COMPANY RESEARCH AND ANALYSIS REPORT

FUJI SOFT INCORPORATED

9749

Tokyo Stock Exchange Prime Market

27-Apr.-2022

FISCO Ltd. Analyst

Yoshihiro Maeda

FISCO

FISCO Ltd.

https://www.fisco.co.jp

Index

Summary

A major independent IT solutions vendor established in 1970, maintaining an offensive management approach
In the new medium-term management plan, targeting net sales of more than ¥300bn and operating income of more than ¥20bn in three years

1. Company outline and business description

FUJI SOFT INCORPORATED <9749> (hereinafter, "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 at the home of Mr. Hiroshi Nozawa, the Company's current Director and Executive Adviser, and two other employees. Today, half a century after this establishment, the Company has grown into a group with 31 consolidated subsidiaries, 2 equity-method non-consolidated subsidiaries, and 1 equity-method affiliates, with over 15,000 employees (as of December 31, 2021).

The Company has three reporting segments: the SI (systems integration) Business (system construction and product service), the Facility Business, and the 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, while the Other Businesses includes a BPO (business process outsourcing) services business, a contact center business, and a regenerative medicine business.

Also, since FY12/17 it has been progressing initiatives in the AIS-CRM domain. This is a word the Company made up from an acronym of AI, IoT, Security, Cloud computing, Robot, and Mobile&AutoMotive, and it covers areas that are expected to grow in the medium to long term.

2. Its core competencies are "superiority in technologies and deep customer insight"

The Company lists its "continually advancing superiority in technologies and deep customer insight" as the reasons why it is chosen by customers. It is highly confident in its core competencies of 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 "superiority in technologies and deep customer insight" which it demonstrates in aspects such as its ability to provide flexible proposals as an independent solutions provider.

3. Efforts to strengthen the Company's financial structure and enhance its growth potential have been well balanced ever since the 2008 financial crisis, underpinned by a flexible management strategy

Although the Company's sales peaked before the economic downturn precipitated by the 2008 financial crisis (FY3/06), it set a new record high for sales in FY12/17. Therefore, while it actually took more than 10 years to renew its peak sales, the Company can be highly evaluated for not only recovering non-recurring revenue, but through a fine balance of both working to strengthen its financial structure based on a flexible management strategy and increasing and augmenting growth potential in that time.

Specifically, the Company realized soundness of major financial indicators, with the equity ratio rising from 47.3% at the end of FY3/06 to 59.9% at the end of FY12/17, the current ratio from 96.4% to 184.9%, and net interest-bearing debt (interest-bearing debt – cash and deposits) amounting to ¥6,204mn in excess cash, down from ¥21,295mn. Meanwhile, from FY12/15 onwards the Company has been engaging in substantial recruitment efforts focused on new graduates, thereby increasing its growth potential. In terms of human resources, the Company has achieved qualitative and quantitative improvements, which has encompassed expanding its workforce by just under 1.6 times on a consolidated basis, having increased its headcount from 9,415 employees at the end of FY3/06 to 14,956 employees at the end of FY12/21. Moreover, the Company has also increased its percentage of certified technicians on a non-consolidated basis (certified specialists and certified project managers under the Company framework as a percentage of the total workforce) from 22.8% at the end of FY12/14 to 32.3% at the end of FY12/21.

As a result, for 5 consecutive periods up to FY12/21, sales increased and ordinary income grew by double digits, and the financial indicators at the end of FY12/21 were an equity ratio of 54.6% (up 3.9 percentage points (pp) on the end of the previous fiscal year), a current ratio of 163.4% (up 10.1pp), and net interest-bearing debt down for excess cash of ¥11,523mn (down from ¥17,864mn at the end of the previous fiscal year and converted to excess cash), and the Company is maintaining a sound financial structure.

4. The FY12/22 consolidated results forecasts are for net sales to increase 3.0% YoY and operating income to rise 2.7%

The Company's FY12/22 consolidated results forecasts are for net sales to increase 3.0% year-on-year (YoY) to ¥265,500mn, operating income to rise 2.7% to ¥17,300mn, ordinary income to grow 2.9% to ¥18,500mn, and profit attributable to owners of parent to increase 6.2% to ¥9,700mn. So the forecasts are for net sales and operating income to increase in actual terms for the ninth consecutive period since it moved to a fiscal period ending in December in 2013.

The Company is forecasting a greatly increased dividend compared to the FY12/21 annual dividend of ¥52 per share (¥26 per share at the end of 2Q and ¥26 per share at the period end) to an annual dividend of ¥109 (¥54 per share at the end of 2Q and ¥55 per share at the period end), which will be the eight consecutive period it has increased the dividend. This significant dividend increase expresses management's intention of actively utilizing capital policies, including returns to shareholders, more than ever before as a company that is committed to improving enterprise value in the medium to long term.

5. In the new medium-term management plan, placing the greatest focus on clarifying the Company's position as its basic strategy

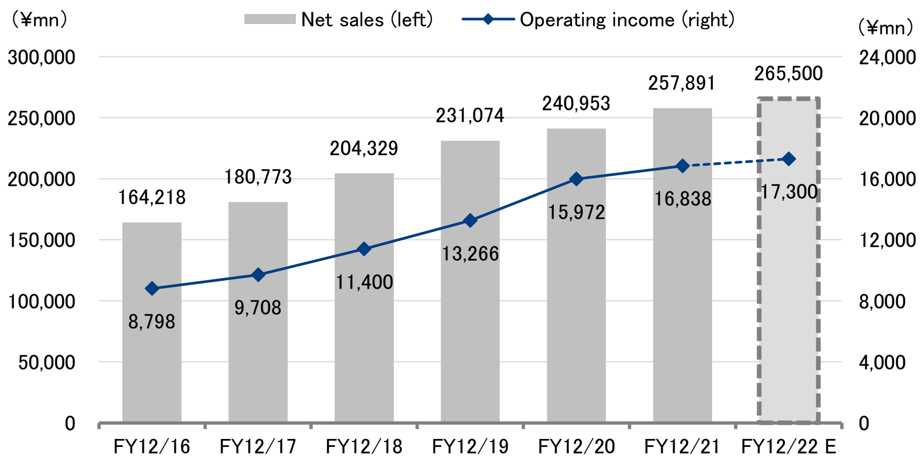
In February 2022, the Company announced its new medium-term management plan. The various numerical targets set within it (in FY12/24, net sales of at least ¥300bn, operating income of at least ¥20bn, ROIC of at least 8.0%, ROE of at least 9.0%, an EBITDA margin of at least 9.0%, and a dividend payout ratio of at least 35.0%) are a significant step up in level compared to the contents of previous medium-term management plans.

On the other hand, what should be focused on from the qualitative side as the first step in formulating the new medium-term management plan is the Company's firm clarification of its own position in the market, which will form the foundation of its business strategy and financial strategy based on aspects such as philosophy and culture, skills and resources, and results and direction. To survive in the era of VUCA (Volatility, Uncertainty, Complexity, and Ambiguity), where it can be difficult to predict the future, the Company can be honestly commended for setting the current numerical targets based on its management approach of "firstly, know yourself, and secondly, develop a strategy to avoid losing."

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 significantly exceeded the ¥200bn barrier for net sales. At the end of December 2021, it had over 15,000 consolidated employees.
- Its core competencies are "superiority in technologies and deep customer insight," as seen in its abundant track record and corporate philosophy. Although results stagnated for a period after the economic downturn precipitated by the 2008 financial crisis, it has strengthened its financial structure and growth potential.
- In the FY12/21 results, the Company achieved higher sales and increases in every profit item for the sixth consecutive period. The FY12/22 Company forecasts are for sales to increase 3.0% and operating income to rise 2.7%.
- The FY12/22 annual dividend forecast is ¥109 per share, which is significantly higher than the FY12/21 dividend of ¥52 per share, and the outlook is for the dividend to increase for the eight consecutive period.
- The Company has formulated a medium-term management plan in which it has set numerical targets that are a step up from the past. The Company's management approach of setting a strategy and targets after clarifying its own position can be highly evaluated.

Results trends



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

Company overview

Greatly exceeded the barrier of net sales of ¥200bn based on a spirit of "Challenge and Creation"
Aiming for even further development through having both the spirit of a start-up and the dignity of a major IT company

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 at the home of Mr. Hiroshi Nozawa, the Company's current Director and Executive Adviser, 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 Company has grown into a group of 31 consolidated subsidiaries (of which, 4 are listed companies), 2 equity-method non-consolidated subsidiaries and 1 equity-method affiliate, 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 aims to give shape to the knowledge expressed by its corporate philosophy, such as through the Group's corporate charter and standards of conduct for executives and employees.

The Company has been moving ahead with a strategy of making both the parent company and subsidiaries listed, and currently has four listed subsidiaries. Although the Group Company Charter states that "each company shall mutually respect the others as independent companies and shall prioritize independence and autonomy," there is a tendency to point to governance issues when listing both the parent and the subsidiaries in capital markets. It goes without saying that there is a requirement for management decisions regarding sustainable value creation and enhancing corporate value. However, the fact that the business companies do not only have a presence in the capital markets and that they face severe competition in the product and services markets and the labor market is extremely important. When comprehensively weighing the advantages and disadvantages for each market, the degree of satisfaction with the Company's strategy of listing the parent and subsidiaries is considered to be fairly high at the current time, even when considering moves being taken by the TSE to restructure its market segments.

The Company has three reporting segments: the SI Business, the Facility Business, and the 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 the Other Businesses includes a BPO service business, a contact center business, and a regenerative medicine business.

In addition, as a business strategy to be implemented across the reporting segments, the Company has been advancing initiatives in the "AIS-CRM" area since FY12/17. AIS-CRM, which is the Company's own unique acronym created by taking the first letters from AI, IoT, Security, Cloud computing, Robot, Mobile & AutoMotive, covers areas that are expected to grow in the medium to long term. Whereas it hasn't been easy for it to amass and hone technologies in these growth fields, in the AIS-CRM area, stand-alone net sales steadily rose from ¥61.8bn in FY12/18 to ¥95.9bn in FY12/21, and the Company appears to be growing in confidence with respect to its AIS-CRM strategy, drawing on its track record thus far.

