COMPANY RESEARCH AND ANALYSIS REPORT

FUJI SOFT INCORPORATED

9749

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Summary

A major independent IT solutions vendor that celebrated the fifty-year anniversary of its establishment in 1970
Keeping a growth-oriented management approach amid the coronavirus pandemic

1. Company outline and business description

FUJI SOFT INCORPORATED <9749> (hereafter, also "the Company") is a major, independent IT solutions vendor established in May 1970. It has its roots in FUJI SOFTWARE LABORATORY, Ltd., which was established in his home by Mr. Hiroshi Nozawa, the Company's current Chairman and Director, and two other employees. Today, half a century after this establishment, the Group has grown to consist of 28 consolidated subsidiaries, 2 equity-method non-consolidated subsidiaries, and 2 equity-method affiliates, with over 15,000 employees (as of June 30, 2020).

The Company has three reporting segments; the SI (systems integration) Business (system construction and product service), the Facility Business, and Other Businesses. In the mainstay SI Business, it provides a diverse solutions menu, centered on the development of embedded / control software and operations software. The Facility Business entails rentals of office buildings, and Other Businesses includes a BPO (business process outsourcing) services business, a contact center business, and a regenerative medicine business.

2. Its core competencies are "technological capabilities and proposal capabilities"

The Company considers that the reasons why it is chosen by customers are its "high-level technological capabilities and proposal capabilities that continue to evolve every day." It is highly confident in its core competencies of its advanced technological expertise acquired through the development of embedded / control software that requires extremely high levels of precision, such as for vehicles and semiconductor manufacturing equipment; systems construction capabilities cultivated through the solutions it has provided to a wide range of industries; and "technological capabilities and proposal capabilities," that it demonstrates in aspects such as its ability to provide flexible proposals as an independent solutions provider.

3. Strengthening financial structure and has surpassed pre-Lehman Brothers bankruptcy peak sales for three consecutive years

The Company's sales peaked before the economic downturn precipitated by the Lehman Brothers bankruptcy (FY3/06), but it set a new record high for sales in FY12/17 and then achieved double-digit sales growth in FY12/19 as well. So while it actually took more than 10 years to renew its peak sales, the Company can be highly evaluated on the point that during that time, it not only recovered flow profits, it also worked to strengthen its financial structure and growth potential.

Specifically, the Company realized increased soundness in key financial indicators, including that the equity ratio rose from 47.3% at the end of FY3/06 to 51.4% at the end of FY12/20 1H, and the current ratio increased from 96.4% to 161.5%. On the other hand, due to the significant increase in the recruitment of mainly new graduates from FY12/15 onwards, the number of consolidated employees increased by 1.6 times in the same period, from 9,415 people to 15,240 people. The percentage of certified technicians on a stand-alone basis (the percentage of certified specialists and certified project managers, based on the Company system, to the total number of employees) also had risen from 22.8% at the end of FY12/14 to 28.3% at the end of June, 2020. From this, it can be understood that growth potential as seen from the aspect of human resources has been enhanced both in terms of quantity and quality.

4. Results are currently strong, and FY12/20 1H results exceeded the initial forecasts

For FY12/20 1H consolidated results, the Company reported net sales of ¥122,568mn, up 7.9% YoY, operating income of ¥8,446mn, up 26.2%, ordinary income of ¥8,677mn, up 27.1%, and profit attributable to owners of parent of ¥3,868mn, up 3.5%. This marked the fifth consecutive 1H of increasing net sales and profits.

Looking at the achievement rates of these results compared to the initial Company forecasts announced in February 2020, firstly, concerning 1H forecasts (net sales of ¥116,500mn, operating income of ¥6,700mn, ordinary income of ¥6,850mn, and profit attributable to owners of parent of ¥3,850mn), the net sales achievement rate was 105.2%, the operating income achievement rate was 126.1%, the ordinary income achievement rate was 126.7%, while the profit attributable to owners of parent achievement rate was 100.5%. This marked the fifth straight 1H that results exceeded initial forecasts. For operating income, the 1H achievement rate was the highest in the past five years.

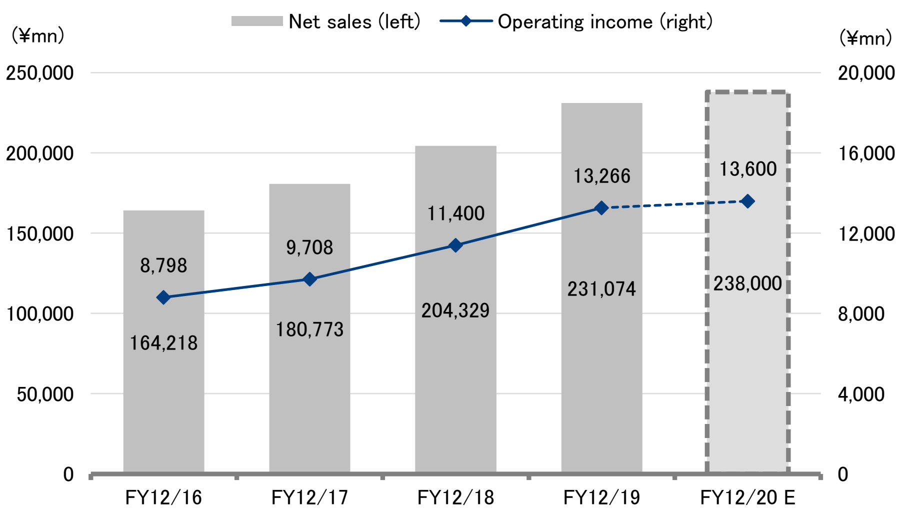
Although the impacts of the novel coronavirus pandemic did not surface so much in 1H flow results, the outlook remains uncertain. Meanwhile, the Company has not experienced significant turmoil in its field operations due to work style reforms including remote work, which it has been actively working on, and the Company is successfully capturing the increase in demand that is becoming apparent in the fields of IT infrastructure system and EC amid the coronavirus pandemic.

The dividend forecast is for an annual dividend of ¥51 per share (a dividend at the end of 2Q of ¥28 per share, which includes a commemorative dividend of ¥5 per share on the 50th anniversary of its establishment, and a period-end dividend of ¥23 per share). This is an increase of ¥9 per share on the FY12/19 annual dividend of ¥42 per share (¥20 per share at the end of 2Q, and ¥22 per share at the period end). If this increase is realized, it will be the fifth consecutive year of higher dividends. On looking in more detail at the current dividend policy in the past 5 years up to FY12/19, even after excluding the commemorative dividend, it can be said to be a forecast of a dividend increase that is unprecedented as a full-fiscal year dividend forecast for the next period that doubles from the previous period-end dividend. Also, with the improvement in full-year results, the Company has increased the year-end dividend above the initial forecast for the past four years in a row. We will pay close attention to how the Company responds amid the coronavirus pandemic.

Key Points

- A major, independent IT solutions vendor established in 1970. Its active investment in human resources and a complementary M&A strategy are proving successful, and it has exceeded the ¥100bn barrier for net sales. At the end of June 2020, it had over 15,000 consolidated employees.
- Its core competencies are "technological capabilities and proposal capabilities," as seen in its abundant track record and corporate philosophy. Results stagnated for a period after the economic downturn precipitated by the Lehman Brothers bankruptcy, but it has strengthened its financial structure and growth potential and is continuing "Challenges and Creation" while aiming to be an innovative corporate group.
- FY12/20 1H results exceeded the Company's initial forecasts for the fifth consecutive year. For full-year FY12/20, despite the coronavirus pandemic, the Company is expecting an increase in both net sales and profits as well as a higher dividend.
- It is impossible to predict the impact of the novel coronavirus, but the work-style reforms that the Company has been actively conducting are proving successful, and there have been no major disruptions at its work sites. Also, the Company is successfully capturing the increase in demand in response to the novel coronavirus pandemic

Results trends



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

Company overview

Based on its corporate motto of "Challenges and Creation," broke through the barrier of net sales of ¥200bn, while remaining independent. The Company is seeing a positive response for the "AIS-CRM" strategy that it is tackling as a growth area.

The Company is a major, independent IT solutions vendor established in May 1970. It has its roots in FUJI SOFTWARE LABORATORY, Ltd., which was established in his home by Mr. Hiroshi Nozawa, the Company's current Chairman and Director, who at that time was a teacher in a computer vocational school and started a business focusing on the prospects for the computer industry with two other employees who had previously been his students. Today, half a century after this establishment, the Group has grown to consist of 28 consolidated subsidiaries (of which, 4 are listed companies), 2 equity-method non-consolidated subsidiaries and 2 equity-method affiliates, with over 15,000 employees.

Even while achieving rapid development in terms of size, the Company, in accordance with its basic philosophy of "Being a corporate group that is more useful for society, makes customers more happy, and that is more considerate to the Earth, and that provides 'relaxed and worthwhile' work environments," has consistently conducted the enlightened management that its founder aimed for to contribute to society through business, and it aims to formulize the knowledge expressed by its corporate philosophy, such as through the Group's corporate charter and the systems to have executives and employees understand it.

