

COMPANY RESEARCH AND ANALYSIS REPORT

I'LL Inc.

3854

Tokyo Stock Exchange First Section

6-May-2021

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FISCO Ltd.

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

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Summary

Results for 1H FY7/21 finished above forecasts. Results forecasts for FY7/21 were upwardly revised based on recent strong performance trends

I'LL Inc. <3854> (hereinafter, the Company) is a total system solutions company that supports business reforms through digital transformation (DX)* with mid-tier and small/medium-size companies as its main customers. The Company stands out for its CROSS-OVER Synergy strategy. This strategy seeks to promote the digital transformation of companies through an IT-driven convergence of real-world and web capabilities, addressing the full range of management issues faced by the Company's customers. Specifically, the Company provides a range of solutions centered on the Aladdin Office series, an internally developed mission-critical operation management system. These solutions encompass mission-critical system construction, system support maintenance, network construction, human resource education, web consulting, EC site construction, mission-critical operation package software, multiple EC site integrated management software, and real-world store and EC customer and loyalty point integrated management software. With these solutions, the Company supports efforts by client companies to enhance their management capabilities. It helps its customers in such ways as strengthening their sales capabilities, streamlining their operations (store management, orders reception and placement, inventory management, and back-side operation, etc.), and assisting with recruitment and training of human resources.

* This is a concept that "wider IT usage changes people's lives in a more positive direction in all aspects" and conversion of existing business models and business methods to digital technology creates new value.

The main characteristics and strengths of the Company are (1) strong sales and inventory management know-how, (2) specialization in mid-tier and small/medium-size company markets, (3) ability to accommodate real-world and web environments and high market share, (4) designated industry emphasis strategy, (5) partner strategy, (6) high proprietary product and service ratios, (7) product ecosystem strategy that realizes total solutions, (8) operations with engineers making up about 70% of employees, (9) omni-channel strategy in retail business, and (10) ability to accommodate individual customization. The Company possesses robust offensive and defensive capabilities thanks to its CROSS-OVER Synergy strategy, which enables it to make hybrid proposals from real-world and web perspectives, and it is steadily increasing the number of customer companies.

The Company changed its policy toward a profit-oriented strategy and is promoting better quality control and improved productivity in development and customization, and expanding recurring sales as a priority measure. As a result, its gross profit margin on a company-wide basis has trended upward from the recent bottom of 38.0% in FY7/16 to reach an all-time high of 44.7% in FY7/20. In 1H FY7/21, the gross profit margin rose to a new record high of 45.8% on a half-year basis.

Summary

1. Overview of 1H FY7/21 results

The Company reported 1H FY7/21 consolidated results with ¥6,596mn in net sales (down 5.2% YoY), ¥954mn in operating profit (down 22.2%), ¥971mn in ordinary profit (down 21.2%), and ¥635mn in profit attributable to owners of parent (down 21.5%). Sales and profits both decreased due mainly to the non-recurrence of special demand recorded in the same period of the previous fiscal year (1H FY7/20) and increased personnel costs. However, recurring business grew steadily due to the rising DX needs of companies. As a result, net sales were 2.0% above the initial forecast, while operating profit was 20.5% above the initial forecast, finishing much higher than initially anticipated. Additionally, the gross profit margin rose 0.7ppt from 45.1% in 1H FY7/20 to 45.8%, reaching a record high on a half-year basis. According to the Company's estimates, excluding the special demand* recorded in 1H FY7/20, net sales increased by 14.6% YoY.

* Special demand reflects the Company's estimates of net sales and operating profit resulting from a reduced tax rate and the completion of Windows operating system (OS) support in FY7/20.

2. FY7/21 outlook

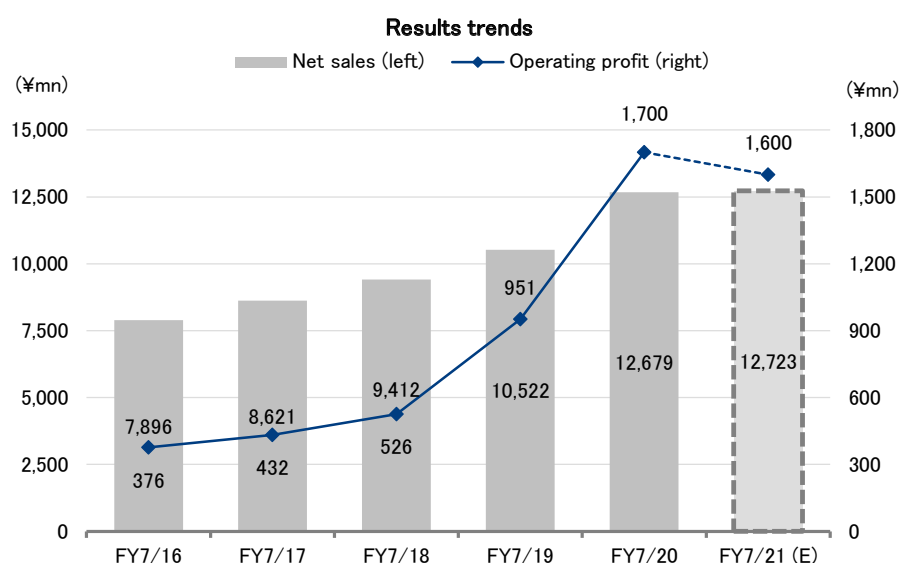
In March 2021, the Company upwardly revised its FY7/21 consolidated results forecasts. It is now forecasting ¥12,723mn in net sales (up 0.3% YoY), ¥1,600mn in operating profit (down 5.9%), ¥1,627mn in ordinary profit (down 5.1%) and ¥1,046mn in profit attributable to owners of parent (down 12.0%). Given that the impact of the spread of COVID-19 was much less severe than anticipated at the time of the initial forecast, the Company upwardly revised the net sales forecast to a YoY increase. Moreover, orders and net sales are performing more strongly than anticipated against the backdrop of the heightened DX needs of companies, and the gross profit margin is rising owing to the positive effects of improved productivity and growth in recurring sales. For these reasons, the Company expects the decline in profits to be smaller than initially forecast. According to the Company's estimates, excluding the impact of special demand in 1H FY7/20, net sales are forecast to increase 13.8% YoY and operating profit is forecast to increase 11.6%. The achievement rate for operating profit as of 2Q FY7/21 was favorable, at 59.6%, and recent trends in orders and sales have been firm. Considering these and other factors, FISCO believes that the Company could upwardly revise its full-year results forecasts even further.

3. Medium-term growth strategies

Meanwhile, the Company aims to be a leading company in DX assistance and has set forth the following medium-term growth strategies: (1) building a robust income foundation through stable growth in the System Solutions Business, (2) cultivating the Web Solutions Business as a second major income source, and (3) entering the field of new business operation systems that incorporate new technologies. The Company promotes a unique CROSS-OVER Synergy strategy and aims to build highly profitable operations through organic coupling of proprietary developed services and products that incorporate new technologies and provision of total solution packages with high added value to the market. In addition to healthy market conditions, profit margins are trending upwards owing to the positive effects of improved quality and productivity and growth in recurring sales. For these reasons, FISCO believes that there is no change in the Company's medium-term growth momentum targeting a position as a DX assistance leader.