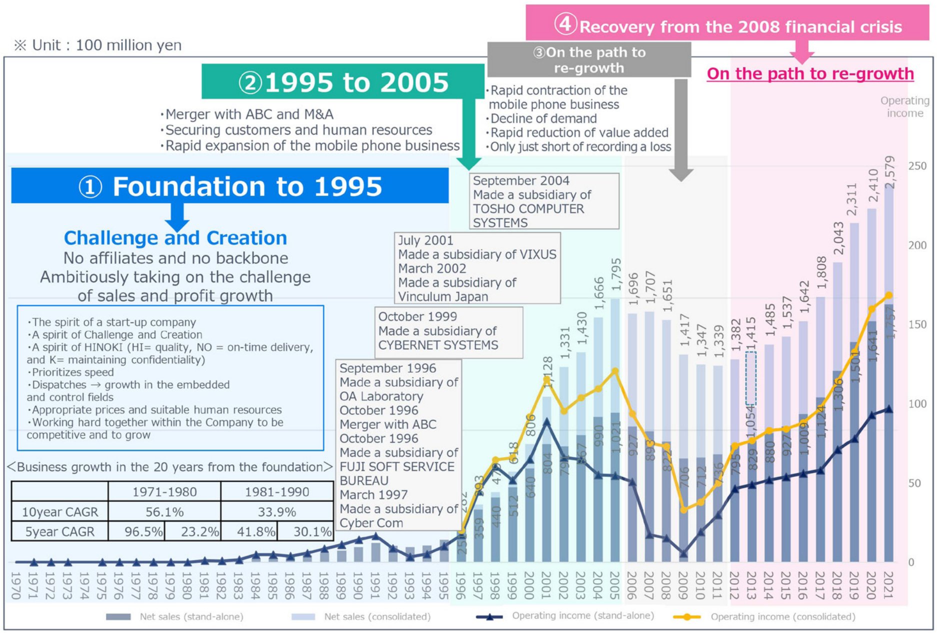
At the time it was established, the Company's business was founded on the dispatch of computer operators. Subsequently, it entered into the software development and systems construction businesses and achieved skyrocketing development supported by the explosive expansion of the computer industry. But what should not be overlooked as a factor behind this growth is that it has maintained an offensive management approach since foundation, aiming to grow and innovate as a company by taking on challenges in new fields and creating new businesses, and the strong belief of the executive management, including the founder, that the time of the computer-dominated society had arrived. While bearing a considerable risk, the Company actively invested in recruiting and training engineers and pursued a complementary M&A strategy to incorporate the technologies and customer bases it did not have. The fact the Company has developed into a corporate Group of a scale where net sales exceed ¥200bn and with 15,000 employees on a consolidated basis while being independent is a significant achievement.

Even though the computer-dominated society has become a reality and the domestic IT services market has expanded in scale to be worth ¥6tn, the major IT services companies with net 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 companies that could be called independent consistently from the time of their founding.

Although it has succeeded at becoming one of the groups with over ¥100bn in net sales in FY3/02, looking at the number of employees to achieve this, which is 4,002 people on a stand-alone basis and 6,353 on a consolidated basis, it can be said that its business expansion has been supported by its active recruitment of human resources and training of engineers since its establishment. Additionally, in 1996, it merged with ABC Co., Ltd., which has strengths in finance-related operations systems, and subsequently also made consolidated subsidiaries of Cybernet Systems Co., Ltd. <4312>, which has its origins in an overseas company in 1999, and MYCAL Systems Corp. (currently VINX Corp. <3784>), whose main business is distribution-related business systems, in 2002. In such ways, the Company has advanced an M&A strategy to incorporate the technologies and customer bases to supplement its strengths in embedded /control software development. It is thought that it would not have been able to exceed net sales of ¥100bn solely from riding the favorable tailwind, but that its bold decision making has also been vital to achieving this.

The Company had to undergo a period of declining sales up to FY3/11 mainly due to the 2008 financial crisis, but in FY12/18 it achieved the major milestone of net sales of ¥200bn, and then in FY12/21 even during the COVID-19 pandemic, it set record high net sales for the fifth consecutive period of ¥257.8bn. In the new medium-term management plan announced in February 2022, based on having both the spirit of a start-up and the dignity of a major IT company, it has first set the targets for FY12/24 of net sales in excess of ¥300bn.

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



Source: From the Company's medium-term management plan

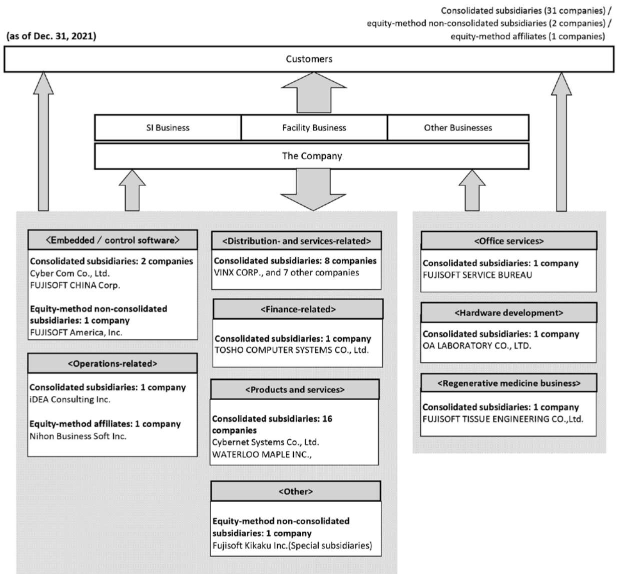
With "superiority in technologies and deep customer insight" as its core competencies, the Company is aiming to be a CSV-style innovative corporate group

The Company lists its "continuously advancing superiority in technologies and deep customer insight" as the reasons why it is chosen by customers. It is highly confident in its core competencies of "continuously advancing superiority in technologies and deep customer insight" which 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). In addition, the Company believes that its key mission is to further societal development through various corporate activities, alongside sustainable growth and the creation of corporate value in the medium to long term. As its medium-term policy, it aims to be "an innovative corporate group that links ICT development to improving value for our customers."

From the messages disseminated by the Company, what stands out are the strong belief in the effectiveness and potential of utilizing ICT and its sense of mission to advance this and a customer-oriented and CSV-type (a company that increases enterprise value through social contributions via its businesses) management policy. Naturally, 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.

This corporate culture was also the foundation for the new medium-term management plan announced in February 2022, and 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 has grown into Japan's largest robot competition. Although the tournament began with the aim of providing a place to experience the enjoyment of building things and to improve technologies through building robots, it is currently recognized as an excellent example of support for developing human resources through manufacturing. For example, since a division for high school students was established in 1993, the National Association of Principals of Technical Senior High Schools has joined the operation, and organizations including the Ministry of Education, Culture, Sports, Science and Technology (MEXT), and Ministry of Economy, Trade and Industry (METI) are also listed as sponsors. Although the Robot Sumo Tournaments, which were scheduled for 2020 and 2021, were called off due to the COVID-19 pandemic, the Company continues to support education by remotely conducting programming workshops for elementary school pupils and accepting interviews from students, and has announced that it will continue its All Japan Robot-Sumo Tournament and related businesses, which serve as a pillar of its social contribution activities, given its commitment to providing a forum for learning about manufacturing.

Business structural program



Source: From the Company's securities report

Business overview

Offering varied ICT services and products that facilitate value improvement for customers

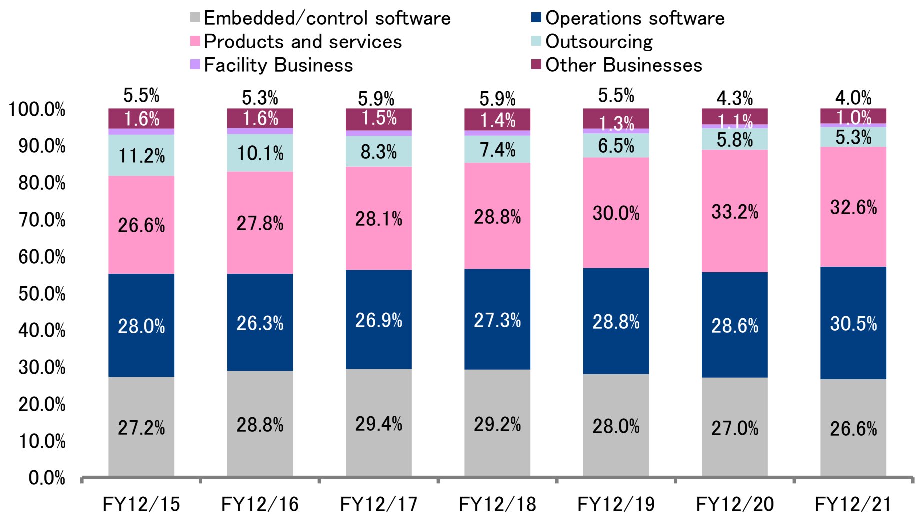
The Company has three reporting segments; the SI Business, the Facility Business, and the Other Businesses. The mainstay SI Business is broadly divided into systems construction, and products and services. Further, systems construction is subdivided into embedded/control software and operations software, while products and services are subdivided into narrowly defined products and services, and outsourcing. In addition, the Facility Business entails rentals of office buildings, while the 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

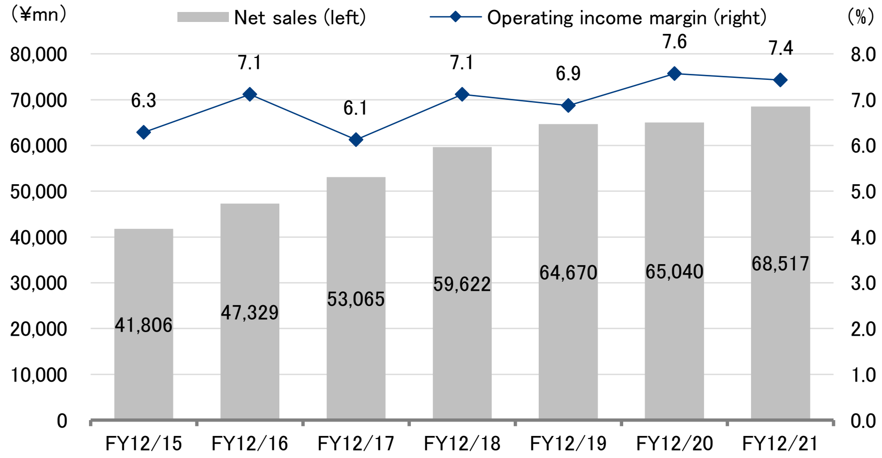
Embedded/control software, which is included in the system construction segment in the SI Business, is a mainstay segment providing 26.6% (FY12/21) of Company-wide net sales and 30.2% (same) of operating income, and its segment profit margin is also higher than on a Company-wide basis. Its FY12/21 results were that net sales increased 5.3% YoY, operating income rose 3.4%, and the segment profit margin was 7.4% (down 0.2pp YoY). However, when looking at the 2H, net sales increased 10.6% compared to the same period in the previous fiscal year, operating income grew 12.7%, and the segment profit margin rose 0.2pp to 8.1%, from which can be read that business sentiment recovered compared to in the 1H.