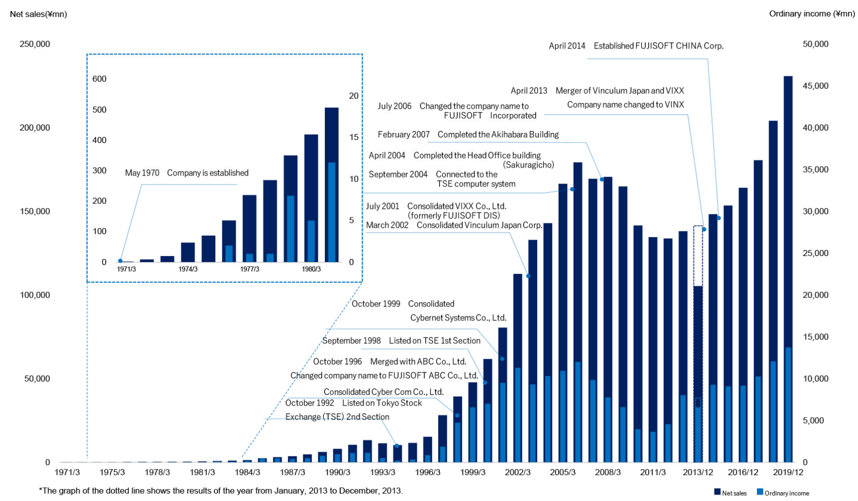
The Company has three reporting segments; the SI Business (systems construction and products and services), the Facility Business, and Other Businesses. In the mainstay SI Business, it provides a diverse solutions menu, centered on the development of embedded / control software and operations software. The Facility Business entails rentals of office buildings, and Other Businesses includes a BPO service business, a contact center business, and a regenerative medicine business. Although the entry into the regenerative medicine business appears at first glance to be an entry into an unrelated business area, it can be said to be a typical example of business creation based on its corporate philosophy.

Also, as a business strategy to be implemented across the reporting segments, the Company is advancing initiatives in the "AIS-CRM" area. This is its own acronym created from AI, IoT, Security, Cloud computing, Robot, Mobile & AutoMotive, and it covers areas that are expected to grow in the medium- to long-term. While it will not be easy to accumulate and refine technologies in these growth fields, if the Company can achieve this, it may be able to keep down the sudden changes to factors that affect the operating rate due to fluctuations in the economic cycle. It appears that the Company is sensing a good response to the results it has accumulated in the cloud domain and the mobile domain among its past initiatives. We will continue to focus on moves going forward.

At the time it was established, the Company's business was founded on the dispatch of computer operators. Subsequently, it entered-into the software development and systems construction businesses and achieved rapid development supported by the explosive expansion of the computer industry. But what should not be overlooked as a factor behind this growth is the conviction of the executive management, including founder Chairman Nozawa that the time of the computer society had arrived, and while bearing a considerable risk, the Company actively invested in recruiting and training engineers and pursued a complementary M&A strategy to incorporate into itself the technologies and customer bases it did not have.

Even as the computer society has become a reality and the domestic IT services market has expanded in scale to be worth over ¥5 trillion, the major IT services companies with sales of more than ¥100bn are comprised almost entirely of manufacturers (such as Fujitsu Ltd. <6702>), user-related companies (such as NTT DATA Corporation <9613>), trading companies (such as SCSK Corporation <9719>), and foreign-owned companies (such as IBM Japan, Ltd.) Including the Company, there are only three so-called independent companies. It has become one of groups with over ¥100bn in net sales in FY3/02, but on looking at the number of employees to achieve this, of 4,002 people on a stand-alone basis and 6,353 on a consolidated basis, we can see that its business expansion has been supported by its active recruitment of human resources and training of engineers since its establishment. Also, in 1996, it merged with ABC Co., Ltd., which has strengths in finance-related operations systems, and subsequently also, it made consolidated subsidiaries of Cybernet Systems Co., Ltd., which has its origins in an overseas company in 1999, and MYCAL Systems Corp. (currently VINX Corp.), whose main business is distribution-related business systems, in 2002. In such ways, the Company has advanced an M&A strategy to incorporate into itself the technologies and customer bases to supplement its strengths in embedded /control software development. It is considered that it would not have been able to exceed net sales of ¥100bn solely from riding the favorable external wave, but that its bold decision making has also been vital to achieving this. Then, in FY12/18, the Company surpassed the major milestone of net sales of ¥200bn, and is forecasting net sales of ¥238bn in FY12/20. Therefore, despite being in the middle of the coronavirus pandemic, the Company is expecting to set a record high in net sales for the fourth consecutive fiscal year.

Since its establishment in May 1970, the Company's size has expanded dramatically



Source: From the Company's 2020 FACT BOOK

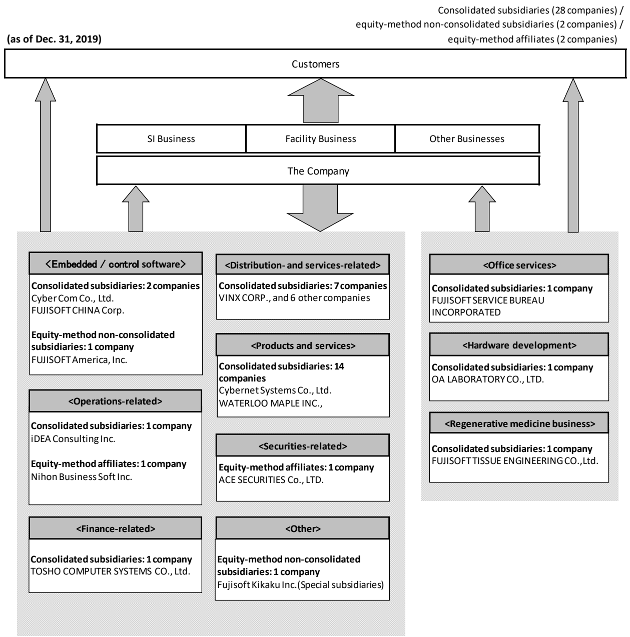
With “technological capabilities and proposal capabilities” as its core competencies, the Company is aiming to be a CSV-style innovative corporate group

The Company considers that the reasons why it is chosen by customers are its “high-level technological capabilities and proposal capabilities that continue to evolve every day.” It is highly confident in its core competencies, of “technological capabilities and proposal capabilities,” that it demonstrates in aspects such as its advanced technological expertise acquired through the development of embedded / control software that requires extremely high levels of precision, including for vehicles and semiconductor manufacturing equipment; its systems construction capabilities cultivated through the solutions it has provided to a wide range of industries; its ability to provide flexible proposals as an independent solutions provider; and its construction of a network of bases close to customers (42 bases in Japan + a global network) . Also, the Company believes that its important mission is for its various business activities to lead to the development of society, alongside sustainable growth and the creation of corporate value in the medium to long term. As its medium-term policy, it is aiming to be “an innovative corporate group that connects the development of ICT to the improvement of value for customers.

What can be read from the messages disseminated by the Company would seem to be “its conviction in the effectiveness and potential of utilizing ICT and its sense of mission to progress this,” and having a “customer-oriented and CSV-type (a company that increases enterprise value through social contributions via its businesses) management policy.” Of course, corporate activities will have CSV-type aspects to a greater or lesser extent, even if the company itself is unaware of this. But in the Company’s case, the fact that the founder’s strong intentions, based on the corporate motto of “Challenge and Creation,” have been incorporated into its corporate culture, is worthy of note.

One of the Company’s unique initiatives as a CSV-type company is the All Japan Robot-Sumo Tournament, which it has held continuously since 1990 and which has grown to become Japan’s largest robot competition. It started with the aim of providing a place to experience the enjoyment of building things and to improve technologies through building robots. But it is currently recognized to be an excellent example of support for developing human resources through manufacturing; for example, since a section for high school students established in 1993, the National Association of Principals of Technical Senior High Schools has joined the operation, and the organizations including the Ministry of Education, Culture, Sports, Science and Technology, and METI are also known as the sponsors as well.

Business structural diagram



Source: From the Company's securities report

Business overview

Offering varied ICT services and products through "Challenge and Creation"

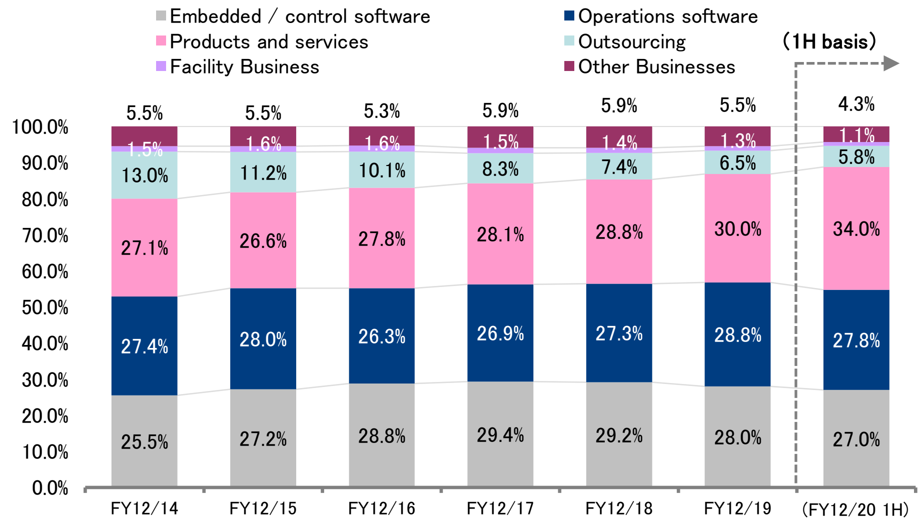
The Company has three reporting segments; the SI Business, the Facility Business, and the Other Businesses. The mainstay SI Business is broadly divided into systems construction, and products and services. Further, systems construction is subdivided into embedded / control software and operations software, while products and services are subdivided into narrowly defined products and services, and outsourcing. Also, the Facility Business entails rentals of office building, while Other Businesses includes the BPO service business, a contact center business, and a regenerative medicine business.