Key Points

- Provides total system solutions to help client companies to enhance their management capabilities through synergies between real-world and web capabilities
- Results for 1H FY7/21 finished above forecasts, and the gross profit margin reached a record high on a half-year basis.
- Results forecasts for FY7/21 were upwardly revised, and they could be upwardly revised further, considering factors such as recent strong performance trends.
- Medium-term growth momentum targeting a position as a DX assistance leader is unchanged



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

Company overview

Delivers total system solutions to help mid-tier and small/medium-size companies to enhance their management capabilities

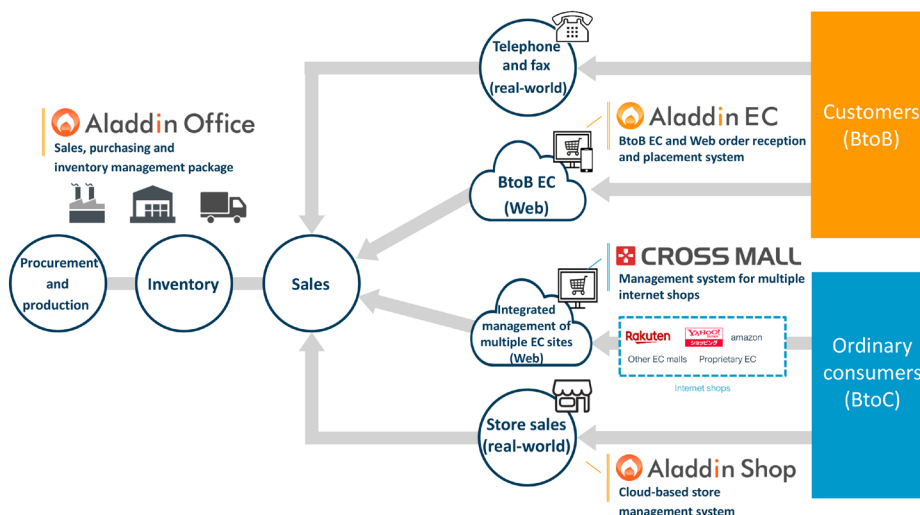
1. Company overview

The Company is a total system solution company that spurs the digital transformation of companies through an IT-driven convergence of real-world and web capabilities, with mid-tier and small/medium-size companies as its main customers. The Company supplies a range of products and services to mid-tier and small/medium-size companies that need to efficiently use IT to enhance their management capabilities. These products and services are centered on the Aladdin Office series, an internally developed mission-critical operation management system. It also operates I'LL Career Colleges (ICCs) in Osaka and Tokyo as educational entities that offer personal and corporate training.

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Company overview

The Company's Solutions



Source: From the Company's results overview

At the end of 1H FY7/21, the Company had ¥354mn in share capital and 25,042,528 shares (including 5,994 treasury shares) in outstanding share volume (following the 2-for-1 stock split on November 1, 2019). Its main locations are the Osaka Headquarters, Tokyo Headquarters, Nagoya Branch, Fukuoka Branch, Sendai Branch, and I'LL Matsue Laboratory, which opened in Matsue (Shimane Prefecture) as a next-generation cloud R&D office in October 2017. Web Base Co. has been a consolidated subsidiary since August 2011.

2. History

The Company was established as a sales company for office computers in February 1991, and subsequently expanded into proprietary software development and sales. It began its digital business design (DBD) business in January 2003 and established a unique strategy and entered the web business in November 2003. It released Aladdin Office, a proprietary sales management software, in October 2004.

The Company went public with a listing on the Osaka Stock Exchange (OSE) Hercules Market in June 2007 (subsequently listing on the OSE JASDAQ Market accompanying a merger of OSE markets in October 2010 and then on the Tokyo Stock Exchange (TSE) JASDAQ Growth Market accompanying a merger of OSE and TSE markets in July 2013). It changed to the TSE Second Section in June 2018 and moved to the TSE First Section in July 2019.

In March 2009, the Company released CROSS MALL, a cloud-based software product for integrated management of multiple EC sites. In April 2013, it released CROSS POINT, a software product for integrated management of real-world store and EC customers and loyalty points. In June 2017, it invested in Sivira Inc. and concluded a capital and business alliance. The Company obtained ISO 27001 (ISMS) certification in September 2016.

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Company overview

Company history

Dates	Main items
February 1991	Founded with the aim of selling office computers and developing computer software (Fukushima-ku, Osaka)
September 1993	Moved the headquarters to Noda (Fukushima-ku, Osaka)
April 1996	Started the PC school business
September 2000	Started the @VAL job openings and job seeker information site
July 2001	Opened the Tokyo Headquarters in Shimbashi (Minato-ku, Tokyo)
April 2002	Moved the headquarters to Kita-ku (Osaka)
January 2003	Started the digital business design (DBD) business
November 2003	Entered the web business
September 2004	Acquired privacy mark certification
October 2004	Released proprietary sales management software Aladdin Office
August 2005	Started the web doctor business
June 2007	Listed shares on the Osaka Stock Exchange's Hercules Market
August 2008	Opened the Nagoya Branch in Sakae (Naka-ku, Nagoya)
March 2009	Released CROSS MALL, an ASP service for integrated management of multiple EC sites
October 2009	Opened the East Osaka Branch in Higashi-Osaka (Osaka)
October 2010	Listed shares on the Osaka Stock Exchange's JASDAQ Market accompanying a market merger by the Osaka Stock Exchange
December 2010	Moved the Tokyo Headquarters to Shibakoen (Minato-ku, Tokyo)
August 2011	Moved the Nagoya Branch to Nishiki (Naka-ku, Nagoya)
August 2011	Acquired Web Base as a subsidiary with the purchase of all shares
September 2012	Opened the Fukuoka Branch in Hakata-ku (Fukuoka) and the Sendai Branch in Aoba-ku (Sendai)
April 2013	Released CROSS POINT, a software product for integrated management of real-world stores and EC customers and loyalty points
July 2013	Listed shares on the Tokyo Stock Exchange's JASDAQ Growth Market accompanying the Osaka Stock Exchange and Tokyo Stock Exchange merger
August 2015	Moved the Nagoya Branch to the Urban net Fushimi Building in Nishiki (Naka-ku, Nagoya)
November 2015	Mission-critical system Aladdin Office for Foods won the 45th Food Industrial Technical Award
March 2016	Moved the Osaka Headquarters to Grand Front Osaka Tower B in Kita-ku (Osaka)
September 2016	Mission-critical system Aladdin Office for Foods won the 19th Excellent Food Machine and Materials Prize
September 2016	Obtained ISO 27001 (ISMS) certification
May 2017	Ranked No.1 in Toyo Keizai Online's White 500 Companies Best for Female Recruits
June 2017	Invested in Sivira and concluded a capital and business alliance
October 2017	Opened I'LL Matsue Laboratory in Matsue (Shimane Prefecture) as a next-generation cloud R&D development office
June 2018	Changed the stock listing to the Tokyo Stock Exchange's Second Section
July 2019	Changed the stock listing to the Tokyo Stock Exchange's First Section
November 2019	Ended service by the @VAL job openings and job seeker information site
March 2020	Introduced in the METI Kansai Bureau of Economy, Trade and Industry's Interesting Kansai Company Examples – New Signs from Company Visits – KIZASHI
July 2020	I'LL services approved as tools covered by METI's IT deployment subsidies 2020
December 2020	Obtained Shopify Experts certification as a Shopify partner

Source: Prepared by FISCO from the Company's website and releases

Business overview

CROSS-OVER Synergy strategy of hybrid proposals from real-world and web perspectives stands out

1. Overview of services

The Company provides total system solutions through IT that address the full range of management issues faced by its customers, with mid-tier and small/medium-size companies as its main customers. The Company stands out for its CROSS-OVER Synergy strategy. This strategy seeks to promote the digital transformation of companies through an IT-driven convergence of real-world and web capabilities.

The Company provides a range of products and services to mid-tier and small/medium-size companies that require effective IT utilization, so that they can solve their management issues. These solutions are centered on the Aladdin Office series, an internally developed mission-critical operation management system, and encompass mission-critical system construction, system support maintenance, network construction, human resource education, web consulting, EC site construction, mission-critical operation package software, multiple EC site integrated management software, and real-world store and EC customer and loyalty point integrated management software. The Company supports efforts by client companies to enhance their management capabilities in a wide range of fields such as strengthening their sales capabilities, streamlining their operations (store management, order reception and placement, inventory management, and back-side operation, etc.), and assisting with recruitment and training of human resources. It also operates I'LL Career Colleges (ICCs) in Osaka and Tokyo.