Looking at the pace of order acquisitions on a quarterly basis, from 2Q FY12/20 to 1Q FY12/21, they continued to decrease by around 5% compared to the same period in the previous fiscal year, but changed direction in 2Q FY12/21 and increased 5.7%, then rose by 14.4% in 3Q and by 3.8% in 4Q (including the apparent negative effect of the review of the order-calculation method), and orders are recovering smoothly. As a result, the order backlog at the end of FY12/21 had increased by 3.8% on the end of the previous period, when based on the previous calculation method.

Embedded/control software is software that runs on a microcomputer or other piece of equipment embedded into a 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 such as CT and MRI.

In this area, the Company has built up an excellent track record within Japan and boasts strengths in FA and other machine control systems and automotive-related fields. Looking strictly at vehicles installations, in practical terms it delivers products to all vehicle manufactures in Japan, and has the top share of the domestic market. The Company's AIS-CRM strategy will most likely lead to opportunities for generating profits over the medium to long term, given that the strategy taps into major trends that include the productivity revolution enlisting AI and robotics, promoting CASE (Connected, Autonomous, Shared/Service, Electric) in the automotive industry, and drawing on IoT technologies in the social infrastructure-related business.

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



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

2. Promoting development of the digital transformation (DX) market in the realm of operations software

Operations software, which is part of the systems construction segment in the SI business, is a main business pillar, providing 30.5% of Company-wide net sales (FY12/21) and 28.0% of operating income (same). In FY12/21, net sales increased 14.0% YoY and operating income rose 21.4%, for the fifth consecutive period of higher sales and a double-digit increase in operating income. The segment profit margin rose 0.4pp to 6.0%. Also, the pace of order acquisitions, which has been recovering since bottoming-out in 2Q FY12/20, maintained its increase momentum in 2H FY12/21 as well, rising 10.5% compared to the same period in the previous fiscal year, and at the end of FY12/21, the order backlog had increased 14.2% on the end of the previous fiscal period.

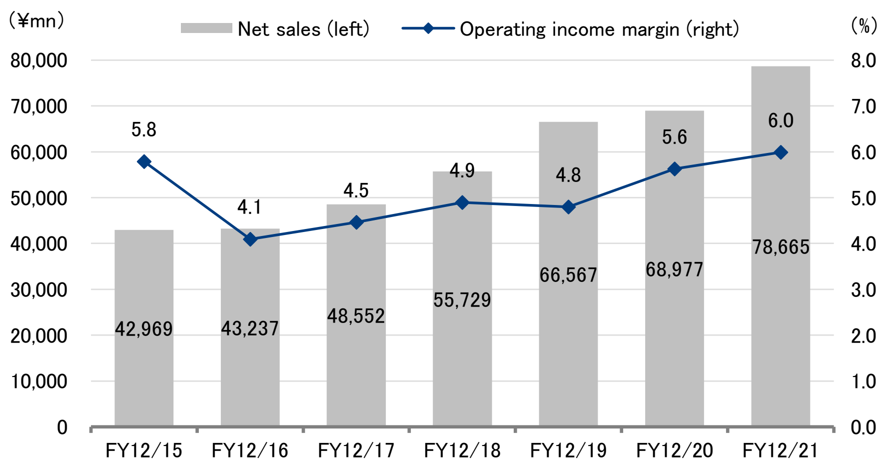
In this area, in addition to organic business growth, the complementary M&A strategy is proving successful, and the Company has established a system that is able to provide a one-stop service from consulting through to development, systems construction, and support, for various solutions, such as for 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, finance, service, 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 these conditions, the Company, based on a spirit of seeing "change as an opportunity," has clearly set out and is implementing an approach of strengthening the development of outsourcing through actively investing in human resources. It truly 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, including promotion of the Company's AIS-CRM strategy, can be said to be the result of the Company accurately providing services in response to changing times and the market structure. For instance, the Company has been encountering a shift to e-commerce in the distribution and services field and growing demand in the digital content field, accelerating its response to various forms of digital transformation (DX) in fields centered on systems infrastructure, promoting utilization of ICT on the theme of work-style reforms, and addressing a growing trend of adopting virtualization technologies particularly with the aim of enhancing security.

Also, in January 2020, the Company established a new business department and 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 the EC field, which is benefiting from the growth of nesting (staying-at-home) demand during the COVID-19 pandemic in addition to the prior achievements, projects for B-to-C, as well as for B-to-B, are strong, and the growth trend is expected to continue in the medium to long term.

Trends in operations software net sales and operating income margin

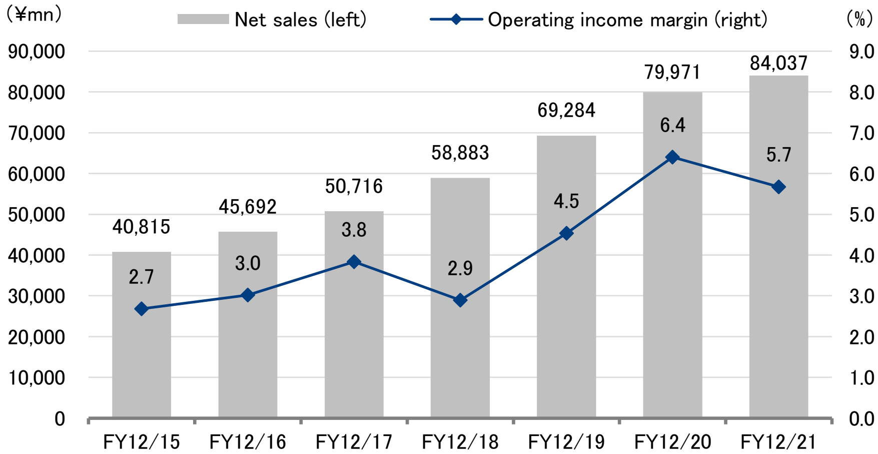


Source: Prepared by FISCO from the Company's results briefing material

3. The Company's narrowly-defined products and services make it more distinctive

In the SI Business, products and services are categorized into narrowly defined products and services and outsourcing. Narrowly defined products and services provided 32.6% of Company-wide net sales (FY12/21) and 28.3% of operating income (same). In FY12/21, net sales increased 5.1% YoY and operating income decreased 6.9%. The main reasons for the decline in operating income despite the increase in sales were that the main driver behind the increase in sales was PC sales projects, which have low profitability, while in contrast sales of the Company's own products, which are highly profitable, declined. Also, in FY12/21, orders received decreased 6.4% YoY due to a slowdown because of a rebound to a previous large-scale order and that special demand for some products has run its course. At the end of the same period, the order backlog had decreased 18.8%.

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



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

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; PALRO, a communication robot; FS030W and FS040W, SIM-free mobile routers; FAMoffice, a virtual office space tool to reduce work-from-home disadvantages such as communication loss, etc.), 2) the license business (Microsoft <MSFT> products, AWS, VMware <VMW>, etc.), and 3) product sales, etc. (PCs, servers, etc.) Looking at the YoY percentage increase in sales in FY12/21, sales of the Company's own products decreased 3% (versus 38% increase in FY12/20), while license business sales were down 4% (versus 46%) and product sales, etc. increased 20% (versus 14% decrease).

The slowdown in sales of the Company's own products is largely attributable to special demand having run its course for SIM-free mobile routers, which had been fueled by mounting demand related to remote work due to the COVID-19 pandemic, and the increase in sales of goods was due to recording sales of PC sales projects, etc. related to the GIGA school.

With respect to the license business, sales have continued to increase even after peaking out of special demand in conjunction with the end of support for Windows 7 (January 14, 2020). In addition, 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 Microsoft 365 (former Office) and various cloud services. Sales of support for deployment of licensed products is recorded in the Company's own products, apparently enabling it to secure high profit margins.

Amid these circumstances, the Company launched its Desktop Full Service in August 2021. The service offers one-stop support for PC lifecycle management tasks encompassing everything from PC selection and rental to kitting, administration and support, application of software updates, and other relevant services. The Company recommends installation of the Microsoft 365 platform for use of this proprietary service, which has the capacity to increase the Company's profitability by generating growth across the narrowly-defined products and services category overall. Microsoft began providing Windows 365 subscription-based services (cloud computing in the form of a virtual desktop for enterprises) in August 2021 and offering its next operating system, Windows 11, in October 2021. At any rate, the Company seems to benefit from launch of its new Desktop Full Service, though it may or may not encounter momentum arising in terms of a market fueled by special demand, as has happened in the past.