Segment breakdown

Segment name				Breakdown
SI Business				
	Systems construction			
		Embedded / control software		
			Machine control systems	Embedded / control software such as FA, OA, digital home appliances
			Automotive-related	Automotive-related embedded / control software
			Mobile-related	Embedded / control software for mobile devices, etc.
			Social infrastructure-related	Embedded / control software for communication control (switches, routers, etc.), base stations, aerospace and defense, etc.,
		Operations software		
			Financial industry	Operations software for financial companies (life insurance, credit cards, securities companies, banks, etc.)
			Distribution and services	Operations software for distribution-related companies (retail, wholesale, trading companies, real estate, construction industry, etc.)
			Manufacturing industry	Operations software for manufacturing
			Other operations-related	Operations software that does not correspond to the above fields
	Products and services			
		Products and services		Products and services of the FUJISOFT Group and of other companies based on strategic partnerships
		Outsourcing		Data center business, systems maintenance operations, etc.
Facility Business				Sales related to the real estate rentals business
Other Businesses				Office services, hardware development, regenerative medicine business

Source: From the Company's results briefing material

Trends in percentages of total net sales by segment



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

1. Mainstay embedded/control software

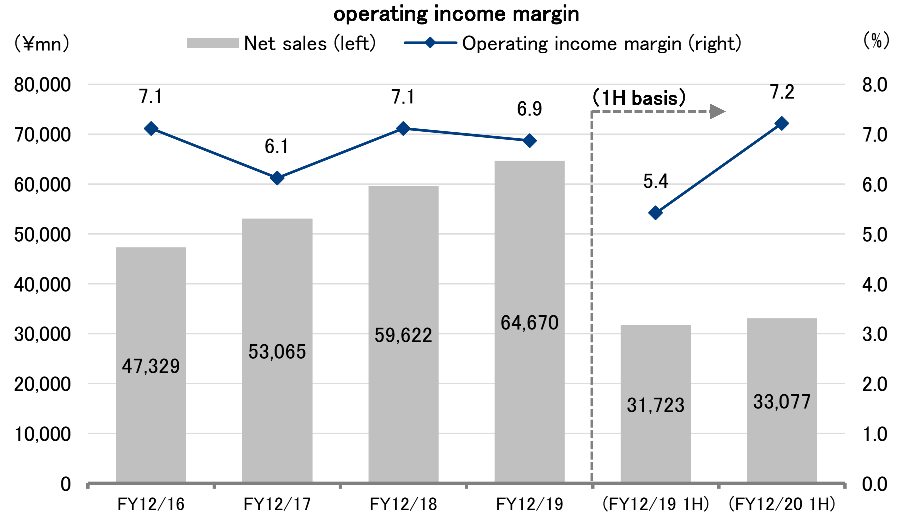
Embedded / control software, which belongs to the systems construction category in the SI Business, accounted for 28.0% of Company-wide sales (FY12/19) and 33.5% of operating income, and the segment profit margin exceeded the Company-wide level. FY12/20 1H performance was solid, as net sales increased 4.3% YoY, operating income rose 38.9%, and the segment profit margin was 7.2% (up 1.8pt). However, although the order backlog at the end of 1H was 3.5% higher than at the end of FY12/19 1H, on an order attainment basis, 1Q (3 months) orders increased 8.0% YoY, but then declined by 5.3% YoY in 2Q, so there is a slowdown trend.

Embedded / control software is software that runs on a microcomputer or other device, embedded into the device to provide specific functions. The Company's technologies are used in a variety of products and devices, including vehicles and mobile phones, home appliances such as TVs and air conditioners, office automation (OA) equipment including printers, robots and semiconductor manufacturing device production equipment, infrastructure equipment such as traffic lights, and medical equipment like CT and MRI.

The Company has accumulated top-class results in Japan in this area, and it has strengths in FA and other machine control systems and automotive-related. If limited to vehicles installations, in practical terms it delivers products to all vehicle manufactures in Japan, and it has the top share of the domestic market.

The developments in the productivity revolution through CASE (Connected, Autonomous, Shared/Service, Electric), AI and robots in the automotive industry are providing a medium- to long-term profit opportunity for the Company. Still, with the coronavirus pandemic, net sales in the CASE domain increased 43% YoY in FY12/19 1H, but this dipped to 12% in FY12/20 1H, so it will be necessary to keep a close watch on the current curbing and postponement of investment.

Trends in embedded / control software net sales and operating income margin



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

2. Further strengthening of initiatives in the online field in operations software

Operations software, part of the system construction category in the SI Business, is a major pillar of earnings, contributing 28.8% of Company-wide net sales (FY12/19) and 24.1% of operating income. Results stopped growing temporarily in FY12/16, but subsequently achieved double-digit increases in sales and profits for third consecutive period. The rate of increase in net sales in FY12/20 1H fell further to a YoY increase of 3.0%, but profit increased by 26.3%, while segment profit margin improved by 0.9pp. Meanwhile, because orders in 2Q (3 months) declined 18.9% YoY, the order backlog at the end of FY12/20 1H was 4.6% lower than at the same point in the previous fiscal year.

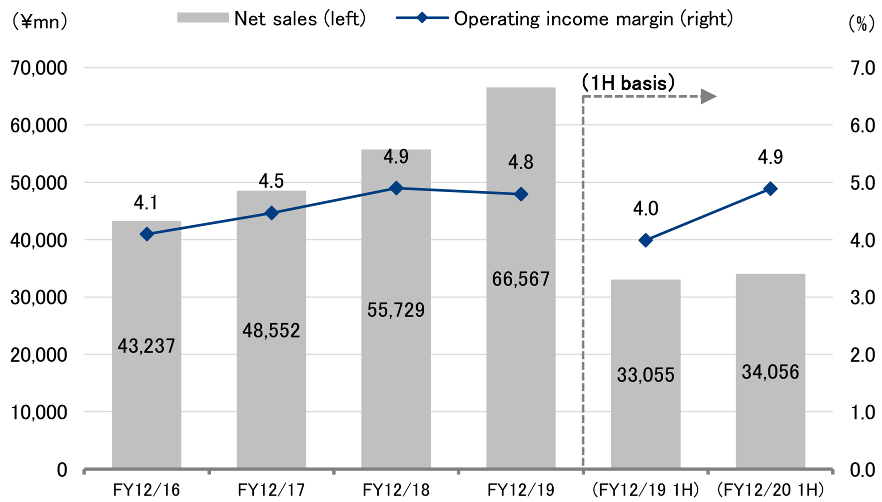
In this area, in addition to organic business growth, the complementary M&A strategy is proving successful, and the Company has established a system that is able to provide a one-stop service, from consulting through to development, systems construction, and support, for various solutions, such as for backbone systems like store and ordering systems and production, sales, inventory, and accounting systems, and also information systems and online services. It provides these solutions to a wide range of industries, including distribution, financial, services, manufacturing, online businesses, social infrastructure, education, medicine, and public institutions.

In the operations software area, which is positioned as the main battlefield in the domestic IT services market, there have been structural changes in the market that could prove to be disadvantageous to the existing players, including 1) the shift from on-premises (operating IT systems, such as servers, through equipment installed within a company) to the use of cloud services, and 2), the evolution from "defensive IT (mainly to improve work efficiency) to offensive IT (mainly to create businesses)." Within this situation, the Company, based on a spirit of seeing "changes as opportunities," has clearly set out and is implementing an approach of strengthening the development of outsourcing through actively investing in human resources. It undoubtedly makes management decisions in accordance with the Company motto, of "Challenge and Creation."

On this point, the strong performance of operations software in recent years can be said to be the result of the Company accurately providing services in response to changing times and the market structure; namely, the shift to e-commerce in the distribution and services fields and the increase in demand in the digital content field, the acceleration of responses to the various digital transformations (DX) in fields centered on systems infrastructure, and the promotion of the utilization of ICT on the theme of work-style reforms.

Also, in January 2020, the Company established a new business department and it is working to further strengthen initiatives in the online business field. This is part of the Company's business strategy that directly addresses an issue that is facing existing players, which is the "inconvenient truth" of the "Amazon Effect" (the phenomenon that includes the disruption of and reforms to various markets alongside the rapid growth of Amazon.com <AMZN>. In addition to the achievements so far, helped by the expansion of stay-at-home consumption due to the coronavirus pandemic, net sales in the EC field (non-consolidated) in FY12/20 1H grew a high 20% YoY, while in addition to BtoC business, BtoB business deals have also performed well, and it is expected that the medium- to long-term growth trend will continue.