The Company's business segments are the System Solutions Business with Aladdin Office series, a mission-critical operation package software series, as the primary product and the Web Solutions Business (CROSS Business and Other Web Business) with CROSS MALL, a software product for integrated management of multiple EC sites, and CROSS POINT, a software product for integrated management of real-world store and EC customers and loyalty points, available as cloud services. Sales breakdown by segment in 1H FY7/21 was the System Solutions Business at 87.1% and the Web Solutions Business at 12.9% (CROSS Business at 9.0%, Other Web Business at 3.9%). The mainstay System Solutions Business and CROSS Business (under the Web Solutions Business) are expanding.

Business activities



Source: From the Company's results overview

Business overview

Sales trend by business

	FY7/17	FY7/18	FY7/19	FY7/20	FY7/21 1H
System Solutions Business	7,496	8,111	9,094	11,111	5,744
Web Solutions Business	1,124	1,301	1,427	1,568	852
(CROSS Business)	611	749	894	1,040	595
(Other Web Business)	513	551	533	527	256
Total	8,621	9,412	10,522	12,679	6,596

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

(1) System Solutions Business

The System Solutions Business designs and develops mission-critical systems and handles hardware maintenance, system operation support, network construction, and security management for customer companies almost entirely on its own. It primarily supplies the Aladdin Office series, an internally developed mission-critical operation management system with deployments at more than 5,000 companies and offers Aladdin Shop, a store management system for the fashion industry, and Aladdin EC, a BtoB EC and web orders reception and placement system that accommodates web usage.

The Company aims to strengthen product capabilities and differentiate itself from rivals by developing systems suited to the industries and business formats of customer companies and conducts flexible customization. Along with reinforcement of product variations designed for individual industries, it also emphasizes recurring business that obtains revenue from maintenance and operational support after sales.

At the industry level, the Company is an approved supporting member of multiple cooperatives, including the Kansainejikyoudoukumiai (Kansai Screw Cooperative) that approved it as the first supporting member from the IT industry in 2006, and leverages industry connections in sales activities. It also enhances product value incorporating the industry's latest information into its systems. Additionally, it operates I'LL Career Colleges that provide educational services for human resource training at customer companies, such as IT and OA literacy education, engineer cultivation, credential acquisition assistance, and business skills.

(2) Web Solutions Business

The Web Solutions Business mainly provides CROSS MALL, a software product for integrated management of multiple EC sites, and CROSS POINT, a software product for integrated management of real-world stores and EC customers and loyalty points. These software products are supplied as cloud-based applications. Profitability is high because these software products are offered as recurring services.

The Other Web Business consists of CROSS STAFF, a cloud-based staff management system for temporary staffing agencies (launched in 2016), BtoB EC assistance and web marketing assistance (corporate webpage production and operation assistance, EC site construction assistance, customer business analysis and strategy consulting, promotions, and updates and revisions based on log analysis results after webpage production). The Company halted services offered by the @VAL job openings and job seeker information site at the end of November 2019.

2. Main products

Below is a list of the Company's main products and leading customer deployment examples.

(1) Mission-critical operation management system for small/medium-size companies Aladdin Office and store management system Aladdin Shop (real-world)

These products support digitalization of operation management, including sales, inventory, production, and store activities, and improved management capabilities by promoting workstyle reforms with better operational efficiency and strengthening internal compliance. Leading deployment examples are shirt and necktie firm Maker's Shirt Kamakura, stocking and socks firm Fukusuke Corporation, ladies' fashion firm ANAP <3189>, high-end leather shoes firm Madras Inc., eco-friendly product importer and wholesale firm e.oct Inc., Nagoya specialty Tenmusu firm Jiraiya, apparel and restaurant business operator under the DOG DEPT brand Net Work Co., Ltd., salt and rock salt wholesale firm Japan Seasoning, Co., Ltd., and screw specialty trading firm Touyo Screw Co., Ltd.

(2) BtoB EC and web orders reception and placement system Aladdin EC (web)

This product supports digitalization of orders reception and placement operation management between companies and internally and stronger sales through workstyle reforms with better operational efficiency and differentiation from other companies. Leading deployment examples are food trading firm PRECO GROUP (group led by Preco Foods Corporation), alcohol and alcohol-related product sales firms Suntory Marketing & Commerce Limited, cosmetics and beauty and health devices and goods firm Comfort Japan Inc., babies and kids clothing firm Kimuratan Corporation <8107>, commercial alcohol wholesale firm Shibata-ya Co., Ltd., dairy product and Western confectionery firm Kurokawa Co., Ltd., bicycle firm RITEWAY (Riteway Products Japan), and restaurant, home-delivered sushi, and catering firm Dream Dining Co., Ltd.

(3) Multiple EC site integrated management software CROSS MALL (web)

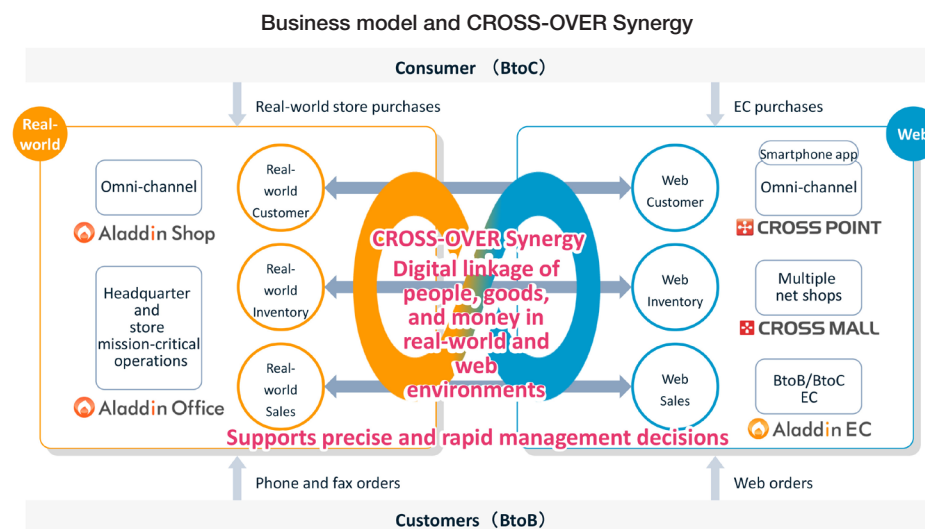
This product handles integrated management of multiple internet shops, including EC mall sites and EC carts, and boosts sales through workstyle reforms with better operational efficiency and reinforced EC initiatives. Leading deployment examples are craft beer production and sales firm YO-HO Brewing Co., Ltd., sporting goods sales firm Murasaki Sports Co., Ltd., ladies' fashion firm ANAP, men's fashion EC business P.B.I. Co., Ltd. with the Silver Bullet brand, eco-friendly product importer and wholesale firm e.oct Inc., and Maruhisa, operator of internet commerce kimono wholesaler Kimono Kyokomachi.

(4) Real-world store and EC customer and loyalty point integrated management software CROSS POINT (web)

This product supports integrated management of real-world store and EC customers and loyalty points through development of a real-world store and EC omni-channel and use of a smartphone app, etc., as well as improved sales via the omni-channel and expansion of the fan segment through enhanced branding. Leading deployment examples are shirt and necktie firm Maker's Shirt Kamakura, stocking and socks firm Fukusuke Corporation, babies', kids', and mothers' clothing firm BRANSHEES, casual women's clothing "w closet" firm Wears Inc., American vintage Ameri EC firm B STONE, ladies' fashion EC "flower" operator Sola Of Tokyo Co., Ltd., and bag and other apparel planning, production, and sales firm COO COMPANY LIMITED.

3. CROSS-OVER Synergy strategy

The Company is known for its CROSS-OVER Synergy strategy that presents hybrid proposals suited to customer needs from real-world (System Solutions Business) and web (Web Solutions Business) perspectives in order to promote proposals to customers more effectively and achieve powerful synergies, and thereby supports stronger management capabilities at mid-tier and small/medium-size companies. This strategy seeks realization of an “all one-stop” service that organically links mission-critical operation systems from the System Solutions Business that support better operation efficiency and services from the Web Solutions Business that assists reinforcement of sales capabilities and creation of stronger synergy effect.