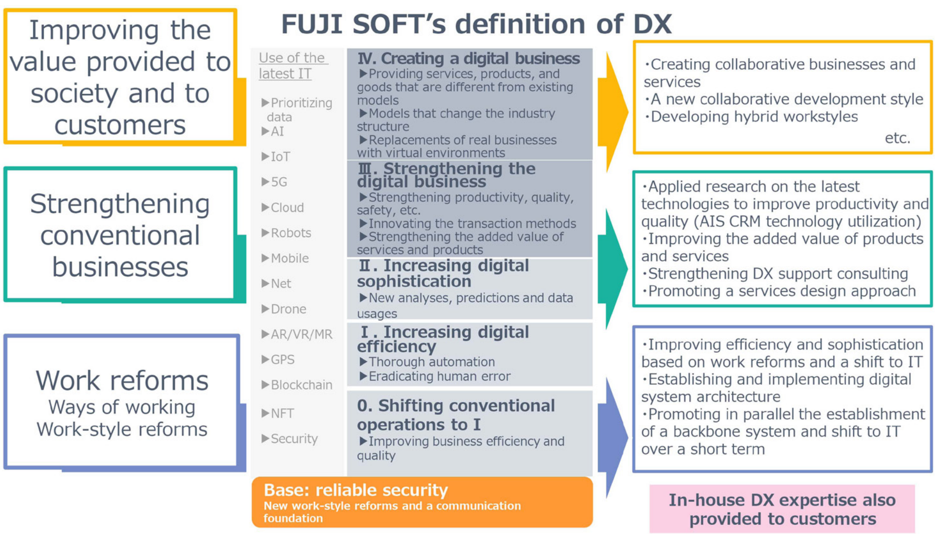
One of the Company's strengths is that, as an independent SIer, it is able to construct systems flexibly without being limited to specific hardware. At the same time, launching proprietary brands and products, including remote education-related products and hardware such as the communication robot and mobile routers, seems to pose unique challenges.

To give an example, it is highly noteworthy that external sales of FAMoffice (started in June 2021), a virtual office space used as an in-house tool for remote working, are not just a typical example of dogfooding (trialing products and services in-house before providing them to customers), but also an example of an initiative for the metaverse market. FAMoffice is an office that can be reproduced in a virtual space, and it is a product that gives a sense of reality, unity, and convenience that is close to that of an actual office. By having an avatar (a character representing yourself in a virtual space) in FAMoffice when starting work, it is not only easy to ascertain the overall situation and the conditions of specific members, it also makes communication (meetings, consultations, and chats) between members simple through its framework, such as for promptly sharing materials and information with other members and holding chats and video calls. Therefore, it makes it possible to increase the advantages of remote working (such as BCP countermeasures, cost reductions, improved work efficiency, and work-style reforms) and to reduce its disadvantages (including security problems and communication-loss problems).

In November 2021, as a new development based on FAMoffice technologies, the Company announced it would conduct a joint demonstration with Gakken Juku Holdings Co., Ltd. and Gakken Method Co., Ltd., which are group companies of Gakken Holdings Co., Ltd. <9470>. Specifically, by integrating the Company's technological and development capabilities in the ICT field with the expertise of the Gakken Group in the education field, they are aiming to draw out new ways of learning online that increase students' desire to learn and competitive spirit, and then based on these results, to develop FAMschool (provisional name) as a new service suitable for the online learning environment. This collaboration, which aims to provide an optimized learning environment to children who will be responsible for society in the future, can be said to be initiative that is extremely characteristic of the Company on the points of being "a business that directly contributes to society" and "a business in which the Company's DX contributes to improving customers' competitiveness."

The strategy of working to create new added value through the Company's own products that are infused with its core competencies, of "superiority in technologies and deep customer insight," 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. With regard to this, the segment profit margin of narrowly defined products and services, which previously trended below the Company-wide level, has shown a significant improvement, having increased by 3.5pp from 2.9% in FY12/18 to 6.4% in FY12/20. Although it declined to 5.7% in FY12/21 due to a worsening of profitability because of a product-mix factor, it can be highly evaluated for being maintained at a level above the FY12/19 result of 4.5%. In the narrowly defined products and services business, short-term fluctuations in the segment profit margin warrant neither hope nor despair given that the segments results depend on the recording of spot sales of products that vary widely in terms of profitability, and it will be worth monitoring developments going forward with a sense of optimism.

The Company's work reforms and response to DX



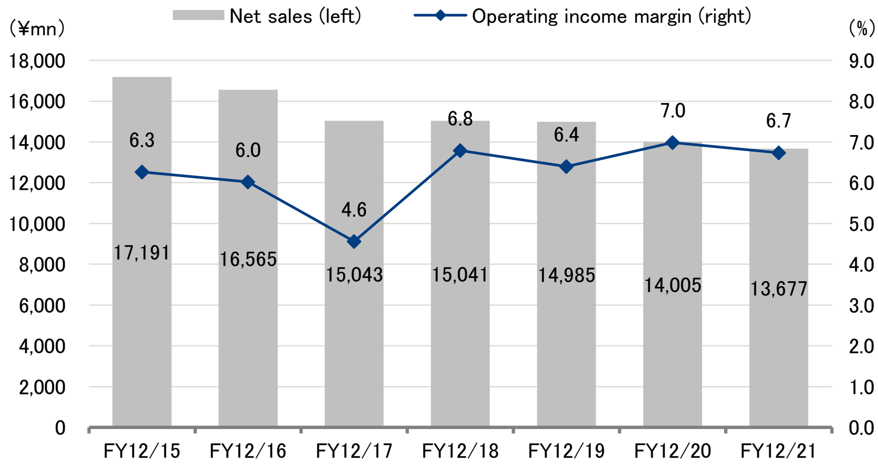
Source: From the Company's medium-term management plan

4. Outsourcing is searching for the bottom

Outsourcing provides services including data centers and systems operations and maintenance, and in FY12/21 it contributed 5.3% of total net sales and 5.5% of operating income, and it had a segment profit margin of 6.7%. In FY12/21, net sales declined 2.3% YoY, operating income decreased 5.9%, while the segment profit margin decreased 0.3pp. Orders received increased 0.3% YoY and the order backlog as of the end of FY12/21 was 11.1% lower than at the same time in the prior year.

Due to business structural reforms and other reasons, the profit margin has been above the Company-wide average since FY 12/18. However, the decline in sales in recent years has been brought on mainly by the decrease in ongoing projects for distribution and services. It is thought that the data center business, in which competition with other companies' cloud services is fierce, continues to look for a phase when data center business sales bottom out.

Trends in outsourcing net sales and operating income margin



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

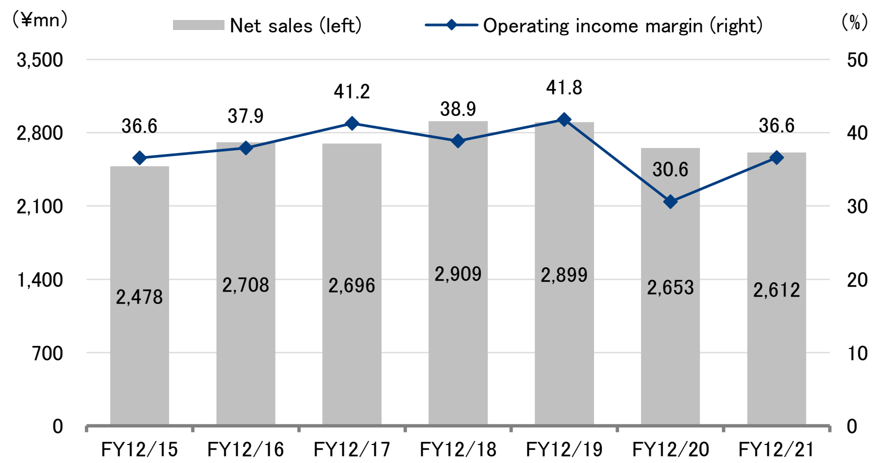
5. While it is a non-core domain, the Facility Business has high earnings

The Facility Business, which obtains rental income from the office buildings owned by the Company, provides 1.0% of total net sales (FY12/21) and 5.7% of operating income, with an extremely high segment profit margin of 36.6%. As for financial results of FY12/21, net sales decreased 1.5% YoY, profit increased 17.9%, and segment profit margin rose by 6.1pp.

The Facility Business is positioned to make effective use of the Company's vacancies where the Company owns properties essentially for its own use. As such, the Facility Business consistently serves to bolster profit levels though considered a non-core domain given that its segment profit margin is significantly higher than the Company-wide average, albeit volatility with respect to its financial results are not cause for concern.

According to the Company's securities report, there are four real estate owned in the Facility Business; the Yokohama Head Office (land-acquisition year: 2000, land and property book value: ¥11,135mn), the Akihabara Office (2005, ¥30,594mn), the Kinshicho Office (2000, ¥6,065mn), and the Ryogoku Office (2018, ¥1,760mn).

Trends in the Facility Business net sales and operating income margin



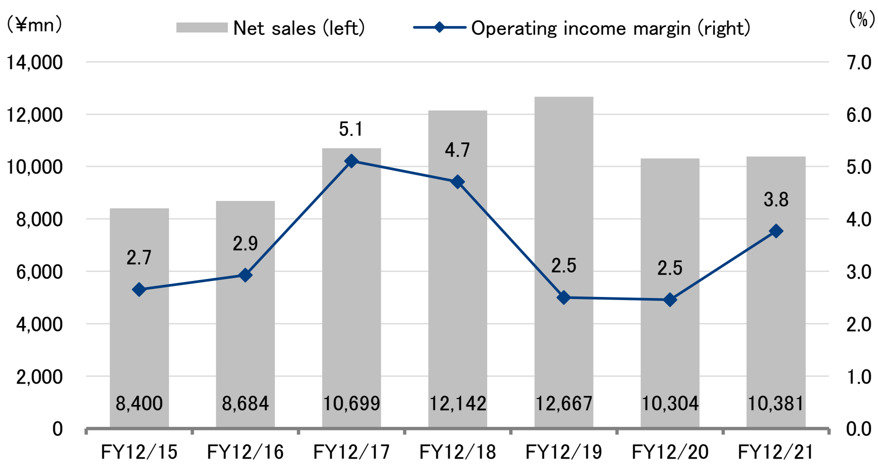
Source: Prepared by FISCO from the Company's results briefing material

6. The Other Businesses is mainly handled by the listed subsidiary FUJI SOFT SERVICE BUREAU

The Other Businesses, which provided 4.0% of net sales (FY12/21) and 2.3% of operating income (same), includes the BPO services business and the contact center businesses conducted by FUJI SOFT SERVICE BUREAU<6188>, which mainly handles this segment.