Trends in operations software net sales and operating income margin



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

3. Narrowly-defined products and services with increased presence

Products and services in the SI Business are divided into narrowly defined products and services and outsourcing. Narrowly defined products and services provided 30.0% of net sales and 23.7% of operating income in FY12/19. In FY12/20 1H, net sales increased 25.0% YoY, while operating income grew by a large 57.4%. Net sales accounted for 34.0% of the Company's overall net sales, while operating income accounted for 38.5% of the Company's overall operating income, so this is increasing its presence. Also, the pace of order attainment increased 18.5% YoY in 1Q, then accelerated to an increase of 30.8% in 2Q, and the backlog of orders at the end of FY12/20 1H was 50.4% higher than a year earlier. With this, the outlook is for order attainment to be solid over the near term.

Narrowly defined products and services are comprised of 1) the Company's own products (including moreNOTE, a paperless system; Mirai School Station, a comprehensive education solution for the information society; smartBYOD, a tool for utilizing employees' personal smartphones and other devices for a company's operations; and PALRO, a communication robot, and SIM-free mobile routers FS030W and FS040W); 2) the license business (Microsoft <MSFT> products, AWS, VMware <VMW>, etc.); 3) product sales, etc. (PCs, servers, etc.)

Looking at the YoY percentage increase in sales in FY12/20 1H, sales of the Company's own products increased 51% (versus 13% in FY12/19), while license business sales were up 46% (versus 28%) and product sales, etc. grew 3% (versus 15%), so the own products business and the license business showed particular strength. Among its own products, it can be noted as a topic that SIM-free mobile routers, which are products in the AIS-CRM domain, have become hit products with a 50% share in the market. Regarding the "Mirai School Station," the government's GIGA School Program (a system in which the government subsidizes the cost of installing communication networks and PCs at elementary and junior high schools nationwide) has been pushed up amid the coronavirus pandemic, and this could be something that stimulates demand.

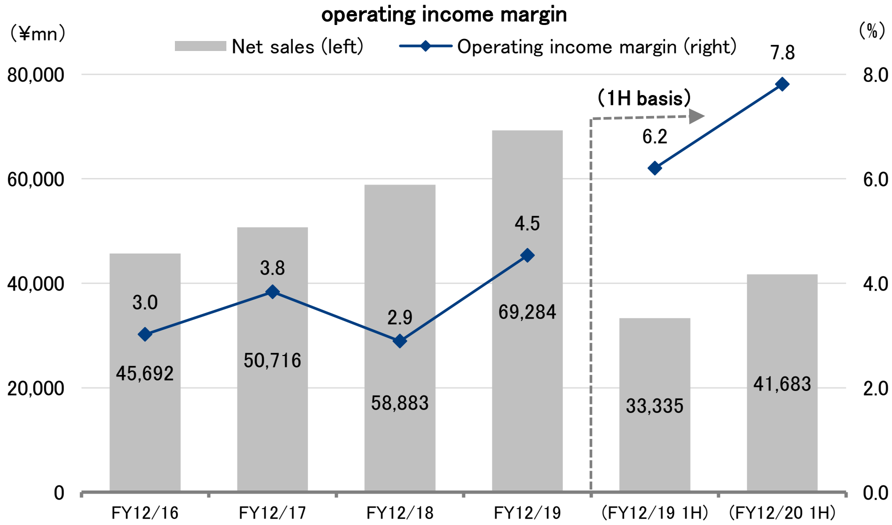
With respect to the license business, sales have continued to increase even after the peaking out of special demand in conjunction with the ending of support for Windows 7 (on January 14, 2020). In addition, generally speaking it is possible that stability in the business has increased thanks to the growing shift to a subscription model for ICT products—a business model in which fees are collected based on length of use, rather than via one-time software sales—including Office 365 and various cloud services. Note that sales of support for deployment of licensed products is recorded in the Company's own products, apparently enabling it to secure high profit margins.

In addition, the Company's series of initiatives backed by long-term personnel development have been highly evaluated by its business partners. Specifically, its achievements since 2019 include: 1) Winning the Modern Device Award in "Microsoft Japan Partner of the Year 2019;" 2) After becoming the first company in Japan to acquire certification of "Government Agency Competency" and "IoT Competency" from Amazon Web Services (AWS), the largest provider of IT cloud services in the world, in 2019, acquiring certification as an APN Premier Consulting Partner which is only granted to partners with particularly excellent track records (May 2020); and 3) Attaining status as a "Principal" (the highest level of certification) in three categories (data center virtualization, network and security, and digital workspace) out of a total of five categories in the new partner system from 2020 implemented by VMware which boasts the largest market share in the world in the IT virtualization market; and winning a VMware 2020 Partner of the Year Award (Cloud Platform Transformation, in Asia-Pacific and Japan).

One of the Company's strengths is that, as an independent SIer, it is able to construct systems flexibly without being tied to specific hardware, but launching proprietary products, including remote education-related products, hardware such as the communication robot and mobile routers, seems to pose unique challenges. The strategy of working to create new added value through the Company's own products that are infused with its core competencies, of "technological capabilities and proposal capabilities," acts in accordance with its corporate motto, of "Challenge and Creation." The Company has said that it is seeking high profitability after the investment phase.

It is worth noting that the segment profit margin for narrowly defined products and services, which up until now had been lower than the Company-wide level, rose to 7.8% in FY12/20 1H, which is the highest in the SI Business segment. In addition to the fact that subsidiary CYBERNET SYSTEMS' profitability continued to improve with upfront investment targeting a bolstering of quality, the sales mix in this category also improved (the products with the thinnest profit margins fell from 50% of sales to 40% of sales, while sales in the license business rose from approximately 25% to 35%, and sales of proprietary products are still around 25%, but on the upswing). Because it depends on the spot sales of products with a wide range of profitability, there is no need to worry about short-term fluctuations in the segment profit margins, but we would like to keep an eye on future trends, as we expect improvements

Trends in narrowly defined products and services net sales and operating income margin

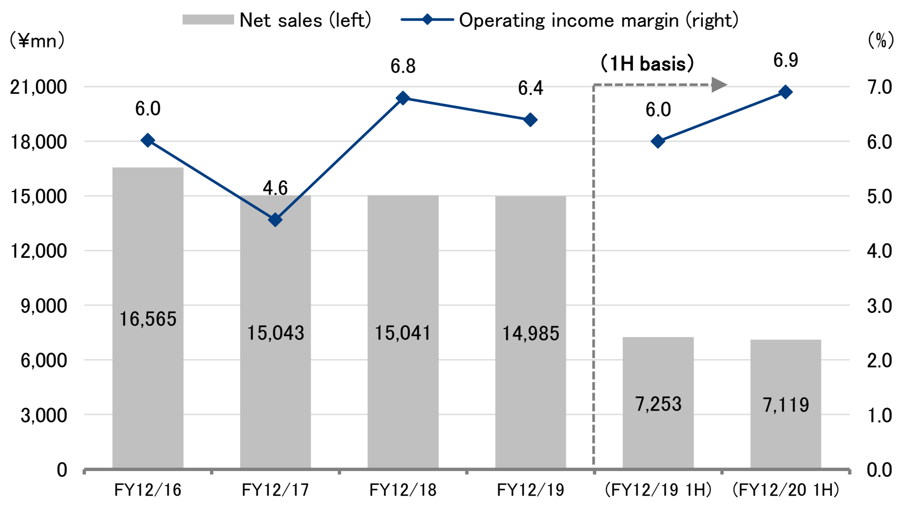


Source: Prepared by FISCO from the Company's results briefing material

4. Outsourcing is searching for the bottom

Outsourcing provides services including data centers and systems operations and maintenance, and in FY12/19 it contributed 6.5% of total net sales and 7.2% of operating income, and it had a segment profit margin of 6.4%. In FY12/20 1H, net sales declined 1.9% YoY, operating income increased 12.5%, while the segment profit margin was 6.9% (up 0.9pp). The order backlog as of the end of 1H was 25.4% lower than at the same time in the prior year. The downward trend in sales in recent years has largely been due to the decrease in ongoing projects for distribution and services, and for the data center business, in which competition with the cloud services of other companies is intense, the Company continues to search for a bottom.

Trends in outsourcing net sales and operating income margin



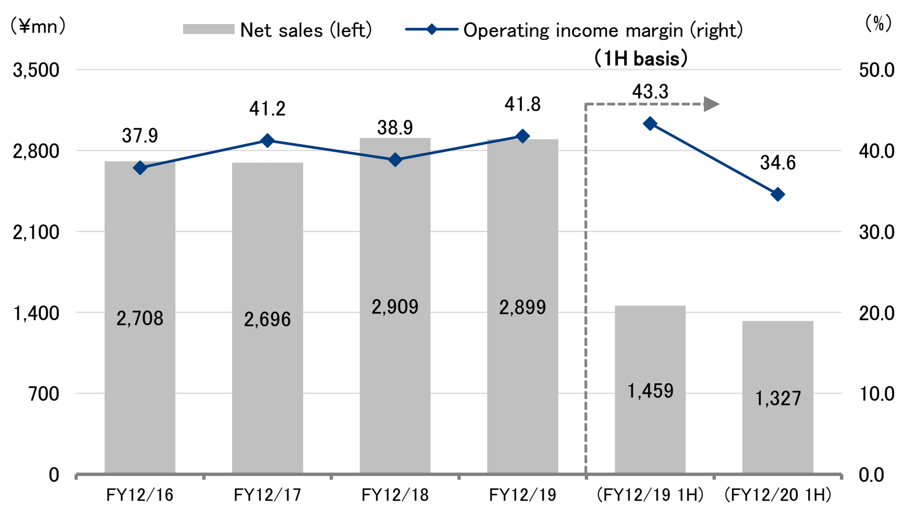
Source: Prepared by FISCO from the Company's results briefing material

5. While it is a non-core domain, the Facility Business has high earnings

The Facility Business, which obtains rental income from the office buildings the Company owns, provides 1.3% of total net sales (FY12/19) and 9.1% of operating income, with a high segment profit margin of 41.8%. In FY12/20 1H, sales decreased by 9.0% YoY and profit decreased by 27.4% due to fluctuation factors within the group and a decline in the occupancy rates of some event spaces and tenant floors, but the segment profit margin remained a high 34.6%. Although it is a non-core domain, it consistently supports the Company-wide profit level.