4. Characteristics and strengths

The Company's main characteristics and strengths are (1) strong sales and inventory management know-how, (2) specialization in mid-tier and small/medium-size company markets, (3) ability to accommodate real-world and web environments and high market share, (4) designated industry emphasis strategy, (5) partner strategy, (6) high proprietary product and service ratios, (7) product ecosystem strategy that realizes total solutions, (8) operations with engineers making up about 70% of employees, (9) omni-channel strategy in retail business, and (10) ability to accommodate individual customization. The Company possesses robust offensive and defensive capabilities thanks to its CROSS-OVER Synergy strategy, which enables it to make hybrid proposals from real-world and web perspectives, and it is steadily increasing the number of customer companies.

(1) Strong sales and inventory management know-how

The Company has consistently provided sales and inventory management software that requires understanding of customer operations since its founding. It has extensive deployments and robust know-how in real-world and web environments for manufacturing, wholesale, retail, and other business formats and industries and sales and inventory management with different management methods for each firm.

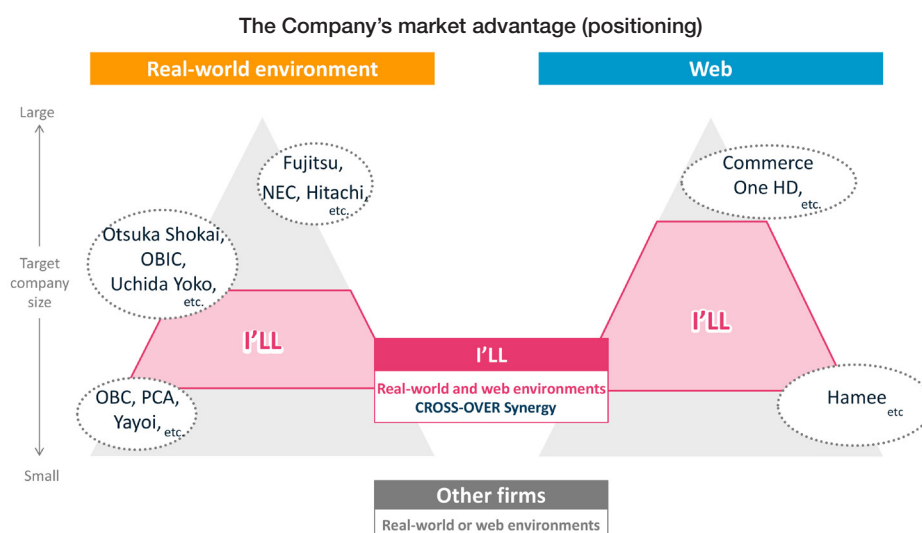
Business overview

(2) Specialization in mid-tier and small/medium-size company markets

The Company has delivered proprietary services that specialize in mid-tier and small/medium-size company markets since its founding. Small/medium-size companies with less than ¥5bn in annual sales account for roughly 90% of customer volume. In recognition of these efforts, the Company received the Special Award (Commerce and Information Policy Bureau Director-General's Award) in METI's "IT Management Awards for Small and Medium Enterprises 2011" in 2011. It also obtained certification as an "IT deployment assistance business" under the "services and other productivity improvement IT deployment assistance business" promoted by METI. Certified services are Aladdin Office, Aladdin EC, CROSS MALL, CROSS POINT, and CROSS STAFF.

(3) Ability to accommodate real-world and web environments and high market share

An important advantage in competing with other firms is the Company's ability to conduct proprietary development and provision of real-world and web support that specializes in mid-tier and small/medium-size companies. The Company is the only provider with market shares exceeding 10% in real-world and web environments.



(4) Designated industry emphasis strategy

Another strength is the Company's strategy of heavy focus on industries with many small/mid-size companies in wholesale, retail, and manufacturing sectors. It forms operations with robust service and sales capabilities, including development of industry-specific systems and establishment of expert teams for individual industries, and thereby boosts new customer acquisition capabilities. Specifically, it positions apparel and fashion, food, medical equipment, screws and metal parts, and steel and non-ferrous metal industries as the five main industries. It seeks to deepen market coverage with industry-specialized package software Aladdin Office series and other products.

(5) Partner strategy

A feature of the Company is that it is also highly trusted by partners in new deal introductions and sales cooperation (banks, system integrators, IT equipment manufacturers, consultants, accounting offices, etc.). Deals introduced by partners represented 42.6% of new orders (on a value basis, 2020) in the System Solutions Business. In addition, inquiries via the Company's website accounted for 34.0% of new orders, indicating an uptrend. The rising percentages of these pull-type sales activities have led to more efficient sales activities.

(6) High proprietary product and service ratios

The Company promotes sales expansion mainly for its own products and services as an important aspect of the management policy of building an income structure that does not depend on sales of other company products, such as hardware, which is readily affected by price fluctuations and has low profit margins. Its own products and services (software, operation, maintenance, membership fees, etc.) hence have a large presence at about 70% of sales.

(7) Product ecosystem strategy that realizes total solutions

The product ecosystem strategy that consists of multiple product groups is also a strength. The Company develops proprietary products and services that cover the internet field of building internet shops and related management assistance services, the real-world store and headquarter field of store sales management and back-side inventory managements, and the real-world and web integration field of integrated management of inventories and loyalty points in real-world and EC operations. It is also capable of making hybrid proposals that combine various products and realizes total solutions for customers.

(8) Operations with engineers making up about 70% of employees

The composition of the Company's 723 employees at end-July 2020 was engineers at 75%, salespeople at 15%, and general staff at 10%. The Company places emphasis on post-system provision support too with an operation in which roughly 70% of employees are engineers. It intends to continue strengthening technology division personnel with the aim of having an organization that promotes cultivation of human resources who handle three roles (industry and operation know-how, mission-critical systems, and web) and reinforcement of technology capabilities. Meanwhile, it has adopted a policy to promote an environment and product development to overcome labor-intensive production.

(9) Omni-channel strategy in retail business

The retail industry has shown interest in recent years in omni-channel strategy that integrates real-world stores and web stores and realizes an environment and distribution paths in which customers are capable of purchasing products in the same way from all channels (sales channels and customer contact points). Since the Company has commercialized integration of real-world and web environments from its founding and accumulated business know-how and a track record that was not achieved in a short period of time, FISCO thinks it possesses an advantage in advancement of omni-channel strategy in the retail industry that cannot be copied by other firms.

(10) Ability to accommodate individual customization

Given differences in operation implementation methods by industries and individual cases at mid-tier and small/medium-size companies, the Company adheres to a fundamental strategy of supporting individual customization of software that meets diverse needs. Meanwhile, the number of companies capable of handling individual customization of software has been trending lower in the software development market in recent years. This shift has lowered orders competition and is boosting profit margin.

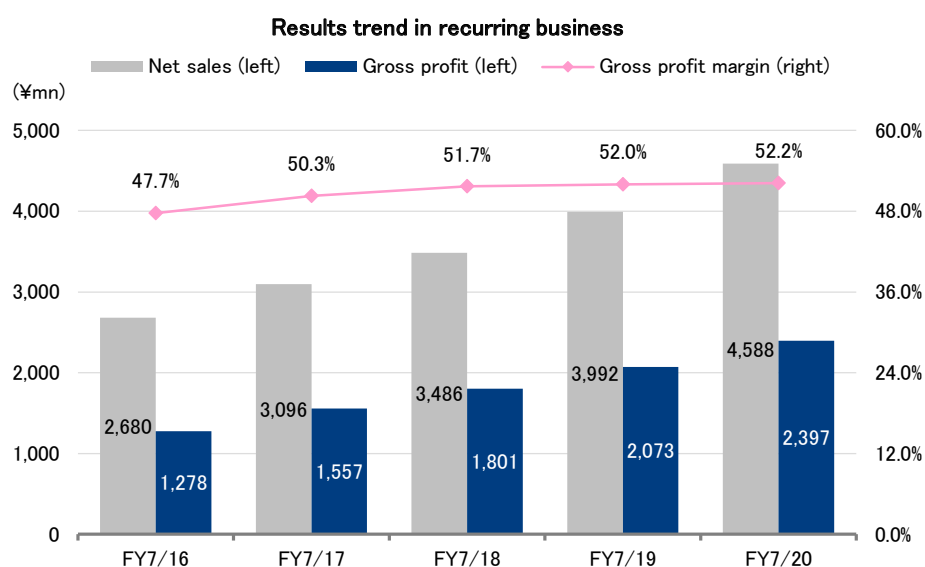
5. Shifting to a policy with emphasis on profits

The Company presented a policy of putting emphasis on profits from FY7/17 and since then has promoted improved quality control and enhanced productivity during development and customization, as well as expansion of recurring sales, etc. as priority measures.

