering services*, sales related to security and vulnerability assessment were also brisk. On the profit and loss front as well, operating profit was secured since an unprofitable project in the same period of the previous fiscal year dropped out.

* Services entailing creating development documents (all kinds of design documents) by deciphering source code, system operations, and so forth.

(3) Offshore

In the offshore segment, net sales declined 9.2% YoY to ¥14mn, and operating profit fell 90.0% to ¥0mn. Despite an uptrend in inquiries from local Japanese companies in the Philippines, sales and profit declined because negative impact from the COVID-19 pandemic lingered and the amount of business declined.

Outlook

Forecasts FY3/23 operating profit growth of 68.8% YoY, advancing up-front investments looking to future growth

1. FY3/23 forecasts

For the FY3/23 consolidated results, the Company forecasts net sales of ¥8,847mn (+31.9% YoY), operating profit of ¥962mn (+68.8%), ordinary profit of ¥972mn (+67.6%), and profit attributable to owners of parent of ¥647mn (+56.6%). It revised up its forecasts announced in August 2022 for net sales of ¥8,506mn and operating profit of ¥801mn. While its forecasts seem conservative, given that major KPIs steadily increased in 1H, the Company stated that this is because it will prioritize up-front investments looking to the next stage of growth, and its plans appear to have leeway.

FY3/23 consolidated forecasts

(Unit: ¥mn)

	FY3/22		FY3/23		
	Result	% of to net sales	Forecast	% of net sales	YoY
Net sales	6,707	100.0%	8,847	100.0%	31.9%
Operating profit	570	8.5%	962	10.9%	68.8%
Ordinary profit	580	8.6%	972	11.0%	67.6%
Profit attributable to owners of parent	413	6.2%	647	7.3%	56.6%

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

2. Key initiatives for 2H FY3/23

The Company has stated it will continue to actively invest towards sustainable growth in 2H, and intends to prioritize investments looking to the future over near-term profits. It mainly plans to implement measures as follows.

(1) Investments to recruit core personnel for FY3/24

Compared with 1H FY3/23, the Company is increasing recruitment expenses by ¥70mn, in addition to expanding its recruitment team by 1.5-fold. Also, it is temporarily raising placement commissions significantly to recruiting companies. Further, it is promoting initiatives such as launching a recruitment PR team, expanding recruiting advertising, updating its recruitment website, and expanding its business partner recruiting team.

(2) Investments to strengthen the organizational structure for Group expansion

The Company will invest in personal other than engineers to expand the organization. Specifically, it will engage in M&A and take steps to strengthen the organizational structure suitable for Group expansion, as well as invest in measures to strengthen various systems with a view to listing on the TSE Prime Market.

(3) Strengthening marketing

The Company will invest to expand sales of subscription-type self-developed tools such as T-DASH and Prime WAF.

(4) Creating a comfortable work environment

The Company will invest to improve the working environment for employees and to accommodate business expansion, such as by relocating the Tokyo Head Office.

3. Business development in FY3/23

The Company has plans for business development in each segment as follows.

(1) Software tests segment

The Company will work to further increase the size of projects and the unit price by expanding enterprise projects. Specifically, it targets increased participation as PMO and QMO from upstream processes on large-scale projects and growth in the unit price. It also aims to expand orders from target industries such as finance, the public sector, and distribution, as well as win orders for existing system migration projects. Moreover, it will expand financial projects through synergies with the new Group member Mint CO., LTD. Meanwhile, it will continue to stabilize the quality of its techniques through its unique education method. Furthermore, it will bolster relationships with business partners by reinforcing the human resource procurement department functions.

(2) Web/mobile app development segment

The Company aims to expand security business and actively introduce and develop new technologies. Specifically, it looks to help raise profitability by capturing security demand via vulnerability assessments. Also, it will enter the metaverse domain (xR technology) and develop new services, in addition to further promoting sales of reverse engineering services.