According to the Company's securities report, there are four properties; the Yokohama Head Office (land-acquisition year: 2000, land and property book value: ¥11,399mn), the Akihabara Office (2005, ¥32,635mn), the Kinshicho Office (2000, ¥6,065mn) and the Monzen Nakacho Office (2003, ¥1,760mn).

Trends in the Facility Business net sales and operating income margin



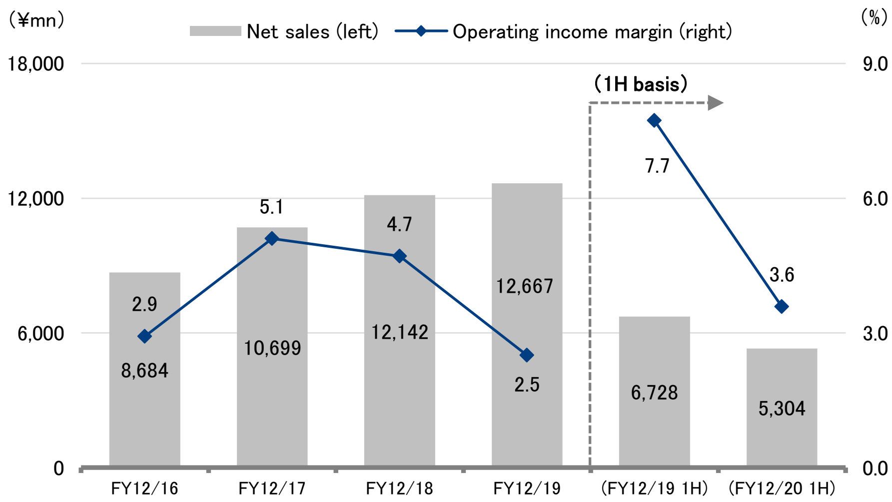
Source: Prepared by FISCO from the Company's results briefing material

6. In Other Businesses, despite a rapid slowdown, subsidiary FUJI SOFT SERVICE BUREAU's results forecast was revised upwards

Other Businesses provides 5.5% of total net sales (FY12/19) and 2.4% of operating income. In FY12/20 1H, sales declined 21.2% YoY, while profits declined 63.4%, marking a rapid slowdown. Segment profit margin declined 4.1pp to 3.6%.

This category's main businesses are the BPO service businesses and the contact center business operated by subsidiary FUJI SOFT SERVICE BUREAU <6188>. The main reason for the decline in performance was that the temporary suspension of FUJI SOFT SERVICE BUREAU's eligibility to participate in competitive tenders for the projects of the Japan Pension Service (from April 8, 2019 to January 7, 2020) applied the brakes to the business. However, the worst is behind it, and on August 5, FUJI SOFT SERVICE BUREAU upwardly revised its results forecast for FY12/20 (April – December) that had been released on May 13.

Trends in the Other Businesses net sales and operating income margin

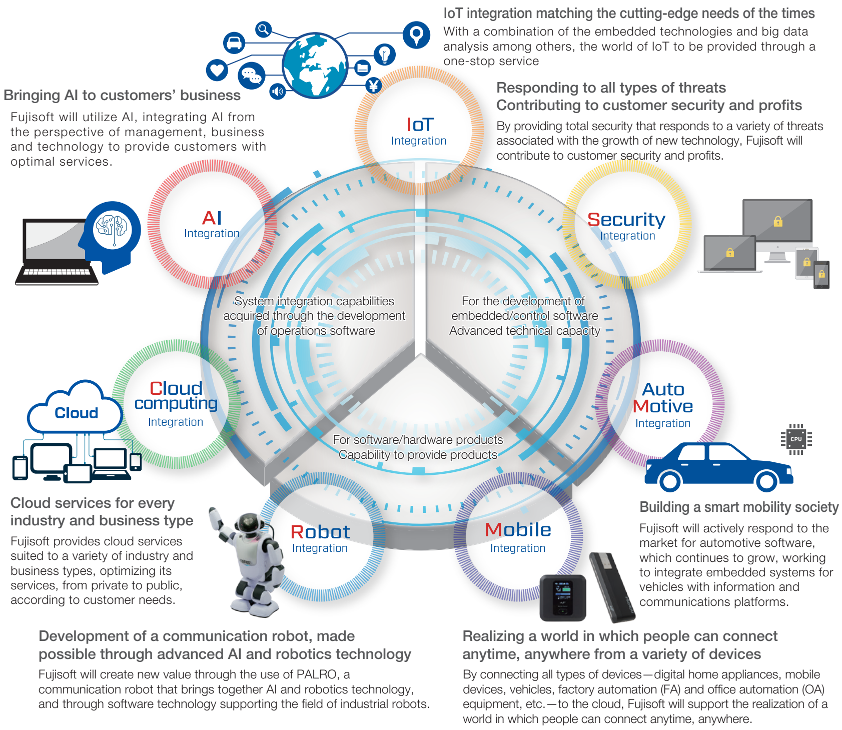


Source: Prepared by FISCO from the Company's results briefing material

7. In the business strategy for initiatives in the "AIS-CRM" area, is taking on the challenge of creating new products and businesses

As previously stated, the Company has positioned "AIS-CRM" as an important-technology field, and it is focusing on creating the seeds of new products and businesses and improving the added-value of existing businesses. At first glance, this might look like it is merely espousing buzzwords, but the superordinate concept of the "AIS-CRM" strategy is included in the Company's core competencies, and the results of these initiatives are steadily being realized. Results are especially strong in the Cloud domain, and SIM-free mobile routers have grown into hit products. Although the details have not been disclosed, the overall "AIS-CRM" domain appears to have already reached a level where it accounts for a majority of the Company's stand-alone net sales.

Summary of AIS-CRM



Source: From the 2019 CSR Report

Results trends

In FY12/19, the Company completely broke all previous results records, and strengthened the financial structure with a backdrop of steady flow business results and carried out proactive upfront investments

The Company's consolidated results have been solid. In FY12/19, operating income increased 16.4% YoY to ¥13,266mn, setting a new record high for the first time in 13 fiscal periods since before the Lehman Brothers bankruptcy (¥12,078mn in FY3/06; it had already set a new record high in FY12/17). In FY12/20 1H, net sales increased 7.9% YoY to ¥122,568mn, operating income rose 26.2% to ¥8,446mn, ordinary income grew 27.1% to ¥8,677mn, and profit attributable to owners of parent rose 3.5% to ¥3,868mn, marking the fifth consecutive fiscal first half of increasing sales and profits.

Looking at the achievement rates of these results versus the initial Company forecasts announced in February 2020 as the 1H plan (net sales of ¥116,500mn, operating income of ¥6,700mn, ordinary income of ¥6,850mn, and profit attributable to owners of parent of ¥3,850mn), net sales achieved 105.2%, operating income 126.1%, ordinary income 126.7%, and profit attributable to owners of parent of 100.5%. This marked the fifth straight 1H that results exceeded initial forecasts. For operating income, the 1H achievement rate was the highest in the past five years.

In this way, in FY12/19 the Company completed the updating of its record high results, and got off to a good start in FY12/20, but it can also be highly evaluated on the point that during this time, it not only recovered flow profits, it also worked to strengthen the financial structure and bolster growth potential.