As ways of strengthening quality control and improving productivity in development and customization, the Company implements comprehensive measures to boost quality and productivity and gross profit margin enhancement measures, such as reducing customization steps and preventing trouble ahead of time through reinforced collaboration between sales and development teams at the orders stage. Since FY7/20, it integrated sales and support (system sales and system support) with organizational change and further enhanced collaboration. Additionally, despite the Company's support for individual customization as a fundamental strategy, it intends to promote further improvement in the gross profit margin by expanding orders that do not require customization and shortening lead time with enhanced quality and productivity.

Moreover, recurring sales from products and services such as system maintenance services in the System Solutions Business and CROSS MALL and CROSS POINT in the Web Solutions Business have grown steadily. This growth has also led to the upward trend in the gross profit margin.

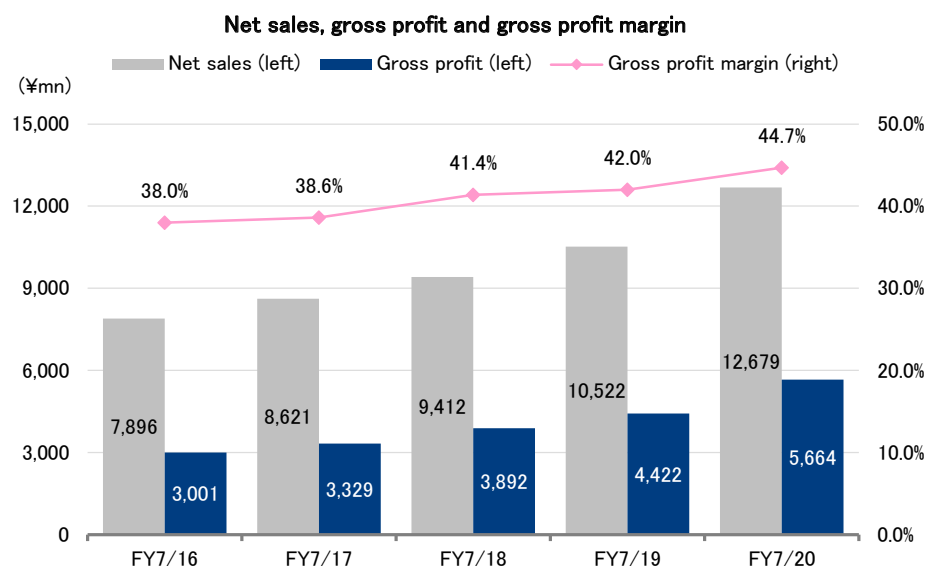
In FY7/20, the Company posted ¥4,588mn in recurring net sales (up 14.9% YoY), ¥2,397mn in gross profit (up 15.6%), and 52.2% gross profit margin (up 0.2ppt). Even with one-time decline in recurring business share due to special demand impact in FY7/20, net sales continued to expand, and there was no change in profit contributions leading an increase in total profit margin.



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

6. Upward trend in gross profit margin

The Company has promoted measures to improve productivity and expanded sales from recurring business. As a result, the gross profit margin on a company-wide basis has trended upward from the recent bottom of 38.0% in FY7/16 to reach an all-time high of 44.7% in FY7/20.



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

Given that the gross profit margin tends to fluctuate on a half-year basis due to one-time factors, the gross profit margin should be compared on a full-year basis, in principle. For reference, although gross profit for 1H FY7/21 decreased due to the non-recurrence of special demand recorded in 1H FY7/20, the gross profit margin rose to a record high of 45.8% on a half-year basis.

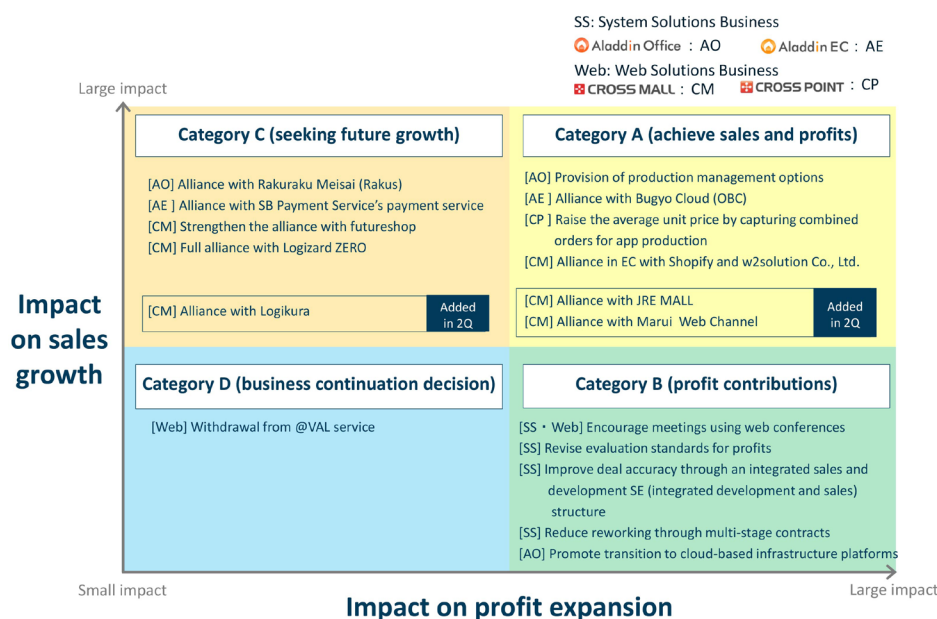
In addition, the Company has developed an income structure where it can cover most of the employee salary component of its fixed costs on a company-wide basis with gross profit from recurring business. Therefore, the Company has adopted a policy that seeks to establish an income structure that can cover personnel costs and fixed costs through efforts to increase recurring sales further.

Business overview

7. Strengthen service collaboration with business partners

The Company promotes strategies such as upgrading existing products, and forming service collaborations with business partners in various fields, as initiatives to drive further sales growth and profit expansion.

Measures to expand sales and profits



Source: From the Company's results overview

The Company added a production management option to the mission-critical operation management system Aladdin Office in January 2020 as an updated version of the existing product. With this capability, manufacturing customers can efficiently systematize production management functions that they require. It also provides functionality handled in customization work as an option. The Company's gross profit margin benefits from reduction of SE process steps and ensuring quality.

Regarding service alliances with business partners, the mission-critical operation management system Aladdin Office in the System Solutions Business has a book ledger data collaboration with Rakus' <3923> web form issuance system "Rakuraku Meisai" (November 2019) and Aladdin EC, the BtoB EC and web orders reception and placement system, interacts with SB Payment Service's payment service (November 2019) and OBIC Business Consultants' (OBC) <4733> Bugyo Cloud (August 2020).

CROSS MALL, a software product for integrated management of multiple EC sites in the Web Solutions Business, supports orders, inventory, and product collaboration with Z Holdings Corporation's <4689> PayPay Mall (November 2019), complies with the CMS function of Future Shop Co., Ltd.'s "futureshop" (March 2020), and interacts with BASE's <4477> BASE (June 2020). Additionally, CROSS MALL interacts with Brain Wave Co., Ltd.'s Happy Logistics (July 2020) and supports fully automated collaboration with Logizard ZERO of Logizard Co., Ltd. <4391> (October 2020). CROSS MALL collaborates with w2Commerce of w2solution Co., Ltd. (November 2020), supports automated collaboration with Logikura Co.'s Logikura (January 2021), and collaborates with the EC shopping mall JRE MALL of East Japan Railway Company <9020> (March 2021), and the online shopping platform Marui Web Channel of MARUI GROUP CO., LTD. <8252> (March 2021).