In FY12/21, in a situation in which projects for local governments trended solidly, the impact of price competition eased and net sales increased 0.7% YoY, operating income grew 54.3%, and the segment profit margin rose 1.3pp to 3.8%.

Trends in the Other Businesses net sales and operating income margin



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

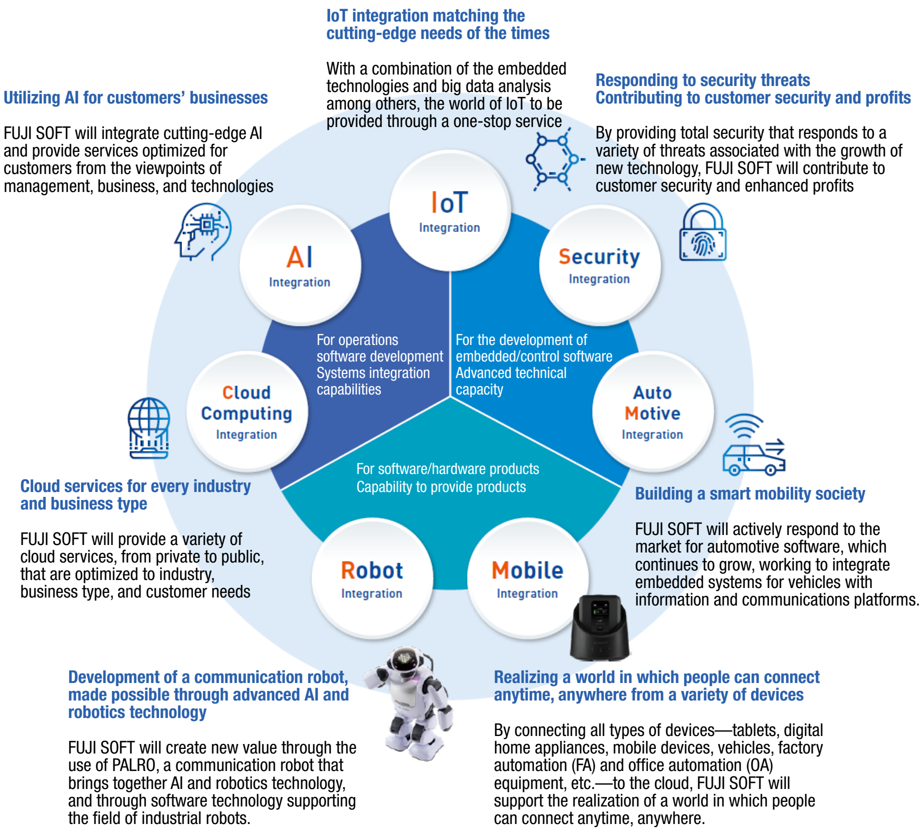
7. The results of the AIS-CRM technological strategy are being realized across the segments

The Company, as a technological strategy it has been implementing across the segments since FY12/17, has set the AIS-CRM domain as a priority technological field, and it is focusing on creating seeds for new products and new businesses and on improving added value in existing businesses. AIS-CRM is the Company's made-up word from an acronym of AI, IoT, Security, Cloud computing, Robot, Mobile&AutoMotive, and it covers areas that are expected to grow in the medium to long term. At first glance, it seems just a sequence of current buzzwords, but the upper concept of the AIS-CRM strategy is set based on the Company's core competency, and this domain's FY12/21 stand-alone net sales were ¥95.9bn (average annual growth rate for the last 3 years: an increase of 15.8%) and constitute around 55% of stand-alone net sales.

Breaking this down, sales of AI mainly related to development were ¥1.9bn (average annual growth rate for the last three years: up 16.6%), of IoT mainly related to development were ¥3.1bn (up 33.6%), of security relating to development and licenses were ¥12.3bn (up 16.9%), of Cloud relating to licenses and SI, infrastructure-related, the online business field, etc., were ¥49.5bn (up 26.6%), of Robot mainly related to development, PALRO, robot SI, etc., were ¥4.4bn (down 8.8%), of Mobile relating to development, products, etc., were ¥6.5bn (up 2.7%), and AutoMotive mainly related to development were ¥18.1bn (up 5.8%). In particular, the strong performance of the cloud field was noticeable, while it seems that in the security field as well, the results of the initiatives implemented in recent years are starting to appear.

As part of a series of developments in the security field, following a business partnership with Red Team Technologies Co., Ltd., in November 2020 (concluded a distributorship agreement, which was announced in November 2020), it started providing a new security service (vulnerability diagnoses) that utilizes the Synack cloud penetration testing platform to financial institutions and other entities providing internet-based services. In June 2021, the Company subsequently entered into an agreement with leading domestic cybersecurity company FFRI Security, Inc. to strengthen collaboration in the cybersecurity field. Then in October 2021, it was awarded the 2021 1st Half Outstanding Partner Japan from Stellar Cyber, a pioneer company for Open XDR (Endpoint Detection and Response), which is security-measures software that makes visible cyber-attacks. These are a few examples of its achievements.

Summary of AIS-CRM



Source: From the 2021 CSR Report

Results trends

In the FY12/21 results, achieved a double-digit increase in ordinary income for the fifth consecutive period
Achieving both maintenance of sound financial structure and proactively engaging in upfront investment

In the FY12/21 consolidated results, net sales increased 7.0% YoY to ¥257,891mn, operating income rose 5.4% to ¥16,838mn, ordinary income grew 10.0% to ¥17,976mn, and profit attributable to owners of parent increased 6.5% to ¥9,130mn. As such, this marks the sixth consecutive year of increased net sales and profits at each income stage.

Looking at the rates of progress of these results compared to the initial Company forecasts announced in February 2021 (net sales of ¥249,000mn, operating income of ¥16,300mn, ordinary income of ¥16,900mn, and profit attributable to owners of parent of ¥8,900mn), net sales were 103.6%, operating income was 103.3%, ordinary income was 106.4%, and profit attributable to owners of parent was 102.6%, marking the sixth straight year for which the Company achieved results exceeding its initial forecasts in all items.

In fact, more than 10 years passed since the Company set new record high net sales in FY12/17, higher than the peak net sales prior to the 2008 financial crisis (FY3/06). It can be highly evaluated for not only recovering non-recurring revenue, but strengthening both the financial structure and growth potential. Moreover, it appears that the Company has been implementing flexible controls in terms of striking a balance between financial soundness and aggressive investment even amid the COVID-19 pandemic.

Specifically, the Company realized soundness for the representative financial indicators, with the equity ratio rising from 47.3% at the end of FY3/06 to 59.9% at the end of FY12/17; the current ratio from 96.4% to 184.9%; and net interest-bearing debt (interest-bearing debt – cash and deposits) amounting to ¥6,204mn in excess cash, down from ¥21,295mn. Based on this, from FY12/15 onwards it conducted major recruitment, mainly of new graduates, so the number of consolidated employees increased by just under 1.6 times, from 9,415 employees at the end of FY3/06 to 14,956 employees at the end of FY12/21. The percentage of certified technicians on a stand-alone basis (the percentage of certified specialists and certified project managers, based on the Company system out of the total number of employees) also had risen from 22.8% at the end of FY12/14 to 32.3% at the end of FY12/21. From this, it is clear that growth potential as seen from the aspect of human resources has been enhanced both in terms of quantity and quality.

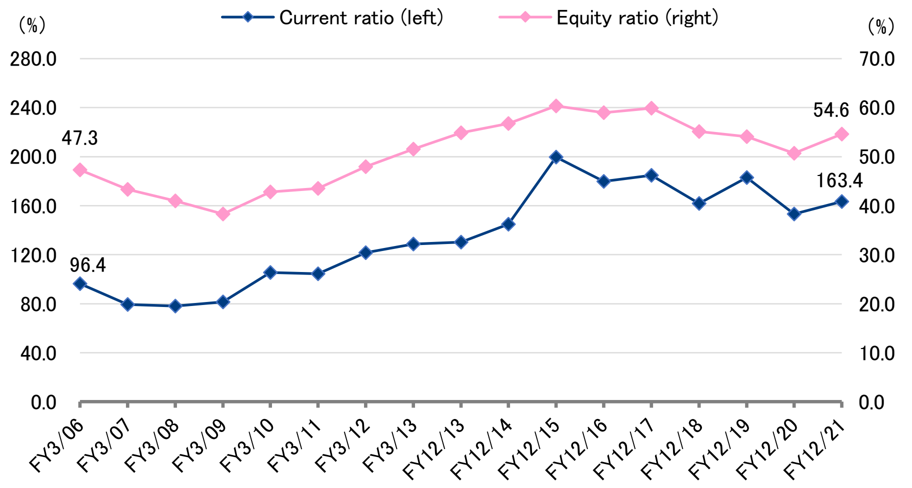
As a result of the above, at the end of FY12/21 the Company had achieved higher sales and a double digit increase in ordinary income for the fifth consecutive period, and the financial indicators at the end of FY12/21 were that the equity ratio was 54.6% (up 3.9pp on the end of the previous fiscal period), the current ratio was 163.4% (up 10.1pp), and net interest-bearing debt was excess cash of ¥11,523mn (down ¥17,864mn on the end of the previous fiscal period and converted to excess cash), and the Company is maintaining its financial soundness.

Looking here at the relationship between the financial indicators and the management strategy, in FY12/15, which is when the Company launched 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. Therefore, the Company can be highly evaluated for making calm management decisions that accurately reflect the changes to its business environment.