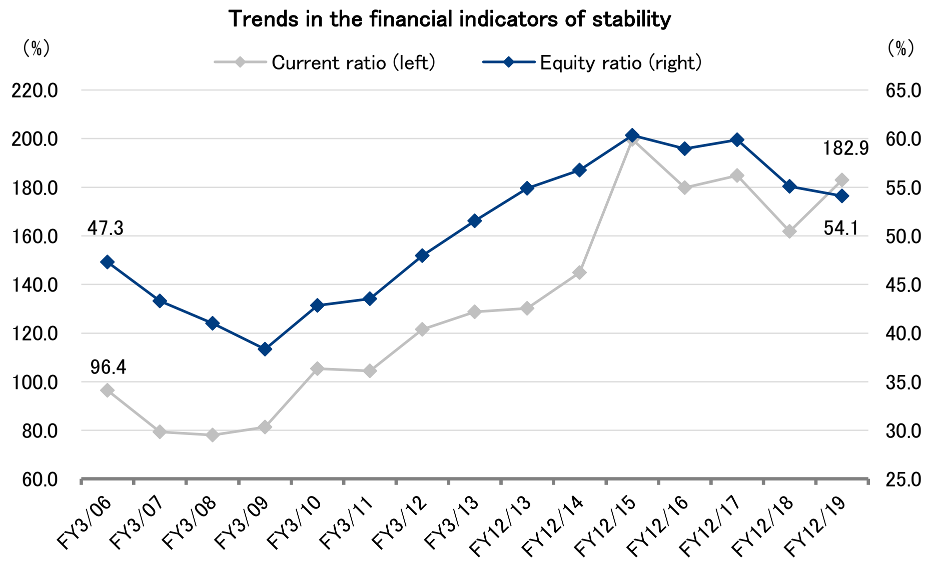
First, looking at the trends in the representative indicators showing the stability of the financial structure, the equity ratio trended from 47.3% at the end of FY3/06, 60.3% at the end of FY12/15, and 51.4% at the end of FY12/20 1H, the current ratio trended from 96.4%, 199.7%, and 161.5%, respectively, and net interest bearing debt (interest bearing debt – cash and cash equivalents) trended from ¥21,295mn, excess cash of ¥3,000mn in FY12/16, and excess cash of ¥13,737mn, respectively, and every indicator is improving significantly, thereby maintaining a sound condition. The deterioration of figures in the most recent period is the result of increase in cash and deposits via short-term loans payable in response to the novel coronavirus pandemic, and is not a cause for concern.

Also, due to the large-scale recruitment since FY12/15, the number of employees has increased by 1.6 times, from 9,415 people the end of FY3/06 to 15,240 people the end of FY6/20. On the other hand, looking at the percentage of certified technicians on a stand-alone basis (the percentage of certified specialists and certified product managers, based on the Company system, to the total number of employees), it had risen from 22.8% at the end of FY12/14 to 28.3% at the end of FY6/20. So the Company has realized both large-scale recruitment and the early training and development of new and young human resources.

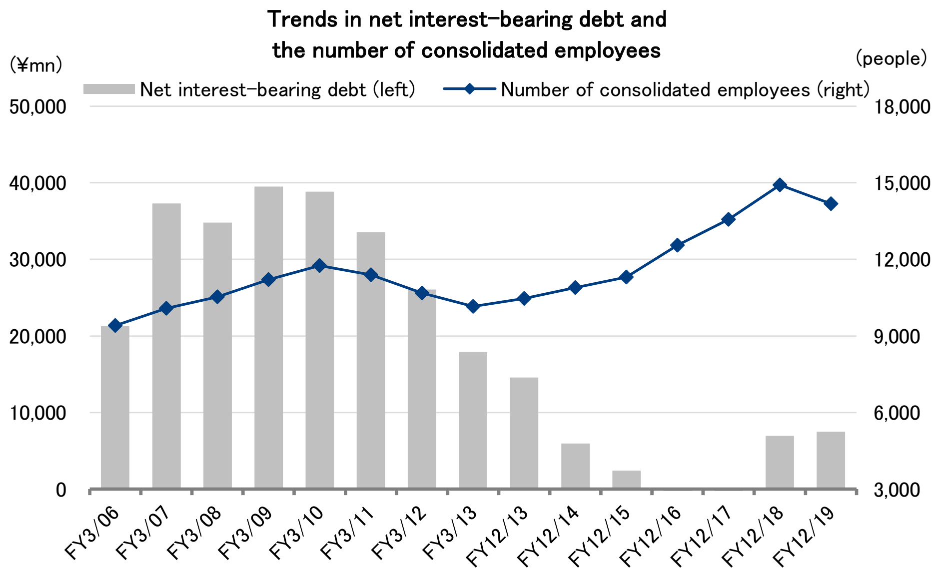
In addition, the capital investment amount increased from ¥3,028mn in F12/14 to ¥22,608mn in FY12/18, and then was ¥8,952mn in FY12/19, while R&D expenses also rose from ¥488mn in FY12/13 to ¥1,011mn in FY12/17, and then were ¥831mn in FY12/19. So the Company has been expanding upfront investment, which together with its investment in human resources, indicates its intention to strengthen growth potential toward “Challenge and Creation.”

Looking here at the relationship between the financial indicators and the management strategy, in FY12/15, which is when the Company embarked on the large-scale recruitment and increased upfront investment, the equity ratio was around the 60% level, the current ratio had improved to nearly 200%, and net interest bearing debt had been reduced to a level of excess cash in FY12/16 and FY12/17. This indicates that FY12/15 was when the Company realized a strong financial structure.

It can be said that the Company’s strengths include its ability to make and implement management decisions quickly through strong leadership, including that of its founder. It did not hesitate to change to “offensive management (actively conducting upfront investment)” precisely because it had progressed “defensive management (strengthening the financial structure)” during a phase of slumping results. So the Company can be highly evaluated for taking dispassionate management decisions that accurately reflect the changes to its business environment.

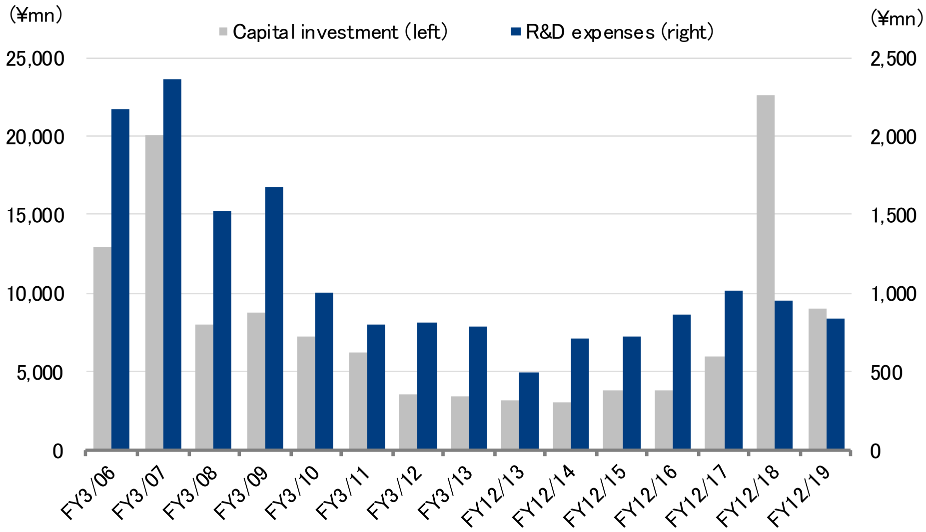


Source: Prepared by FISCO from the Company's securities report and financial results



Source: Prepared by FISCO from the Company's securities report and results briefing material

Trends in R&D expenses and capital investment



Source: Prepared by FISCO from the Company's securities report and results briefing material

Simplified income statements

(¥mn)

	FY12/16	FY12/17	FY12/18	FY12/19
Net sales	164,218	180,773	204,329	231,074
YoY	6.9%	10.1%	13.0%	13.1%
Cost of sales	126,024	138,708	156,808	178,337
YoY	7.2%	10.1%	13.0%	13.7%
Gross profit	38,193	42,065	47,520	52,736
YoY	5.8%	10.1%	13.0%	11.0%
Gross profit margin	23.3%	23.3%	23.3%	22.8%
SG&A expenses	29,394	32,357	36,119	39,470
YoY	6.2%	10.1%	11.6%	9.3%
SG&A expenses ratio	17.9%	17.9%	17.7%	17.1%
Operating income	8,798	9,708	11,400	13,266
YoY	4.5%	10.3%	17.4%	16.4%
Operating income margin	5.4%	5.4%	5.6%	5.7%
Ordinary income	9,166	10,260	12,071	13,749
YoY	0.8%	11.9%	17.7%	13.9%
Profit attributable to owners of parent	5,042	5,797	6,516	7,836
YoY	2.4%	15.0%	12.4%	20.3%

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

Simplified balance sheets

(¥mn)

	End-FY12/16	End-FY12/17	End-FY12/18	End-FY12/19	End-FY12/20 1H	Change
Current assets	67,350	72,457	77,315	88,009	97,746	9,737
Cash and deposits	19,134	18,851	22,554	22,278	30,830	8,551
Notes and accounts receivable - trade	36,727	40,288	44,456	49,570	49,608	38
Non-current assets	96,513	102,110	115,310	119,609	125,181	5,572
Property, plant and equipment	65,796	65,220	82,356	86,334	89,787	3,453
Intangible assets	5,949	6,821	4,738	4,043	4,485	442
Investments and other assets	24,766	30,068	28,214	29,231	30,909	1,677
Total assets	163,863	174,568	192,625	207,618	222,928	15,310
Current liabilities	37,461	39,197	49,428	48,106	60,516	12,409
Notes and accounts payable - trade	9,444	9,977	9,526	13,361	13,094	-267
Short-term loans payable and others	9,410	8,464	16,207	7,158	22,295	15,135
Non-current liabilities	17,400	16,959	23,526	32,691	32,246	-445
Long-term loans payable	6,723	4,182	13,319	22,618	22,272	-345
Total liabilities	54,861	56,156	72,955	80,797	92,762	11,964
(Interest-bearing debt)	16,134	12,647	29,527	29,776	44,567	14,791
Total net assets	109,001	118,411	119,670	126,820	130,166	3,345

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

Simplifies cash flow statements

(¥mn)