(3) Offshore segment

The Company aims to expand business by actively increasing engineers to respond to post-lockdown economic normalization. Specifically, it aims to expand business with local Japanese companies, and deliver stable sales each quarter. Also, it plans on actively hiring engineers and utilizing freelance business partners.

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Medium- to long-term growth strategy

Aiming for sales of ¥10bn in FY3/24








1. Business environment

In terms of the Company's future business climate (market expansion, etc.), it can be said that the following will be tailwinds.

(1) Target industry's growth potential

Naturally, the Company will target markets including various kinds of software and the IT industry going forward, and the global software testing market's compound annual growth rate (CAGR) is forecast at 12.4%, so the industry itself is likely to achieve strong growth.

Software testing market potential

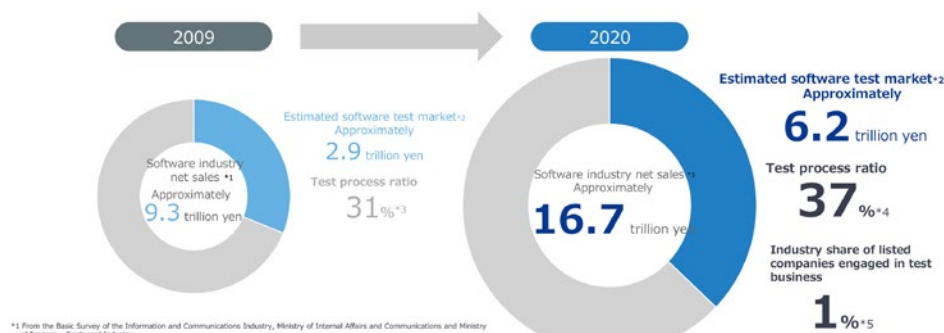
		Scale of market			CAGR	Source
	Enterprise IT	Japan	2024	12.8 trillion yen	3.4%	IDC Japan Japanese enterprise IT market forecast
	AI	Japan	2025	491.0 billion yen	25.5%	IDC Japan Japanese AI system market forecast
	Metaverse	Global	2024	783.3 billion US dollars	13.1%	Bloomberg https://www.bloomberg.com/professional/blog/metaverse-may-be-800-billion-market-next-tech-platform/
	Web/e-commerce	Global	2024	4.9 trillion US dollars	20.7%	eMarketer, Dec2016 Infrastructure Development for a Data-Driven Society in Japan in FY2017 (Market Research on E-Commerce), Ministry of Economy, Trade and Industry, Global BtoC e-commerce market size
	IoT	Japan	2025	10.2 trillion yen	10.1%	IDC Japan Japanese IoT market spending forecast
	Smart automobile/ automated driving	Japan	2025	1.9 trillion yen	19.5%	Yano Research Institute Ltd. Japanese connected car-related market size trends and forecasts
Other Japanese and international software test related industries market scale combined with the overall global potential						
	Software tests	Global	2025	34.49 billion US dollars	12.4%	Technavio Software Testing Services Market by Product, Geography, and End-user - Forecast and Analysis 2021-2025

Source: The Company's results briefing materials

(2) Rise in outsourcing ratio for software tests

According to the Company's research, the Japanese software industry's net sales were ¥16.7tn in 2020, with an estimated roughly 37% (about ¥6.2tn) from testing processes. Moreover, listed companies including the Company only have a mere 1% share in that test market, and, while some unlisted companies are performing tests, the majority are being handled in-house by Sler.

Trends in the ratio of testing processes to software industry net sales and estimated market scale



*1 From the Basic Survey of the Information and Communications Industry, Ministry of Internal Affairs and Communications and Ministry of Economy, Trade and Industry.
 *2 Calculated by multiplying software industry net sales by the test process ratio.
 *3 From white paper on software development data, Information-technology Promotion Agency, Japan (IPA).
 *4 From Software Development Data Collection 2020, Information-technology Promotion Agency, Japan (IPA).
 *5 From the total sales of listed companies mainly engaged in the testing and debugging business.