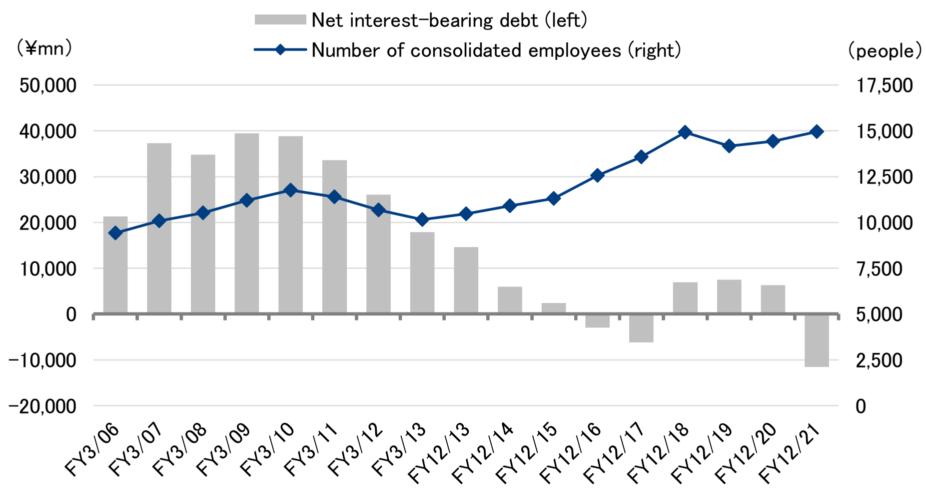
Results trends

Trends in the financial indicators of stability

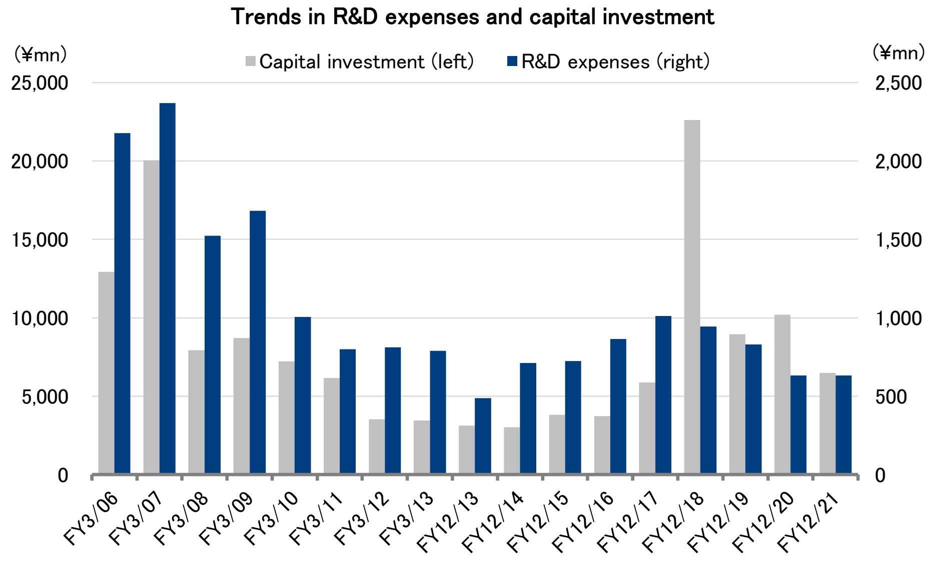


Source: Prepared by FISCO from the Company's securities report and financial results

Trends in net interest-bearing debt
and the number of consolidated employees



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



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

Simplified income statements

(¥mn)

	FY12/16	FY12/17	FY12/18	FY12/19	FY12/20	FY12/21	FY12/22 (E)
Net sales	164,218	180,773	204,329	231,074	240,953	257,891	265,500
YoY	6.9%	10.1%	13.0%	13.1%	4.3%	7.0%	3.0%
Cost of sales	126,024	138,708	156,808	178,337	186,105	201,055	-
YoY	7.2%	10.1%	13.0%	13.7%	4.4%	8.0%	-
Gross profit	38,193	42,065	47,520	52,736	54,847	56,835	-
YoY	5.8%	10.1%	13.0%	11.0%	4.0%	3.6%	-
Gross profit margin	23.3%	23.3%	23.3%	22.8%	22.8%	22.0%	-
SG&A expenses	29,394	32,357	36,119	39,470	38,875	39,997	-
YoY	6.2%	10.1%	11.6%	9.3%	-1.5%	2.9%	-
SG&A expenses ratio	17.9%	17.9%	17.7%	17.1%	16.1%	15.5%	-
Operating income	8,798	9,708	11,400	13,266	15,972	16,838	17,300
YoY	4.5%	10.3%	17.4%	16.4%	20.4%	5.4%	2.7%
Operating income margin	5.4%	5.4%	5.6%	5.7%	6.6%	6.5%	-
Ordinary income	9,166	10,260	12,071	13,749	16,343	17,976	18,500
YoY	0.8%	11.9%	17.7%	13.9%	18.9%	10.0%	2.9%
Profit attributable to owners of parent	5,042	5,797	6,516	7,836	8,573	9,130	9,700
YoY	2.4%	15.0%	12.4%	20.3%	9.4%	6.5%	6.2%

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	End-FY12/21	Change
Current assets	67,350	72,457	77,315	88,009	105,363	111,128	5,764
Cash and deposits	19,134	18,851	22,554	22,278	38,330	40,351	2,021
Notes and accounts receivable - trade	36,727	40,288	44,456	49,570	52,750	57,352	4,602
Non-current assets	96,513	102,110	115,310	119,609	129,173	117,786	-11,386
Property, plant and equipment	65,796	65,220	82,356	86,334	89,928	90,344	416
Intangible assets	5,949	6,821	4,738	4,043	4,705	4,547	-157
Investments and other assets	24,766	30,068	28,214	29,231	34,539	22,894	-11,645
Total assets	163,863	174,568	192,625	207,618	234,537	228,915	-5,622
Current liabilities	37,461	39,197	49,428	48,106	68,751	68,018	-733
Notes and accounts payable - trade	9,444	9,977	9,526	13,361	12,519	12,947	428
Short-term loans payable and current portion of long-term loans payable	9,410	8,464	16,207	7,158	24,156	19,462	-4,693
Non-current liabilities	17,400	16,959	23,526	32,691	30,623	17,928	-12,694
Long-term loans payable	6,723	4,182	13,319	22,618	20,515	9,366	-11,149
Total liabilities	54,861	56,156	72,955	80,797	99,374	85,946	-13,427
(Interest-bearing debt)	16,134	12,647	29,527	29,776	44,671	28,828	-15,843
Total net assets	109,001	118,411	119,670	126,820	135,163	142,968	7,805

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

Simplified cash flow statements

(¥mn)

	FY12/16	FY12/17	FY12/18	FY12/19	FY12/20	FY12/21
Net cash from operating activities (a)	9,530	9,244	11,192	12,584	14,787	15,907
Net cash from investing activities (b)	-4,337	-4,524	-23,424	-9,442	-16,109	4,894
Net cash from financing activities	1,076	-4,462	-14,766	-1,451	12,703	-17,871
Free cashflow (a) + (b)	5,192	4,720	-12,232	3,142	-1,322	20,801
Cash and cash equivalents at end of period	21,790	22,157	24,587	26,158	37,450	40,876

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

Outlook

Focus on the new medium-term management plan formulated in the midst of the VUCA era
Aiming for sustainable growth through a grounded growth strategy based on a human resources strategy

1. FY12/22 consolidated results forecasts

For the FY12/22 consolidated results, the Company is forecasting net sales to increase 3.0% YoY to ¥265,500mn, operating income to rise 2.7% to ¥17,300mn, ordinary income to grow 2.9% to ¥18,500mn, and profit attributable to owners of parent to increase 6.2% to ¥9,700mn. Therefore, it is actually forecasting the ninth consecutive period of higher net sales and operating income since 2013 when it transitioned to a fiscal period ending in December.

Compared to the three-year targets in the new medium-term management plan (annual growth of 5% for net sales and annual growth of 6% for operating income) the FY12/22 forecasts appear cautious. But this is because 1), the Company has maintained a conservative policy since the past for single fiscal year published values; 2) the forecasts fully incorporate the temporary factors at subsidiaries that will push-down results, and 3) the sense of uncertainty about the macro environment, specifically the prolonging of the COVID-19 pandemic, the increase in geopolitical risk, the rise of inflation concerns, and the conversion of the financial phase. As a result, there is not considered to be a great sense of dissonance between the targets and the forecasts.

The Company has greatly increased the dividend forecast from the FY12/21 result of an annual dividend of ¥52 per share (¥26 per share at the end of 2Q and ¥26 per share at the period end) to an annual dividend of ¥109 (¥54 per share at the end of 2Q and ¥55 per share at the period end), and the outlook is that it will increase the dividend for the eighth consecutive year.

With regards to the Company's current major increase in the dividend, its dividend policy indicates that "While implementing the basic policy of stably returning profits to shareholders at the same time as securing a certain level of internal reserves for proactive business development and to prepare for unforeseen risks, upon comprehensively considering conditions including business growth potential, stability and capital efficiency, the consolidated dividend payout ratio shall be at least 30%." While still being based on the previous policy of "With the basic policy of returning profits to shareholders in the form of stable and continuous dividends, dividends will be implemented upon comprehensively considering factors including strategic growth investment, rapid changes to the economic environment, and responding to unforeseen business risks," it has incorporated capital efficiency and consolidated dividend payout ratio into the policy's wording, and as a company that is committed to improving enterprise value in the medium to long term, this policy expresses management's intention to actively utilize capital policies, including returns to shareholders, even more than in the past.