	FY12/16	FY12/17	FY12/18	FY12/19	FY12/20 1H
Net cash from operating activities (a)	9,530	9,244	11,192	12,584	5,235
Net cash from investing activities (b)	-4,337	-4,524	-23,424	-9,442	-10,032
Net cash from financing activities	1,076	-4,462	-14,766	-1,451	13,733
Free cashflow (a) + (b)	5,192	4,720	-12,232	3,142	-4,797
Cash and cash equivalents at end of period	21,790	22,157	24,587	26,158	35,079

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

Outlook

The Company is steadily carrying out proactive investment and workstyle reforms, and productivity is steadily increasing even amid the upfront investments

1. For FY12/20, the Company expects higher sales and profits, as well as an increase in dividends despite the coronavirus pandemic

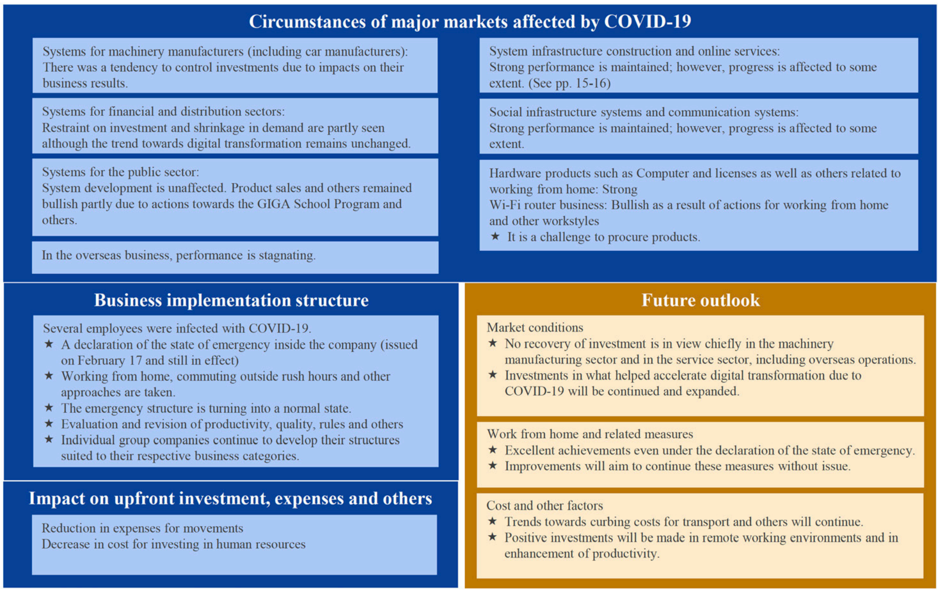
The FY12/20 results forecasts announced by the Company in February 2020 are for net sales to increase 3.0% YoY to ¥238,000mn, operating income to rise 2.5% to ¥13,600mn, ordinary income to grow 0.7% to ¥13,850mn, and profit attributable to owners of parent to climb 2.1% to ¥8,000mn. Since FY12/15, the Company has been setting its initial forecasts by expecting net sales to increase by around 3% and assuming an operating margin of around the same level as in the previous fiscal year's results, and we think that the same pattern was employed in FY12/20.

Looking at the progress rates in 1H versus the full-year forecasts, the net sales progress rate was 51.5%, the operating income progress rate was 62.1%, the ordinary income progress rate was 62.6%, and the profit attributable to owners of parent progress rate was 48.4%. These numbers indicate that both operating income and ordinary income are making solid progress. The average progress rates in the previous four fiscal years (in which results exceeding initial forecasts were realized for each indicator) were as follows: 53.4% for net sales, 51.0% for operating income, 51.4% for ordinary income, and 51.1% for profit attributable to owners of parent. The progress rate in FY12/20 1H for profit attributable to owners of parent was a bit low, however considering the fact that this was mainly the result of loss on valuation of investment securities without cash-out, and the booking of expenses for dealing with the pandemic (which is an extraordinary factor), there is no need to view this particularly negatively.

Although the impacts of the novel coronavirus pandemic did not surface so much in 1H flow results, the outlook remains uncertain in the system construction domain, as indicated by the rapid slowdown in orders in this domain in 2Q. However, the Company has not experienced significant turmoil in its field operations due to work style reforms including remote work, which it has been actively working on, and the Company is successfully capturing the increase in demand that is becoming apparent in the fields of IT infrastructure system and EC amid the coronavirus pandemic. As a result, the large increase in the order volume in the narrowly defined products and services segment (up 50.4% YoY) made up for the weakness in order volume in the system construction segment (down 1.5% YoY), resulting in an 11.2% YoY increase in order backlog as of the end of FY12/20 1H on a Company-wide basis.

The dividend forecast is for an annual dividend of ¥51 per share (a dividend at the end of 2Q of ¥28 per share, which includes a commemorative dividend of ¥5 per share on the 50th anniversary of its establishment, and a period-end dividend of ¥23 per share). This is an increase of ¥9 per share on the FY12/19 annual dividend of ¥42 per share (¥20 per share at the end of 2Q, and ¥22 per share at the period end). If this increase is realized, it will be the fifth consecutive year of higher dividends. Taking a more detailed look at the current dividend policy, even after excluding the commemorative dividend, the dividend is more than the period-end dividend in the past 5 years up to FY12/19 that doubles the previous period-end dividend, making it unprecedented as a full-fiscal year dividend forecast. The Company has stated that its “basic policy is to return profits to shareholders through realizing stable and continuous dividend payments based on a comprehensive consideration of factors including strategic growth investment and the need to respond to sudden changes in the economic environment and to various unforeseen business risks.” From the forecasts of unprecedented dividend increases that have continued since the announcement of a higher interim dividend in 2019, we can sense the Company’s intention to raise its degree of freedom for its dividend policy, while avoiding dividend increases that are weighed more heavily on the period-end dividend. In addition, the Company has raised its period-end dividend from the initial forecast for the past four consecutive years based on an upturn in full-year results, so we are interested to see what the Company will do this time around amid the coronavirus pandemic.

Overview of coronavirus pandemic impact and future outlook



Source: From the Company's results briefing material

Results forecast

(¥mn, %)

	Net sales		Operating income		Ordinary income		Profit attributable to owners of parent		Net income per share (¥)
	Amount	YoY	Amount	YoY	Amount	YoY	Amount	YoY	
FY12/18	204,329	13.0	11,400	17.4	12,071	17.7	6,516	12.4	208.22
FY12/19	231,074	13.1	13,266	16.4	13,749	13.9	7,836	20.3	250.40
FY12/20 (E)	238,000	3.0	13,600	2.5	13,850	0.7	8,000	2.1	255.64

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

2. Productivity is improving from the focus on upfront investment and work-style reforms

On the one hand, the Company is focusing on investing in human resources, centered on the large-scale recruitment of new graduates, while on the other hand, it is assiduously implementing work-style reforms that are tailored to a variety of lifestyles, and providing support for these reforms, toward realizing "relaxed and worthwhile" working environments.

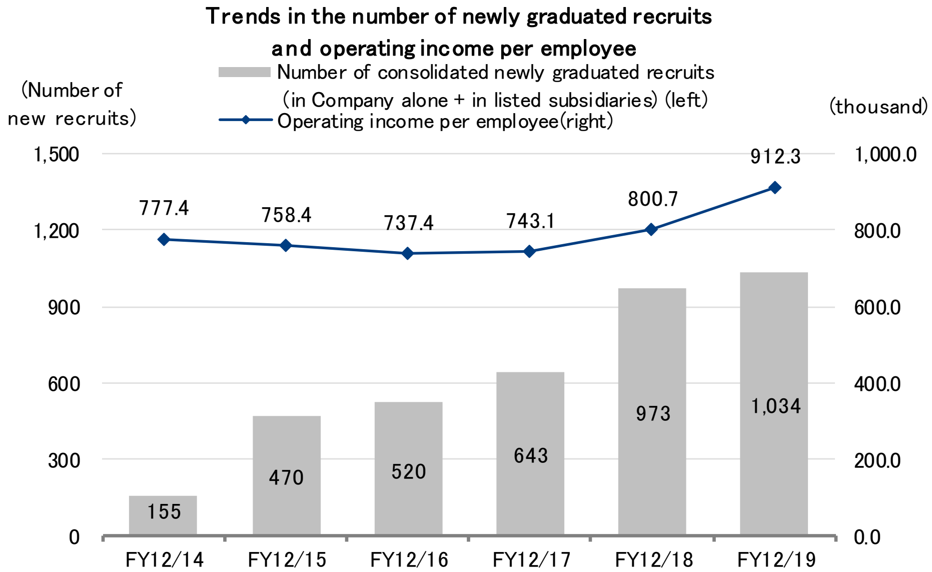
Specifically, based on the upgraded version of the Super Flex System, introduced in 1990 that had no core working hours, the Company introduced the Ultra Flex system (the Super Flex system + a system enabling acquisition of paid-leave on units of 30 minutes without fixing the time period, and 'refresh time' of 10 minutes)," and working to establish a working environment for remote locations and also on the fully fledged management of a teleworking system for which all employees are eligible. As a result of these efforts, in 2018 (the totaling period was April to March), it achieved the following results; 1) paid-leave acquisition rate: 72.9% (private-sector average, 51.1%; government target, 70% by 2020), 2) number of employees using the teleworking system: 5,930 in total, 3) number of employees taking child-care leave: 165, and 4) number of people working more than 80 hours of overtime a month: 0. The Company achieved some excellent results in 2019 as well, including that the number of employees using the teleworking system rose to 9,614 people. These excellent results are also being highly evaluated and recognized by external organizations, including being awarded the Platinum Kurumin Certification based on the Act on Advancement of Measures to Support Raising Next-Generation Children (Ministery of Health, Labour and Welfare) and the highest rank of the Eruboshi Certification based on the Act on Promotion of Women's Participation and Advancement in the Workplace (Ministery of Health, Labour and Welfare). Moreover, it has been included in the Top Hundred Telework Pioneers (Ministry of Internal Affairs and Communications), the Certified Health & Productivity Management Outstanding Organizations Recognition Program (Ministry of Economy, Trade and Industry), and the Kanagawa businesses that promote the support of children and child raising (Kanagawa Prefecture).