Business overview

In July 2020, the Company's IT services received certification for METI's IT deployment subsidies 2020 program. Moreover, in December 2020 the Company received certification for Shopify Experts, which is a partner program of Shopify, a cloud-based multi-channel commerce platform.

8. Risks, income characteristics, and measures

System development-related companies confront fluctuation in profit margin from profitability of individual development projects. General income risks are longer development periods accompanying increasingly larger projects, increase in personnel costs and outsourcing expenses, individual projects becoming unprofitable and other factors. In the Company's case, however, since it mainly develops and sells package software, there is less risk of incurring losses on individual projects compared to system development companies that primarily handle consigned development work.

The Company encounters profit margin setback from increase in process steps and software bugs in development and customization because it pursues differentiation from rivals through provision of flexible customization suited to customers. It is addressing this challenge with the policy of stronger emphasis on earnings described above. Specific measures are efforts to reduce customization process steps and prevent trouble ahead of time by strengthening collaboration between sales and development and initiatives to boost quality and productivity with improvements in the workplace environment.

Another income feature at system development-related companies is volatility in quarterly results due to booking sales from large projects and timing of customer inspections. The Company whose fiscal year ends in July similarly tends to book higher sales in 2H (February to July) than in 1H (August to January). SG&A expenses are typically higher in 4Q (May to July) due to entry of new employees and incentives.

In response to these characteristics, the Company has been trying to mitigate the uneven timing of sales recognition by spreading out orders and increasing orders for maintenance and other recurring services. It expects to make gradual progress on standardizing income recognition. In FY7/20 and FY7/21, meanwhile, the income composition was irregular on a quarterly and half-year basis, because of special demand-related factors and the rebound from those factors.

Looking at market competition, as stated earlier, the Company has seen a steady increase in the number of its customer companies, supported by its robust offensive and defensive capabilities, reflecting the Company's advantages and strengths derived from its ability to make real-world and web proposals as a single entity. As a result, the Company boasts a dominant winning percentage in competition for projects (91.8% in FY7/20) and a high customer repeat rate (98.3% in FY7/20). With fewer and fewer companies able to support individual customization of software in the software development market, the Company can be said to have a strong competitive advantage.

Results trends

Results for 1H FY7/21 finished above forecasts, despite sales and profit decreases due to the non-recurrence of special demand

1. Overview of 1H FY7/21 results

The Company reported 1H FY7/21 consolidated results with ¥6,596mn in net sales (down 5.2% YoY), ¥954mn in operating profit (down 22.2 %), ¥971mn in ordinary profit (down 21.2%), and ¥635mn in profit attributable to owners of parent (down 21.5%).

Results for 1H FY7/21

	1H FY7/20 Results	1H FY7/21			
		Initial forecasts	Results	YoY change	Versus initial forecasts
Net sales	6,957	6,467	6,596	-5.2%	2.0%
System Solutions Business	6,165	-	5,744	-6.8%	-
Web Solutions Business	792	-	852	7.6%	-
(CROSS Business)	511	-	595	16.4%	-
(Other Web Business)	281	-	256	-8.9%	-
Recurring net sales	2,238	-	2,523	12.7%	-
Gross profit	3,136	-	3,021	-3.7%	-
Gross profit margin	45.1	-	45.8	-	-
System Solutions Business	2,791	-	2,599	-6.9%	-
Web Solutions Business	344	-	421	22.4%	-
(CROSS Business)	270	-	329	21.9%	-
(Other Web Business)	74	-	91	23.0%	-
SG&A expenses	1,910	-	2,067	8.2%	-
SG&A expenses ratio	27.5	-	31.3	-	-
Operating profit	1,226	792	954	-22.2%	20.5%
Ordinary profit	1,232	802	971	-21.2%	21.1%
Profit attributable to owners of parent	809	521	635	-21.5%	22.0%

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

Sales and profits both decreased due mainly to the non-recurrence of special demand recorded in the same period of the previous fiscal year (1H FY7/20) and increased personnel costs. However, recurring business grew steadily due to the rising DX needs of companies. As a result, net sales were 2.0% above the initial forecast. Meanwhile, operating profit was 20.5%, ordinary profit was 21.1%, and profit attributable to owners of parent was 22.0% above initial forecasts. All profit items finished much higher than initially forecast. According to the Company's estimates, ¥1,200mn of net sales of ¥6,957mn for 1H FY7/20 was attributable to special demand. Therefore, excluding the impact of special demand, net sales for 1H FY7/21 increased by 14.6% YoY.

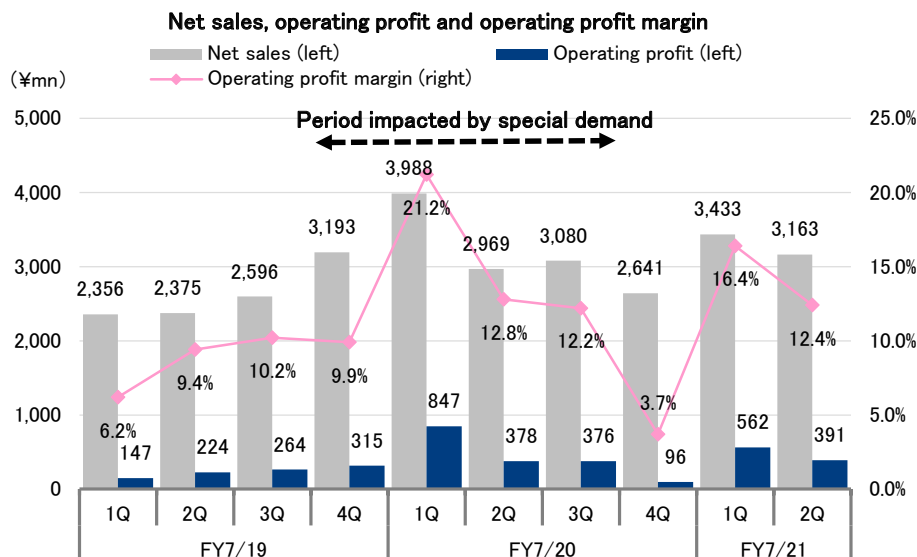
Looking at the performance at the business level, System Solutions Business sales decreased due to a large impact from the non-recurrence of special demand recorded in 1H FY7/20. However, CROSS Business sales grew steadily, partly because the Company can now handle the entire process from opportunity development to contracts over the web, and this growth contributed to the rise in the gross profit margin. In addition, recurring sales grew steadily, up 12.7% to ¥2,523mn. As a result, recurring sales also contributed to the rise in the gross profit margin.

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Results trends

Gross profit decreased 3.7% YoY in line with the decline in net sales, but the gross profit margin rose 0.7ppt to 45.8%. The main contributing factors were improved productivity and increased sales from recurring business. On the other hand, SG&A expenses increased 8.2%. This increase was mainly due to an increase in personnel costs reflecting factors such as an increase in the number of employees and raises in salary levels, despite scaling back sales promotion initiatives amid the COVID-19 crisis. The SG&A expenses ratio rose 3.8ppt to 31.3%, partly due to the decline in net sales.

Looking at quarterly performance, in 1Q FY7/21, net sales were ¥3,433mn and operating profit was ¥562mn. In 2Q FY7/21, net sales were ¥3,163mn and operating profit was ¥391mn. In terms of comparisons with the same quarter of the previous fiscal year, in 1Q FY7/21, net sales decreased 13.9% and operating profit decreased 33.6% due to the non-recurrence of special demand recorded in the same period of the previous fiscal year. However, with the impact of the non-recurrence of special demand diminishing in 2Q FY7/21, sales and profits returned to a growth trajectory, with net sales up 6.5% and operating profit up 3.4%.