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	
FY12/20	240,953	4.3	15,972	20.4	16,343	18.9	8,573	9.4	273.96
FY12/21	257,891	7.0	16,838	5.4	17,976	10.0	9,130	6.5	291.47
FY12/22 (E)	265,500	3.0	17,300	2.7	18,500	2.9	9,700	6.2	309.38

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

2. Has formulated a new medium-term management plan that is step up from the past, and first targeting net sales of more than ¥300bn and operating income of more than ¥20bn in FY12/24

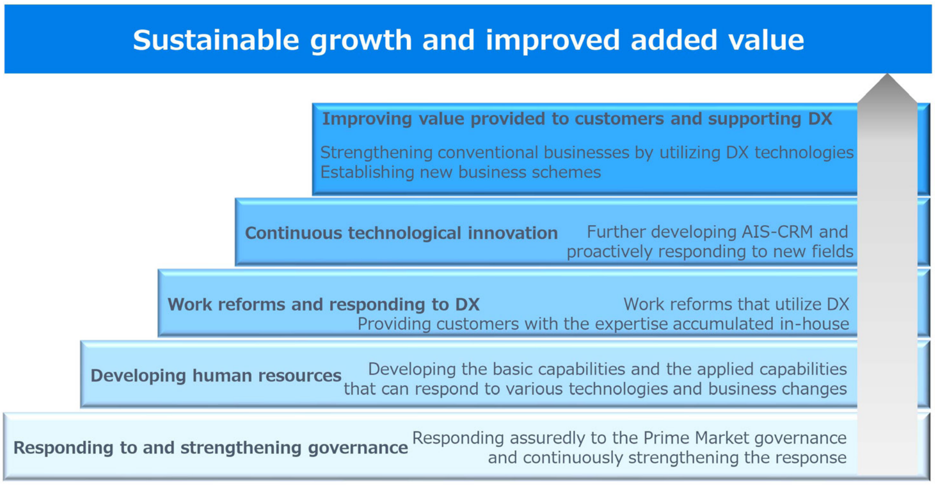
In February 2022, the Company announced a new medium-term management plan centered on "the management policy," "various strategies," "the financial policy," and "numerical targets." The contents of "the management policy" and the "various strategies" set out in the plan are on a continuous, uninterrupted line without deviations from previously. Conversely, the contents of the "the financial policy" and "the numerical targets" (net sales of at least ¥300bn, operating income of at least ¥20bn, ROIC of at least 8.0%, ROE of at least 9.0%, an EBITDA margin of at least 9.0%, and a dividend payout ratio of at least 35.0% in FY12/24) are a step up in level when compared to the contents of previous medium-term management plans.

That said, it is true that there are some market participants who feel unsatisfied with the “numerical targets.” However, what should be focused on here as the first step in formulating the new medium-term management plan is the Company’s firm clarification of its own position in the market as the foundation of its business strategy and financial strategy, taking into account factors such as philosophy and culture, skills and resources, and results and directionality. To survive in the era of VUCA (Volatility, Uncertainty, Complexity, and Ambiguity), where it can be difficult to predict the future, the Company can be honestly commended for setting the current numerical targets based on its management approach of “firstly, know yourself, and secondly, develop a strategy to avoid losing.”

Also, on the one hand the Company is emphasizing continuing an offensive management approach in which it is not acceptable to not aim for growth and to practice reduced, equilibrium-type management prioritizing efficiency and profits, while on the other hand it has declared that it will behave resolutely as a major IT company and respond to the Prime Market, and it has added ROE and ROIC to the KPI and has also decided to raise the dividend payout ratio.

Based on these points, we can get sense of the Company’s intention in the new medium-term management plan, of aiming to improve enterprise value in the medium to long term not through binary opposition, such as start-up or major company, growth or efficiency, and investment or distribution, but through a dynamic duality. We can expect it to realize a growth story through having both the spirit of a start-up and the dignity of a major IT company

The three-year management policy in the new medium-term management plan



Source: From the Company’s medium-term management plan

The numerical targets in the new medium-term management plan

(¥100mn)

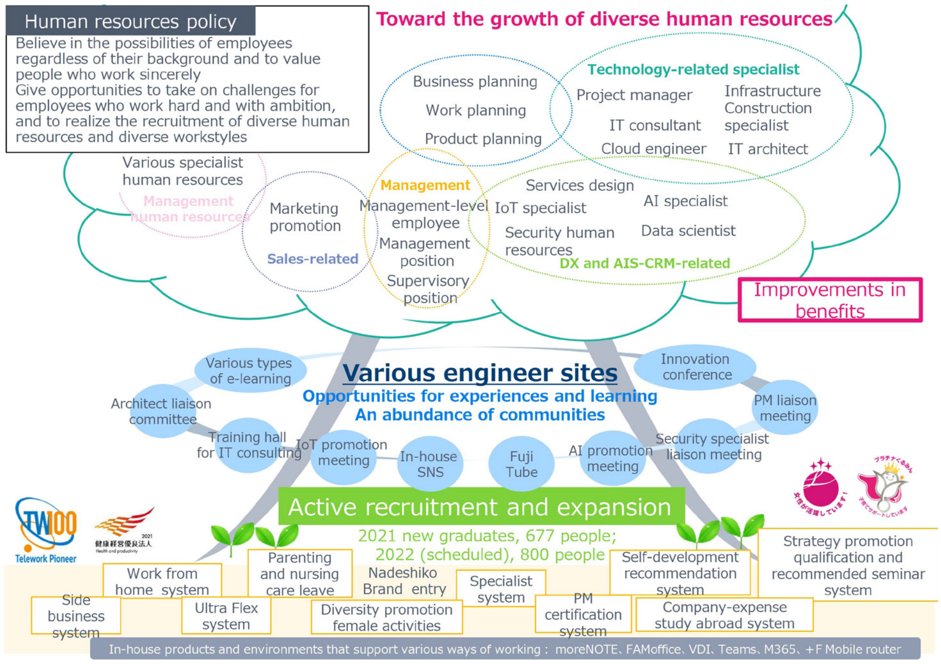
	FY12/21 results	FY12/22 forecasts		FY12/24 targets
Net sales	2,579	2,655	→Three-year CAGR 5%	At least 3,000
Operating income	168	173	→Three-year CAGR 6%	At least 200
Operating income margin	6.5%	6.5%		At least 6.7%
ROIC	7.4%	7.7%		At least 8.0%
ROE	7.5%	7.6%		At least 9.0%
EBITDA margin	8.6%	8.8%		At least 9.0%
Dividend payout ratio	17.8%	35.0%		At least 35.0%

Source: Prepared by FISCO from the Company’s medium-term management plan

3. Progressing sustainable growth and investment in human resources that is the foundation for improving added value

In the new medium-term management plan, the Company is pushing to the fore its human resources strategy, which is centered on proactive recruitment and expansion and support for the growth of diverse human resources. Its human resources policy is to believe in the possibilities of employees regardless of their background, to value employees who work sincerely, to give opportunities to take on challenges for employees who work hard and with ambition, and to realize the recruitment of diverse human resources and diverse workstyles. Looking at the Company's history and diverse business domains, it seems the essence of the Company's growth to become a major company while remaining independent is expanding opportunities for value-added creation by adapting to its employees' growth.

Human resources strategy in the new medium-term management plan



Source: From the Company's medium-term management plan

In addition, the Company's series of initiatives backed by long-term personnel development have been highly evaluated by its business partners. Specific results achieved by the Company since 2019 due to such initiatives are as follows.

From Microsoft, the Company received the Modern Device Award in the Microsoft Japan Partner of the Year 2019, and also received the Microsoft Teams Award in the Microsoft Japan Partner of the Year 2021.

In 2019, the Company received the "Government Agency Competency," "IoT Competency," and "Managed Service Provider" certifications from Amazon Web Services (AWS), the largest provider of IT cloud services in the world, thereby making the Company the first in Japan to gain the first two of the three designations. In 2020, the Company received "APN Premier Consulting Partner" certification, which is only granted to partners with particularly excellent track records. Also in 2020, the Company received the "Migration Competency," "AWS well-Architected Partner Program," and "Oracle Competency" certifications, which require comprehensive skills and a track record to migrate from on-premises environments to AWS. In 2021, the Company's engineers were selected as "APN Ambassadors" and "APN AWS Top Engineers" in recognition of their outstanding technical skills with AWS and ongoing efforts to disseminate information.

The Company attained the status of "Principal," which is the highest level of certification in the three categories (out of a total of five categories) of data center virtualization, network and security, and digital workspace in the new partners system from 2020 implemented by VMware, which has the largest market share in the world of the IT virtualization market. The Company also won the VMware 2020 Partner of the Year Award (Cloud Platform Transformation, in Asia-Pacific and Japan). In 2021, the Company received the 2021 VMware APJ Partner Innovation Award.

Blue Prism, which is a global leader in the corporate intelligent automation field including RPA (robotic process automation), awarded the Company in 2021 with the "Corporate Territory Best Partner Award" in recognition of its track record of supporting customer adoption and its advanced technologies. In 2022, the Company became the first enterprise in Japan to be certified as a Gold Delivery Provider (having acquired certification as a Silver Delivery Provider in 2020).

In 2021, the Company became the first enterprise in Japan to serve as a partner in the "NVIDIA DX Acceleration Program," which was newly established by NVIDIA GK, a Japanese subsidiary of NVIDIA Corporation of the U.S., which is a global leader in GPU computing, and NVIDIA has given the Company high marks for its track record of AI development and integration, which ranks at the top in Japan. The purpose of the "NVIDIA DX Acceleration Program" is to assist companies encountering challenges involving digital transformation (DX) and AI by providing them with support from planning DX initiatives aligned with growth strategies to development and operation, enlisting the coordination of NVIDIA and program partners that include business consultants, AI experts and system integrators to do so.

4. Productivity trending upward due to human resource development and emerging effects of operational and work-style reforms

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 the acquisition of paid leave on units of 30 minutes and refresh time on units of 10 minutes without fixing the time period). Based on this, it has been working on reducing overtime work, promoting acquisitions of paid leave, establishing an environment for remote work, and also working on the fully fledged operations of a work-from-home system geared toward all Company employees. In 2020, it adopted the system two months prior to the Japanese government's declaration of a state of emergency. Beginning in April 2020, it introduced a system for homeworking allowance (temporary allowance payments for initial expenses) and a support fund (monthly allowance payments for electricity and communication expenses).

