

DIGITAL HEARTS HOLDINGS Co., Ltd.

3676

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Continued aggressive investment in 1H, signs of significant earnings recovery in 2H

1. Debugging and system testing both performed strongly, Enterprise Business moves into black in Q2 (July to September)

DIGITAL HEARTS HOLDINGS Co., Ltd. <3676> (hereafter, also "the Company"), in its FY2019 1H (April to September) results, achieved net sales of ¥10,222mn (up 9.5% year-on-year (YoY)), operating income of ¥518mn (down 33.3%), ordinary income of ¥513mn (down 32.0%), and profit attributable to owners of parent of ¥277mn (down 45.4%). The Company is currently in its "second startup period" and is focusing on the pursuit of further growth in its mainstay Entertainment Business and expansion of the Enterprise Business to develop a successive second earnings pillar, with strong net sales in Q2 consolidated results for the key debugging and system testing services. The Entertainment Business and Enterprise Business both recorded increased sales, reaching record highs. Conversely, profits decreased, but this was because the Company actively engaged in investment for future growth such as recruiting engineers and undertaking M&A. The Enterprise Business, on which the Company is placing its highest priority focus during the second startup period, moved into the black during Q2 (July to September) with improvement in the gross profit margin due to an enhanced test engineer operating rate.

2. In the Entertainment Business, the debugging mainstay increased in sales and profits

In results by segment, in the Entertainment Business, which mainly covers the debugging of console games, mobile games, and amusement equipment, outsourced development of games, and support for promotional activities, net sales of this business segment were ¥8,127mn (up 3.2% YoY) and segment profit was ¥1,487mn (down 1.6%). For the mainstay debugging, sales increased for console games, mobile games, and amusement equipment. Services for console games, in particular, achieved a significant increase in sales due to receiving projects for multiple major titles. And needs of debugging services for amusement were steadily incorporated into new equipment development while the market trends are recovering from a strongly regulated severe environment. Sound results can be expected from the debugging business in 2H. In the media business, particularly in 4Gamer.net, made a good result of the business through the successfully speedy transmission of high-value-added information due to exclusive reports, and additionally customer support services steadily captured projects as well. The creative business, however, decreased in sales due to a significant reduction in new title developments in mobile games, becoming a cause for reduced profits in the Entertainment Business overall. The harsh operating environment will continue for creative services in 2H, but the Company is aiming for improved sales and profits through such means as strengthening collaboration between creative and debugging services.

3. The Enterprise Business went into the black for the first time under the second startup period

In the Enterprise Business, net sales were ¥2,094mn (up 43.5% YoY), while segment loss was ¥181mn (against a loss of same period of the previous year's ¥119mn) due to the impact of moving ahead with alliances and M&A to expand the business. The Company increased the number of new graduate and mid-career recruit test engineers (including candidates) by about 40 from the end of FY2018 Q4, so the segment booked a loss of ¥184mn in FY2019 Q1 (April to June), but became profitable for the first time ever under the second startup phase in FY2019 Q2 (July to September), suggesting the framework is in place for the segment to gradually improve profitability.

The Enterprise Business mainly provides system testing and outsourced system development for enterprise systems, IT support and security and other services. For system testing, the Company continues to actively invest in human resources to secure and develop test engineers who are indispensable to acquiring new projects. The newly established Integrated Control Center is working to achieve efficient operations management by thoroughly managing the work conditions of test engineers and their progress in projects. Furthermore, through an M&A on August 1, 2019, the Company took into its Group LOGIGEAR CORPORATION (LogiGear) and its subsidiaries. LogiGear is a US company with advanced technological capabilities associated with automated testing and a rich track record. These measures advanced new customer development and expanded the scale of transactions per company, leading to significant revenue growth of 83.4% YoY for system testing. In IT services and security services, outsourced system development performed strongly, while in security services, the Company acquired new projects for penetration testing services of Synack, Inc. from the US, resulting in double-digit expansion as revenue growth was 19.7% YoY. The Company plans to consolidate LogiGear group from FY2019 Q4, and forecasts significant growth in net sales in Q4 in system testing in particular.

4. For FY2019, initial plans remain unchanged, while large-scale recovery of operating income is expected from 2H

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%). The Company's actual operating income of 1H was 28.8% compared to the initial full-year target, but as the six months of 1H was originally intended for aggressive investment and 2H for investment recovery, progress has been broadly as the Company intended. In 2H, the Entertainment Business' debugging segment will enter a busy period with its end-of-year peak sales season, while sales in the Enterprise Business will continue at a pace likely to significantly exceed the previous year, leading to expectations of an accelerated recovery in operating income on a consolidated basis with a profit, continuing on from having moved into the black in Q2.

5. Established Red Team Technologies Co., Ltd., a joint venture with LAC, to further expand the security business

One of a closely related business to the Company's main system testing services is diagnosing vulnerabilities and security services for endpoint security. In 2018, the Company started the Cyber Boot Camp training program aimed at developing security specialist human resources from among the testers within the Group and also began collaboration with Synack, whose record includes providing services to the US Department of Defense and US Internal Revenue Service. The Company announced the establishment of Red Team Technologies Co., Ltd. (which the Company has a 60% stake), a joint venture with LAC Co., Ltd. <3857> with the aim of further reinforcing the Company's business foundations. LAC has provided security services mainly to major corporations for more than 20 years and aims to create Japan's leading white hacker services provider by fusing the technologies and other resources of both companies.

The Company announced on November 11, 2019 its intention to acquire treasury stock, aiming to buy back 700,000 shares (equating to 3.18% of the total number of issued shares, excluding treasury shares) for up to ¥500mn. The buyback period will run from November 12, 2019 to February 6, 2020. The Company will continue investment aimed at ongoing growth but seeks to acquire treasury stock from the standpoint of being able to conduct flexible capital policies and shareholder returns.



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