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

2. Trends by business segments

(1) System Solutions Business

The System Solutions Business reported ¥5,744mn in net sales (down 6.8% YoY) and ¥2,599mn in gross profit (down 6.9%). Although sales and profits decreased due to the non-recurrence of special demand recorded in 1H FY7/20, the gross profit margin was kept at 45.3%, mostly unchanged from 1H FY7/20. The main contributing factors were enhanced profitability on the build-up of sales from recurring business, improved deal accuracy through an integrated sales and development SE structure, and reduced customization process steps. Another contributing factor was growth in recurring business such as maintenance and support, supported by a high level of inquiries reflecting the increased DX needs of companies. Excluding the special demand recorded in 1H FY7/20 (net sales of ¥1,200mn and gross profit of ¥547mn according to the Company's estimates), net sales increased 15.7% YoY and gross profit rose 15.8% YoY.

(2) Web Solutions Business

The Web Solutions Business reported ¥852mn in net sales (up 7.6% YoY), including the CROSS Business at ¥595mn (up 16.4%) and the Other Web Business at ¥256mn (down 8.9%), and ¥421mn in gross profit (up 22.4%), including the CROSS Business at ¥329mn (up 21.9%) and the Other Web Business at ¥91mn (up 23.0%). On the sales front, CROSS MALL, a cloud-based software product for integrated management of multiple EC sites, and CROSS POINT, a software product for integrated management of real-world stores and EC customers and loyalty points, both achieved growth. As a result, the gross profit margin of the CROSS Business rose 2.4ppt to 55.3%. Besides the positive effect of higher net sales, another contributing factor was improved production efficiency following the completion of the coordination of standards with major partners for CROSS POINT.

3. Financial conditions and management indicators

In financial standing, total assets increased ¥194mn YoY to ¥7,779mn and total liabilities decreased ¥248mn to ¥3,623mn at end-1H FY7/21. In assets, cash and cash equivalents and notes and accounts receivable-trade increased. In liabilities, borrowings decreased. Total net assets were up ¥442mn to ¥4,156mn due to increased retained earnings. The equity ratio rose by 4.4ppt to 53.4%. FISCO believes these results indicate that the Company has a sound financial standing.

Results trends

Main management indicators

	FY7/17	FY7/18	FY7/19	FY7/20	1H FY7/21
(¥mn)					
Net sales	8,621	9,412	10,522	12,679	6,596
Cost of sales	5,291	5,519	6,099	7,014	3,575
Gross profit	3,329	3,892	4,422	5,664	3,021
Gross profit margin	38.6%	41.4%	42.0%	44.7%	45.8%
SG&A expenses	2,897	3,366	3,471	3,964	2,067
SG&A expenses ratio	33.6%	35.8%	33.0%	31.3%	31.3%
Operating profit	432	526	951	1,700	954
Operating profit margin	5.0%	5.6%	9.0%	13.4%	14.5%
Non-operating profit	28	24	25	23	18
Non-operating expenses	4	4	3	8	0
Ordinary profit	455	546	972	1,715	971
Ordinary profit margin	5.3%	5.8%	9.2%	13.5%	14.7%
Extraordinary income	-	-	2	-	-
Extraordinary losses	0	0	0	2	0
Profit before income taxes	455	545	975	1,713	971
Total income taxes	155	208	354	523	335
Profit attributable to owners of parent	299	336	621	1,189	635
Profit attributable to owners of parent margin	3.5%	3.6%	5.9%	9.4%	9.6%
Comprehensive income	370	355	654	1,175	642
Total assets	5,565	5,719	6,646	7,585	7,779
(Current assets)	4,076	3,936	4,409	4,993	5,162
(Non-current assets)	1,488	1,783	2,236	2,591	2,617
Total liabilities	3,410	3,321	3,794	3,871	3,623
(Current liabilities)	1,798	1,781	2,335	2,366	2,065
(Non-current liabilities)	1,611	1,539	1,459	1,505	1,557
Total net assets	2,155	2,397	2,851	3,713	4,156
(Shareholders' equity)	2,205	2,429	2,850	3,727	4,162
Share capital	354	354	354	354	354
Total number of outstanding shares at period end excluding treasury stock (shares)	25,042,856	25,042,576	25,042,528	25,037,434	25,036,534
Net income per share (yen)	11.98	13.45	24.81	47.55	-
Net assets per share (yen)	86.06	95.74	113.87	148.33	-
Dividend per share (yen)	4.5	5	8	15	7
Equity ratio	38.7%	41.9%	42.9%	49.0%	53.4%
Cash flows from operating activities	920	217	1,006	2,088	-
Cash flows from investing activities	-287	-451	-600	-587	-
Cash flows from financing activities	-21	-332	-420	-663	-
Cash and cash equivalents at end of period	1,938	1,371	1,356	2,194	-

Note: Values per share retroactively revised for 2-for-1 stock splits on August 1, 2018 and November 1, 2019 respectively.

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

■ Outlook

Full-year results forecasts for FY7/21 were upwardly revised

1. FY7/21 outlook

In March 2021, the Company upwardly revised its FY7/21 consolidated results forecasts. It is now forecasting ¥12,723mn in net sales (up 0.3% YoY), ¥1,600mn in operating profit (down 5.9%), ¥1,627mn in ordinary profit (down 5.1%) and ¥1,046mn in profit attributable to owners of parent (down 12.0%). Relative to initial forecasts, the Company upwardly revised net sales by ¥373mn (up 3.0%), operating profit by ¥400mn (up 33.3%), ordinary profit by ¥401mn (up 32.7%), and profit attributable to owners of parent by ¥262mn (up 33.4%).

FY7/21 outlook

	FY7/20 Results	FY7/21			
		Initial forecasts	YoY change	Revised forecasts	YoY change
Net sales	12,679	12,350	-2.6%	12,723	0.3%
Operating profit	1,700	1,200	-29.4%	1,600	-5.9%
Ordinary profit	1,715	1,226	-28.5%	1,627	-5.1%
Profit attributable to owners of parent	1,189	784	-34.0%	1,046	-12.0%
Net income per share (yen)	47.55	31.35	-	41.78	-

Note: The revised forecasts for FY7/21 were announced on March 5, 2021.
Source: Prepared by FISCO from the Company's financial results

Given that the impact of the COVID-19 crisis was much less severe than anticipated at the time of the initial forecast, the Company upwardly revised the net sales forecast to a YoY increase. On the profit front, operating profit is forecast to decrease because of increased SG&A expenses owing to revisions to personnel recruitment and bonus levels aimed at future growth. However, orders and net sales are performing more strongly than anticipated against the backdrop of the heightened DX needs of companies, and the gross profit margin is rising owing to the positive effects of improved productivity and growth in recurring sales. For these reasons, the Company expects the decline in profits to be smaller than initially forecast. According to the Company's estimates, the impact of special demand in FY7/20 amounted to net sales of ¥1,500mn and operating profit of ¥266mn. Excluding the impact of special demand in FY7/20, net sales are forecast to increase 13.8% and operating profit is forecast to increase 11.6%.

The Company has a strong tendency to announce conservative numerical estimates overall, the achievement rate for operating profit as of 2Q FY7/21 was favorable, at 59.6%, and recent trends in orders and sales have been firm. Considering these and other factors, FISCO believes that the Company could upwardly revise its full-year results forecasts even further.

2. Priority measures

With the COVID-19 crisis, DX needs for standardizing and streamlining operations have been increasing among companies, and IT investments utilizing subsidies are expected to pick up. For these reasons, the Company plans to advance its strategy for expanding sales and profits by implementing priority measures that address DX needs.

Outlook

Specifically, the Company intends to promote recruitment of new customers using the web, customer development in a new channel by holding webinars, and stronger collaboration with business partners. It will also work to expand sales of Aladdin EC, the BtoB EC and web orders reception and placement system that eliminates fax services, and CROSS MALL, the integrated management software for operating multiple EC sites. The Company will also enhance system functionality, improve deal accuracy through an integrated sales and development SE structure, and increase average unit prices by capturing combined orders for CROSS POINT app production. It will also work to improve SE productivity with customized part templates for Aladdin Office. In addition, the Company will strive to reduce reworking through multi-stage contracts for each development phase.