As a result of the above, the Company achieved excellent results for 1) paid-leave acquisition rate: 67.5% (56.3% among private-sector companies with at least 30 employees in 2020 according to the General Survey on Working Conditions, Ministry of Health, Labour and Welfare, from April 2020 to March 2021), 2) permanently or primarily working from home: 44% of employees (from April to December 2021), 3) employees taking childcare leave: 192 employees (from April 2020 to March 2021), and 4) annual average overtime hours: 24 hours 33 minutes (from April to December 2021. These excellent results are highly evaluated and recognized by external organizations. For instance, the Company was awarded the Platinum Kurumin Certification based on the Act on Advancement of Measures to Support Raising Next-Generation Children (Ministry 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 (Ministry 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 certified as a Kanagawa business that promotes the support of children and child-raising (Kanagawa Prefecture).

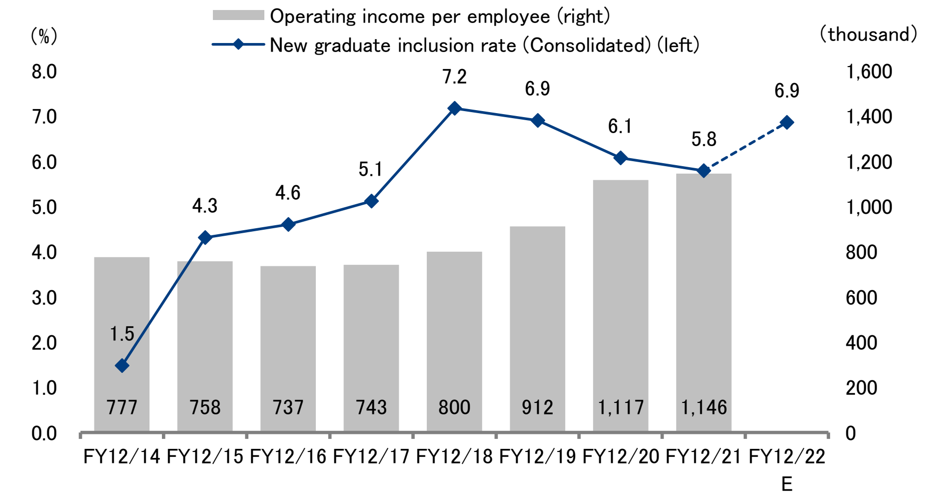
Large-scale recruitment of new graduates not only dilutes workforce capabilities, it also has the potential to raise the turnover rate, and the promotion of work-style reforms leads directly to shorter working hours for existing employees and higher upfront costs. Therefore, in many cases, these are 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 short term. 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. However, in FY12/21, it improved to just under ¥1.15mn (up 55.4% 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 alone + in listed subsidiaries/the number of employees on a consolidated basis at the end of the previous fiscal year) rose each year from 1.5% in FY12/14 to 7.2% in FY12/18, and subsequently peaked at 5.9% in FY12/21. In addition, the average monthly overtime hours have stayed within 25 hours from FY12/16 onward, 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 around 70% consecutively since FY12/15. 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 under ¥1.15mn in FY12/21) and turnover peak (stand-alone basis of 11.6% in FY12/20 to 6.4% in FY12/21) in conjunction with the increase in expenses per employee (from ¥5.98mn in FY12/14 to ¥6.36mn in 12/21) (consolidated personnel costs/the number of employees on a consolidated basis at the beginning and end of the fiscal year). This is something that should be evaluated highly, as can be said 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 types of work and work environments.

The work-style reforms advanced by the Company thus far have become a powerful weapon for ensuring business continuity without significant disruptions even amidst the COVID-19 pandemic. Furthermore, the Company's extensive implementation of teleworking and work-from-home arrangements as an IT solutions vendor may be regarded as typical “dogfooding,” which seems to have been extremely significant for the experience of exposing the Company to advantages (reducing costs, improving work efficiency, etc.) and disadvantages (security issues, lack of communication, etc.) of such work arrangements. Actually, it is being leveraged from a business aspect in the form of external sales of FAMoffice and for DX collaboration with customers.

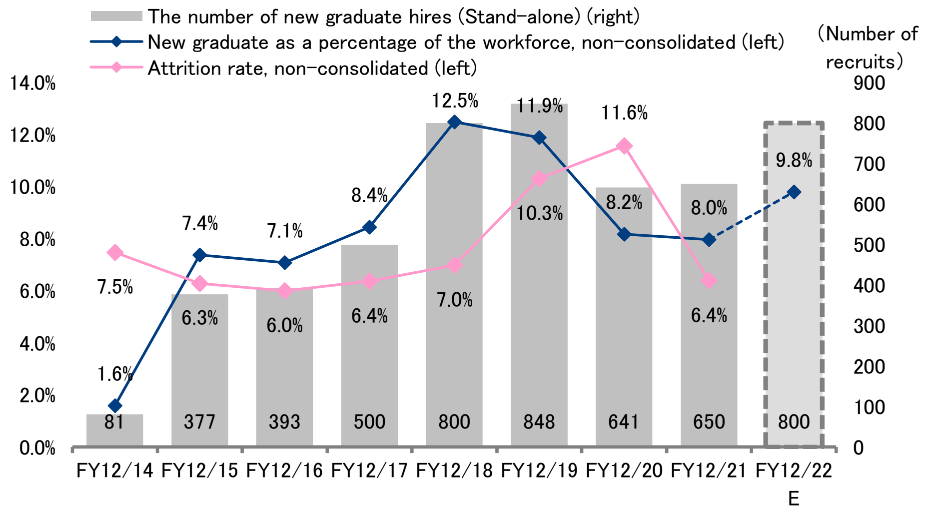
The room to reduce overtime and to increase paid leave has already been diminished, and going forward, we can expect efficiency to improve through work reforms and work-style reforms. In FY12/22, the new graduate inclusion rate is forecast to once again rise by as much as 6.9%, and for the FY12/24 profitability targets indicated in the new medium-term management plan, there is the strong sense that they assume the acceleration of investment in human resources. However, as the Company has currently reached a scale of 15,000 employees, it is not necessarily the case that the new graduate inclusion rate will continue to increase every year. On taking a medium- to long-term perspective, there seems an increasing probability of realizing the effects of the improved productivity per employee, and it should be noted that it is possible that profitability will improve even more from 2025 onwards.

Trends in operating income per employee (consolidated) and the new graduate inclusion rate (stand-alone + listed subsidiaries)



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

Trends in the number of new graduate hires and turnover rate (Stand-alone)



Source: Prepared by FISCO from Company materials and interviews

5. Investment in human resources and in real estate as a set

The Company, which is founded on a strategy of investing in human resources to improve added value, positions production worksites, such as offices, as spaces to create added value by human resources, and it has progressed its own acquisitions of them. In terms of the advantages to the Company of owning real estate, it seems its awareness is that qualitatively, they enable it to obtain a high degree of freedom, such as to respond to security issues and to projects and to improve creditworthiness, brand power and motivation, and quantitatively, to achieve a high return on investment and the stabilization of the corporate foundation through the effects of stably keeping down costs.

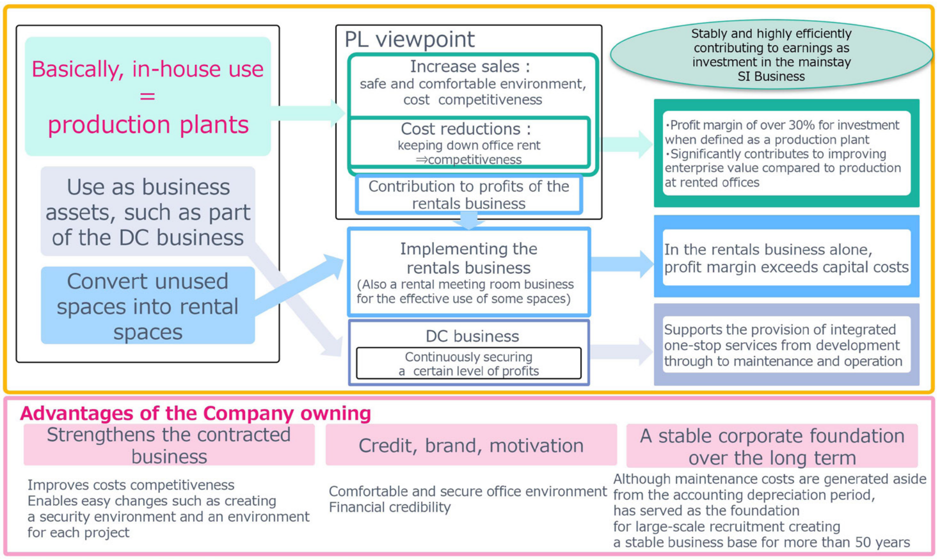
It is difficult for external analysts to verify a high profit margin compared to investment that is independently defined by the Company. Therefore, with regards to tangible assets per employee, land rent, and the depreciation costs of buildings, we attempted a comparison with 5 companies in the same industry with net sales on a scale of from ¥200bn to ¥500bn.

When expressing as approximate numbers because the disclosure standards, such as for land rent, are not the same between the companies, 1) the Company's tangible assets per employee are around double the average of the 5 companies in the same industry, although there are some companies at the same level; 2) the Company's land rent per employee does not reach ¥200,000 annually and is extremely low as an absolute level; 3) for the depreciation costs of buildings per employee, no significant difference was seen between the Company and the other companies in the same industry.

The Company's land rent per employee, even when considering depreciation costs relating to buildings, is estimated to be around a fraction of the other companies in the same industry. When assuming it is around one-fifth of the Company, whose number of consolidated employees trends at around 15,000 people, can be estimated to be stably realizing annual cost savings of around ¥12bn. In other words, at the current point in time, even without adding the contribution of the Facility Business (operating income of just over ¥900mn) and the unrealized capital gains from real estate owned (around ¥15bn), it can be considered that the Company's real estate investment is having a positive effect on its profitability.

Naturally, alongside the improvement to the Company's profitability, the hurdle for an investment decision, including for real estate investment, will become higher. Also, it seems clear that the arrival of the with-COVID 19 era and the development of the metaverse will have major impacts on investment decisions in the future. For the Company as well, it is preferable for it to establish investment discipline to respond to the growth stage and to environmental changes.

Positioning of the real estate investment that the Company is considering



Source: From the Company's medium-term management plan

FISCO

Disclaimer

■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp