

DIGITAL HEARTS HOLDINGS Co., Ltd.

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Accelerating growth of the system testing business, which it is focusing on transforming into a second earnings pillar after the game debugging business

In Q1 (April to June), results were driven by debugging, and the Enterprise Business grew by 1.5 times YoY

DIGITAL HEARTS HOLDINGS Co., Ltd., <3676> (hereafter, also “the Company”), in its FY2019 Q1 (April to June) results, achieved net sales of ¥4,988mn (up 12.1% year-on-year (YoY)), operating income of ¥189mn (down 37.2%), ordinary income of ¥189mn (down 37.0%), and profit attributable to owners of parent of ¥112mn (down 38.2%). Net sales were a new record high for Q1. Sales increased in both the Entertainment Business and the Enterprise Business, while in the Entertainment Business, debugging sales grew by double digits and drove the results overall. Also, the Enterprise Business, which the Company focuses on, grew by 1.5 times YoY. Conversely, profits decreased, but this was because the Company actively conducted upfront investment. Since the change of President in June 2017, the Company has established a new management structure, positioned the current time as the “second startup period,” and implemented management reforms. What is most important in this second startup period is the expansion of the Enterprise Business, and in FY2019 Q1, the Company, as indispensable actions, has actively invested in human resources and taken measures related to next M&A or business alliances. Especially investments in human capital is one of the most important measures for building a solid business foundation to meet the outsourcing needs of system testing, which is expected to increase in the future.

In the Entertainment Business, results trended favorably for the mainstay debugging

In results by segment, in the Entertainment Business, which mainly covers the debugging of console games, mobile games, and amusement equipment, the outsourced development of games, and support for promotional activities and other services, net sales of this business segment were ¥4,033mn (up 6.2% YoY) and segment profit was ¥727mn (up 7.3%). For the mainstay debugging, in services for console games, proposal-type sales activities that accurately meet customer needs and include continuous measures to improve service quality were successful, leading to the acquisition of multiple large-scale projects. In addition, the amusement equipment industry, in which the severe market environment has continued, has begun to show signs of a recovery. On the back of customer companies' development of new equipment gradually becoming more active, the Company is meeting their debugging needs. And as a result, debugging sales increased significantly to ¥3,444mn (up 10.7%).

In the Enterprise Business, the growth of system testing is accelerating

In the Enterprise Business, net sales were ¥954mn (up 46.3% YoY), while the segment loss was ¥184mn due to the impact of the upfront investment and other factors. For system testing, which is a service to detect defects in enterprise systems, the Company continues to actively invest in human resources in order to secure and develop test engineers who are indispensable to acquiring new projects and to strengthen the system for receiving orders as well. In this situation, it is acquiring projects, including large-scale automotive-related projects, such as for driving tests. Also, the Integrated Control Center, which was newly established in FY2019 Q1, is working to achieve efficient operations management by thoroughly managing test engineers' work conditions and the progress made in projects, and net sales increased significantly to ¥430mn (up 65.8%). In IT services and security services, which provide services such as for outsourced system development, IT support, and security, net sales were also strong at ¥523mn (up 33.4%). Sales of outsourced system development services trended favorably, while in security services, the Company acquired new projects for penetration testing services (a service that identifies vulnerabilities for entire systems) that it jointly provides with Synack, its partner in the United States.

Acquired LOGIGEAR CORPORATION in the US. Aiming for discontinuous growth of system testing

As of August 1, 2019, the Company acquired LOGIGEAR CORPORATION (LogiGear) of the United States through acquiring its shares and by undertaking a third-party allotment of capital implemented by LogiGear. The aim is to utilize the cutting-edge technologies of LogiGear, which has advanced technological capabilities and a strong track record for the automation of testing. The group companies of LogiGear, which are in Vietnam and Japan, also became the Company's affiliates. The Company will utilize the technological capabilities and expertise of the LogiGear Group and the sales capabilities of Digital Hearts Co., Ltd. to focus on acquiring large-scale continuous testing projects with high affinity with the automation of testing, mainly in the Japanese market where the automation of testing has not yet spread, toward realizing the discontinuous growth of the system testing business.

Period up to FY2019 1H is for active investment, while 2H onwards is the phase to recover earnings

For the FY2019 results, the Company is forecasting net sales of ¥23,000mn (up 19.5% YoY), operating income of ¥1,800mn (up 12.1%), ordinary income of ¥1,830mn (up 10.8%), and net income attributable to owners of parent of ¥1,250mn (down 20.7%). Although the rates of progress toward achieving the full fiscal year profit forecasts as of Q1 are not particularly high, the Company plans to continue aggressive investment in specialist human resources, etc. in the 1H, looking to make a leap forward from the 2H onwards. Therefore, the progress made would seem to be basically in line with the Company's expectations. The results of the LogiGear Group are scheduled to be included from Q3 or Q4 onwards with a negligible impact expected on the FY2019 forecasts, but we anticipate synergies from these companies joining the Company's Group, including from utilizing their automation tools.

For investment in human resources, which has been conducted continuously up until now, the Company instantly acquired around 500 test engineers through acquiring the LogiGear Group, so it is possible that this investment will settle down. However, even when utilizing automation tools, it is difficult to automate whole of the testing process, so the investment in human resources is expected to continue, albeit on a smaller scale.

Aiming for system testing net sales of ¥10bn and a ratio of testing automation projects of 70% in three to five years

In order to grow the system testing business to be the second pillar of earnings after the game debugging business, the Company acquired the LogiGear Group, which has testing automation technologies, and set a strategy of realizing the discontinuous growth of the system testing business. In terms of the market environment, agile development, in which software is developed in a short period of time, is spreading, and continuous updates, such as to improve operability and add functions, is occurring due to the acceleration of the shift to cloud computing. As a result, testing is frequently conducted in a short cycle with consistent environments, procedures, and settings, and therefore the need for low-cost and efficient testing is growing. The Company is responding to this rising demand through the automation of testing. Going forward, it is aiming to increase the ratio of tests including automation processes to 70% and is focusing on acquiring testing projects in the industries where paradigm shifts are taking place. The targeting industries are 1) software, which has a high affinity with automation of testing, 2) markets that are expected to grow continuously in the future, and 3) markets in which processes are expected to be outsourced quickly (because the enormous amount of testing work cannot be handled only by the resources within a company, and there are no engineers with system testing expertise within a company). The Company considers industries such as distribution (e-commerce), automotive, and information and communication (applications).

The numerical targets for the system testing business are net sales of ¥2.5bn in FY2019, ¥5bn in FY2020, and ¥10bn from FY2021 onwards. The plan is to increase the ratio of tests including automation processes to 10% in FY2019, 40% in FY2020, and 70% from FY2021 onwards.



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