Medium-term growth strategy

Aim at being the leading company in DX assistance

1. Basic strategy for growth

The Company delayed disclosure of goals for the new three-year medium-term management plan (FY7/21–FY7/23; rolling plan updated once a year) because of higher uncertainty with the COVID-19 outbreak. Going forward, the Company has said that it will review the plan as necessary based on the impact of the COVID-19 crisis and will disclose its goals when it is able to determine its quantitative results forecasts.

While the Company has postponed the disclosure of its goals, it aims to be being a leading company in DX assistance and has set forth the following basic strategies for growth: (1) building a robust income foundation through stable growth in the System Solutions Business, (2) cultivating the Web Solutions Business as a second major income source, and (3) entering the field of new business operation systems that incorporate new technologies. The Company promotes a unique CROSS-OVER Synergy strategy and aims to build highly profitable operations through organic coupling of proprietary services and products that incorporate new technologies and provision of total solution packages with high added value to the market.

(1) Building a robust income foundation through stable growth in the System Solutions Business

The Company is accelerating reinforcement of various industry package products, expansion of its customer base in five specialization industries (apparel and fashion, food, medical equipment, screw and metal parts, steel and non-ferrous industry), opening new sales locations and widening commercial zone areas, and development of the ERP market and BtoB EC market. In customer segment expansion, while wholesale business had been the main segment previously, it is pursuing expansion of manufacturing, import, and retail customers in the five specialization industries utilizing functions and know-how cultivated in industry-specific standard package development for the Aladdin Office mission-critical operation management system.

(2) Cultivating the Web Solutions Business as a second major income source

The Company intends to promote reinforcement of back-side assistance for the BtoB EC market through development of next-generation cloud services and formulation of a new fee plan.

(3) Entering the field of new business operation systems that incorporate new technologies

The Company plans to promote development of services utilizing blockchain and artificial intelligence (AI).

2. Active investment in R&D

(1) Utilizing blockchain technology through a capital and business alliance with Sivira

The Company invested in Sivira and formed a capital and business alliance in June 2017. Utilizing Sivira's proprietary blockchain technology Broof, it is jointly enhancing security in cloud services, opening up inventory data, and planning, developing, and selling an open platform that extends across companies, stores, and services. In August 2017, it started operation of Sivira's blockchain technology Broof in the CROSS Series, its operation management cloud service.

(2) Next-generation cloud R&D office I'LL Matsue Laboratory

The Company opened I'LL Matsue Laboratory in Matsue (Shimane Prefecture) as a next-generation cloud R&D office and began full-fledged operations in October 2017. Matsue is a "sacred city" for engineers as a city promoting use of "Ruby," the first programming language developed in Japan approved as an international standard. The Company aims to achieve high quality more efficiently in development of the next-generation version of existing cloud service "CROSS Series" by uniformly adopting Ruby, a programming language known for its simplicity and high productivity and flexibility, as the development language.

(3) Actively investing in R&D for services utilizing AI

According to the Company, 85.8% of orders from mid-tier and small/medium-size companies are made through "analogue" methods (fax, telephone, email, in-person sales, exhibitions), and the BtoB EC deployment rate remains at only 14.2%. Nonetheless, approximately 40% of companies say they intend to shift to digital methods.

Anticipated trends in the market environment are growing IT investments toward realizing DX, rising IT investments in ERP and other products as part of promoting workstyle reforms (boosting productivity), expansion of the EC market, and expansion of blockchain, AI, and other new technology markets. The Company is promoting R&D activities for data analysis and automated operations utilizing AI in operation system areas as an initiative to boost competitiveness in this market environment. It also plans to build a proprietary CROSS-OVER platform that incorporates know-how cultivated in mission-critical systems and cloud services and further accelerate mutual collaboration between mission-critical systems and cloud services.

3. Medium-term growth momentum unchanged as a trend

Market conditions are healthy, and customer volume is increasing. Profit margin is also rising on improved quality and productivity and expansion of recurring business. FISCO hence thinks medium-term growth momentum targeting a position as a DX assistance leader is unchanged, despite the irregular trend in FY7/21 due to the one-time impact from the non-recurrence of special demand.

Shareholder return policy

Dividend forecasts for FY7/21 were upwardly revised

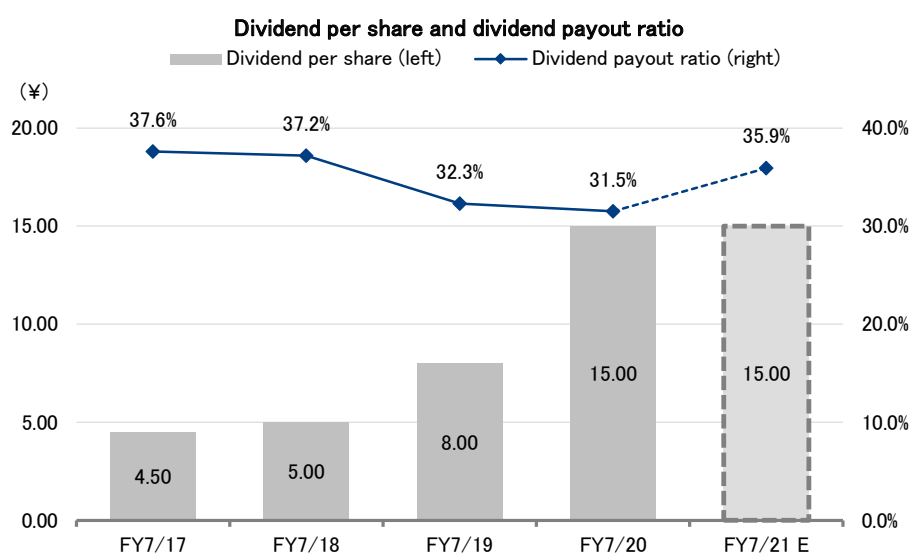
The Company's basic policy is to pay a dividend based on results while comprehensively considering things like management and the balance between retained earnings for maintaining and strengthening its competitiveness in the industry and return on equity (ROE) when allocating profits. The Company targets a dividend payout ratio in the 30% range and a stable dividend.

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Shareholder return policy

Based on the Company's basic policy, the Company increased the dividend forecast for FY7/21 in conjunction with the upwardly revised consolidated results forecasts. The annual dividend forecast was increased by ¥3.00 per share (increases of ¥1.00 per share in the interim dividend and ¥2.00 per share in the year-end dividend) from the initial forecast. As a result, the annual dividend for FY7/21 is now forecast at ¥15.00 per share (interim dividend of ¥7.00 per share, year-end dividend of ¥8.00 per share), which is the same amount as in FY7/20, while the projected dividend payout ratio is 35.9%.

The Company is also considering revising the dividend payout ratio and can be expected to further enhance shareholder returns through such means as increasing dividends in conjunction with earnings growth.



Note: The Company conducted 2-for-1 stock splits on August 1, 2018 and November 1, 2019 and has retroactively adjusted figures for FY7/19 and prior fiscal years accordingly.
Source: Prepared by FISCO from the Company's financial results

SDGs initiatives

The Company is also actively engaged in SDGs initiatives. For example, as part of its social contribution activities, the Company has supported MOVE FES. 2019, an event held by WITH ALS General Incorporated Association. WITH ALS carries out awareness-raising activities for ALS (amyotrophic lateral sclerosis), an intractable disease.

The Company also conducts community support initiatives in Matsue, Shimane Prefecture. At I'LL Matsue Laboratory, which was opened in 2017, the Company conducts local recruitment of personnel primarily from Shimane University and National Institute of Technology, Matsue College. It has also made office space on the first floor available to the public as an IT networking space, using this facility as a base for programs to enhance IT skills and increase interest in this field. Moreover, since 2017, the Company has continuously supported the RubyWorld Conference, a locally held event designed to expand the market and business pertaining to the Ruby programming language. Going forward, the Company plans to continue to strengthen its SDGs initiatives.

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