Source: The Company's results briefing materials

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Medium- to long-term growth strategy

For Sler, outsourcing these testing processes, which account for 37% of total development, frees up resources that can be diverted to new development projects, in addition to shortening the process timeline, ensuring quality, and leading to higher productivity via human resource optimization. Meanwhile, benefits for users include a reduction in personnel assigned to testing processes, quality maintenance, and a reduction in rework man-hours for Sler and development companies placing the orders. Given these points, the outsourcing ratio in the software testing market is expected to continue to rise moving forward, and is bound to be a tailwind for the Company.

2. Basic strategies

The Company plans on achieving both growth in scale and high profitability, mainly by implementing the four basic strategies of (1) investment in human capital, (2) expansion of enterprise domain, (3) expansion of intellectual property, and (4) M&A and organizational strengthening, as well as controlling investments.

(1) Investment in human capital

The Company will sustain growth by promoting proactive, systematic recruitment of human resources, quick turning of inexperienced human resources into competitive forces, advancement of seasoned personnel's skills, and effective use of external human resources.

(2) Expansion of enterprise domain

The Company aims to improve profit margins and build barriers to entry by advancing the establishment of specialized departments, hiring of high-level personnel, collaboration with external parties, and accumulation of knowledge.

(3) Expansion of intellectual property

The Company will build barriers to entry and create new value by promoting the accumulation of testing and training know-how, accumulation of knowledge, development of new technology, and investment in and collaboration with new technology companies.

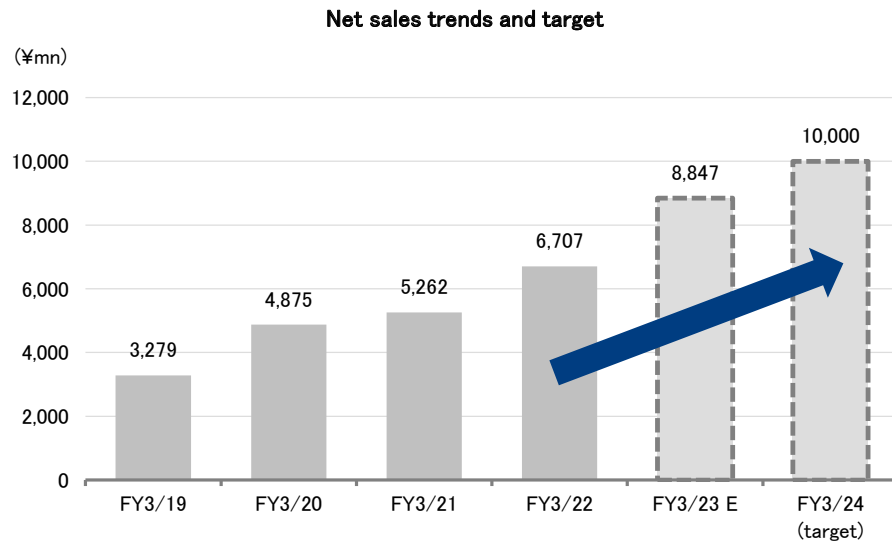
(4) M&A and organizational strengthening

The Company aims to increase its sales, corporate value, and ability to respond to changes in the environment by advancing M&A in existing domains, portfolio diversification, optimization of M&A organizational structure, and improvement of Group governance.

3. Numerical targets

The Company has set net sales of ¥10bn in FY3/24 as a quantitative target. Since it forecasts net sales of ¥8.84bn in FY3/23, that target can be said to already be within range. The Company has not disclosed profit targets at this time as it plans on investing to advance to the next stage.

Medium- to long-term growth strategy



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

Shareholder return policy

Prioritizing internal reserves with an eye to growth

The Company has not announced any particular shareholder returns policy, and plans on no annual dividends. This is because it intends to prioritize internal reserves over profits to accelerate growth since its business is currently growing. In fact, the Company forecasts ROE of 31.3% in FY3/23, which means shareholders can receive high returns, so it should not really be an issue even if it does not pay dividends. However, the Company is bound to announce a shareholder returns policy at some point in time.

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