In addition, when considering the attitude of management, of attempting to convert the crises facing the Company into opportunities, it can be thought highly likely that, in response to the novel coronavirus pandemic, it will promote work-style reforms even further. So we shall be paying attention to the further steps taken by the Company, which is realizing productivity improvements through work-style reforms even while still providing labor-intensive IT services.

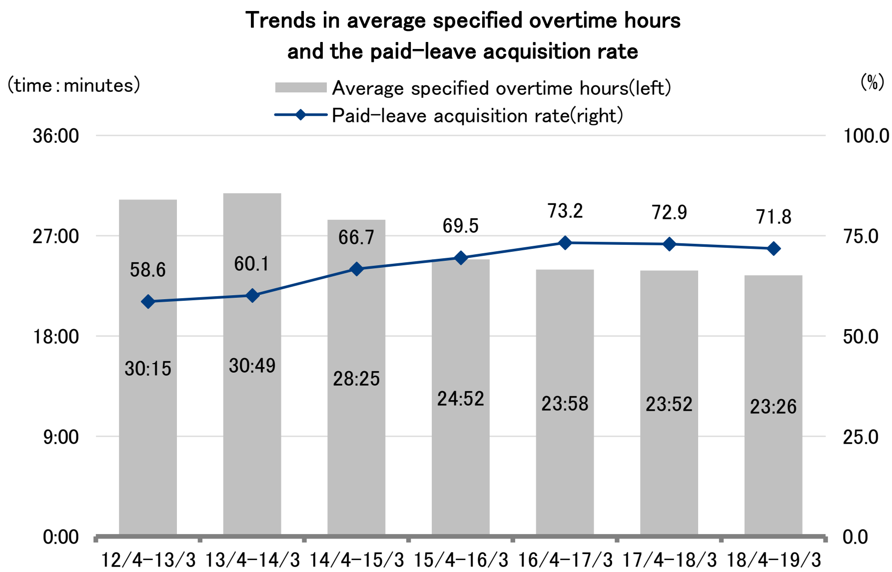
Work-style reforms, which will cause a reduction in the working hours of existing employees, and the large-scale recruitment of new graduates will lead directly to a dilution in the fighting strength of employees and an increase in upfront costs. So in many cases, in the short-term these are factors keeping down the productivity indicator of operating income per employee (operating income / the average number of employees at the end of the period). In the case of the Company, in the two years after FY12/15, when it began the large-scale recruitment of new graduates while producing positive effects from work-style reforms, operating income per employee decreased but since FY12/17, it changed direction and has been increasing. In FY12/19, it improved to just above ¥910,000 (up 24.6% versus FY12/16).

Taking a closer look, the new graduate inclusion rate found using a simple calculation (the number of recruited new graduates in the Company along + in listed subsidiaries / the number of employees on a consolidated basis at the end of the previous year) rose each year, from 1.5% in FY12/14, to 7.2% in FY12/18, and subsequently stayed at a high level in the 6% range. In addition, the FY2019 (April 2019–March 2020) average monthly overtime hours were 23 hours and 26 minutes, which was a significant decline from the 30 hours and 49 minutes in FY2014, while the paid-leave acquisition rate has stayed at a high level above 70% for three straight years from FY2017. Amid this, the Company has achieved an increase in work productivity (operating income per employee increased from just under ¥780,000 in FY12/14 to just over ¥910,000 in FY12/19) in conjunction with the increase in expenses per employee (from ¥5.98 million in FY12/14 to ¥6.09 million in 12/19) (consolidated personnel costs / the number of employees on a consolidated basis at the beginning and end of the fiscal year). This is something that we should evaluate highly, as it appears to be the result of the Company's earnest efforts to improve the work framework and create relaxing and rewarding working environments for employees through the utilization of ICT and by continuously reviewing working forms and the work environment.

Going forward, the remaining room to further reduce overtime and increase the number of people taking paid-leave will shrink, while an increase in remote work efficiency is expected and the new graduate inclusion rate is expected to peak-out. Therefore, the positive effects from improving hourly productivity will become easier to realize. We can have high expectations for the future of the Company, which is aiming to further improve profitability in the long term.



Source: Prepared by FISCO from the Company's securities report and results briefing material



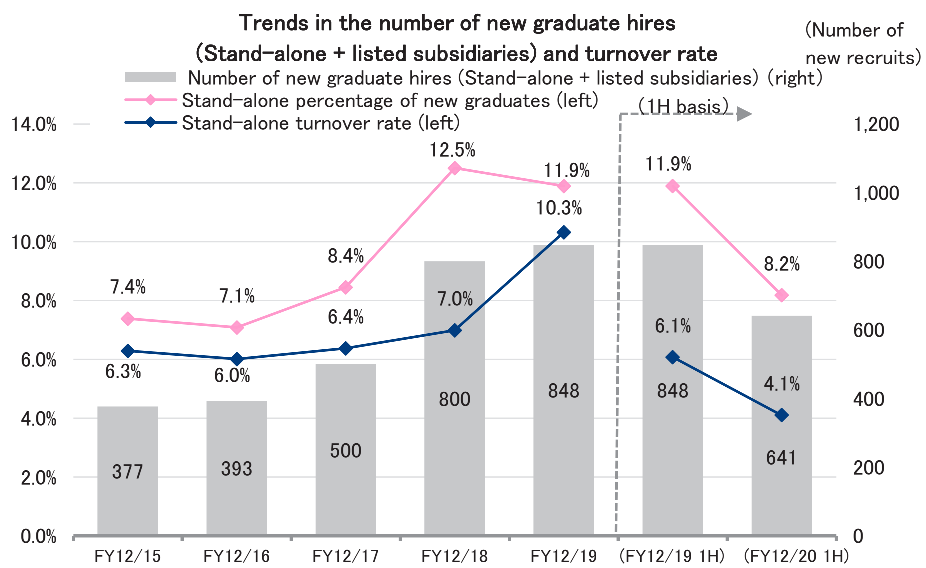
Source: Prepared by FISCO from the Company's CSR report

3. Entered cruising stage for human resource investment and retainment rate improved, so expect emergence of productivity improvement effects

Looked at on a stand-alone basis, which offers a more detailed disclosure of the Company's human resource investment trends, even as the new graduate inclusion rate (the number of recruited new college graduates / the number of employees at previous year's end) jumped from 1.6% in FY12/14 to the 7% range from FY12/15 onward, the turnover rate (the annual number of employees who leave the company / the number of employees at the end of the previous fiscal year) actually settled down from 7.5% in FY12/14 to the 6% range between FY12/15 and FY12/17. However, the FY12/18 new graduate inclusion spiked to 12.5% (a 4.1pp YoY increase), and remained at a high level of 11.9% in FY12/19. This is one factor for the turnover rate rising to 10.3% in FY12/19.

While the absolute turnover rate itself is not at a level that requires excessive concern, given the fact that the Company places particular emphasis on human resource investment, we can see how the Company quickly reviewed the balance between the quantity and quality of human resource investment. Specifically, the Company's per-graduate spending on recruitment training (recruitment training costs on a consolidated basis / the number of new graduates hired by the Company alone plus its listed subsidiaries), which had been on a downward trend (from ¥1.94mn in FY12/14 1H to ¥0.76mn in FY12/20 1H) even as it increased the number of new graduate hires, swung back in FY12/19 1H, to ¥0.91mn (a 18.6% YoY increase), and was maintained at ¥0.90mn in FY12/20 1H. Also, the new graduate inclusion rate (stand-alone basis) (went from 12.5% in FY12/18 to 11.9% in FY12/19 and 8.2% in FY12/20). While the Company is still proactive in hiring new graduates in comparison with companies in general, it seems that the Company is keeping down its new graduate inclusion rate vis-à-vis its previous approach. As a result, the stand-alone turnover rate in FY12/20 1H was 4.1%, which was a 2.0pp decline versus the same period of the previous fiscal year.

Generally speaking, a company's human resource investment entering the cruising stage and the human resource retention rate improving can lead to increased productivity. FY12/20 is both the final year of the three-year results forecast announced by the Company in February 2018 as well as the milestone year of the 50th anniversary of the Company's establishment. Given that the Company will leverage the coronavirus pandemic to strengthen workstyle reforms that will lead to future improvements in productivity, in its next three-year results forecast we can expect the Company to send a message of setting its sights even higher than it has up until now.



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

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