COMPANY RESEARCH AND ANALYSIS REPORT

Scala, Inc.

4845

Tokyo Stock Exchange First Section

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Summary

Expanding the service lineup and developing the B-to-C business with the aim of increasing sales and profits by double digits in FY6/18

Scala, Inc. <4845> (hereafter, also "the Company") is a leading provider of website search, FAQ service, and other services for corporate websites. It provides a wide range of services using the latest technologies, mainly a stock-type business model SaaS/ASP service* and related to the Internet of Things (IoT) and Big Data. It leverages contacts with customers from direct sales to reflect their needs in development activities and has steadily expanded its service lineup to achieve steady growth. It also actively uses M&A to expand its business area and purchased the shares of Softbrain Co., Ltd. <4779>, a major supplier of SFA/CRM software, in July 2016 and made it a consolidated subsidiary (it held 50.23% of voting rights as of March 2, 2017). From FY6/16, the Company adopted IFRS accounting, which is being promoted to introduce to Japanese listed companies by the Tokyo Stock Exchange.

* Service that supplies application software functionality to customers over a network

1. Sales and profits greatly increased in FY6/17 on Softbrain being made a subsidiary

In the FY6/17 consolidated results, sales revenue increased 295.8% year on year (YoY) to ¥10,663mn and operating profit rose 505.7% to ¥3,736mn. The main reasons for the higher sales and profits was that Softbrain was made a consolidated subsidiary and the recording of ¥2,633mn as a gain related to the staged acquisition of Softbrain shares. In order to show a more realistic result, operating profit based on non-GAAP standards that excludes extraordinary revenue increased 125.2% YoY to ¥1,389mn. In the existing SaaS/ASP business, sales revenue increased 4.2% to ¥2,807mn, while operating profit based on non-GAAP standards decreased 35.7% to ¥396mn. Although monthly stock revenue grew steadily, this decrease was due to the rise in outsourcing expenses from the Company focusing on developing high value-added services that are expected to contribute to earnings in the future, and also higher personnel expenses, rent, and other expenses.

2. Forecasts double-digit increases in sales and profits in FY6/18 based on non-GAAP standards

Looking at the FY6/18 results based on non-GAAP standards, the forecasts are for double-digit increases in sales and profits, with sales revenue to rise 18.2% YoY to ¥12,600mn and operating profit to climb 23.1% to ¥1,710mn. In addition to the continued higher profits at Softbrain, growth is expected to continue in the SaaS/ASP business, with double-digit increases in sales and profits from the effects of launching new services and other factors. The main services, including i-ask (a FAQ system) and "IVR" (an Interactive Voice Response service), are continuing to expand. We can expect contributions to earnings from "i-assist" (virtual assistance) and "i-livechat" (a web chat system), which have been introduced as new services, and also from the development and management of a social gift service. In terms of expenses, the increase in outsourcing expenses will come to an end, while personnel expenses will also rise only slightly, so the forecast is for the profit margin to improve.

3. Acquisition of a trading card EC site through an M&A

In addition to the growth of its existing businesses, the Company is pursuing a growth strategy of expanding its business domains through M&A and business collaborations. It is targeting the EC, robot, and AI fields as new business domains, while in FY6/18 it also plans to newly enter the EC field. It acquired an EC site used to buy and sell trading cards for a competition-type game, and it consolidated and started operations from August 2017. The aim of this acquisition is to obtain EC site management expertise for the B-to-C market, and the plan for the future is to expand its EC site management business.

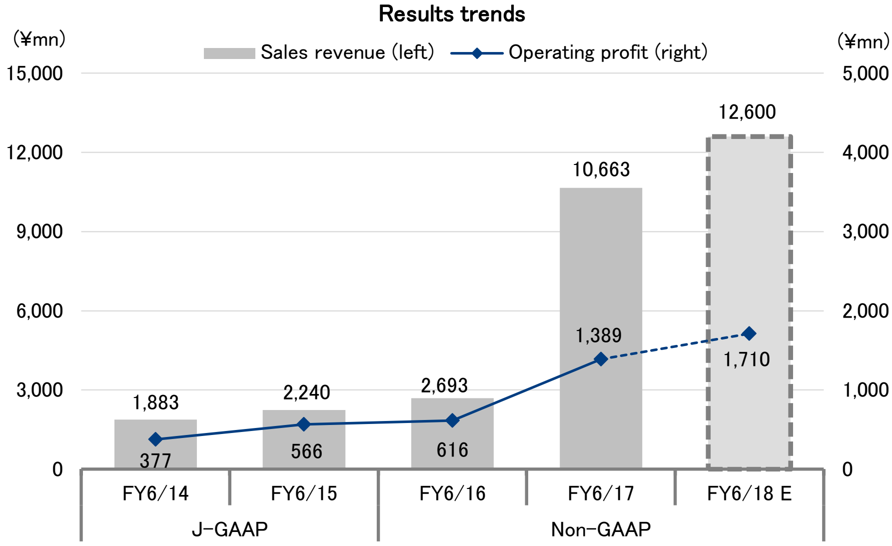
4. Will continue to increase dividends, assuming earnings growth

The Company's basic dividend policy is to stably and continuously pay dividends while retaining the internal reserves necessary to strengthen its financial structure and to develop its businesses in the future. In FY6/18, it plans to pay a dividend per share of ¥20, up ¥2 YoY, for the ninth consecutive fiscal year of higher dividends. It also aims to continue to increase the dividend in the future alongside the growth in earnings.

Key Points

- The corporate cloud service is its core business and it is expanding business scale through an M&A strategy
- The forecasts for the FY6/18 consolidated earnings are double-digit increases in sales and profits, based on non-GAAP standards
- Is launching new services one after another, including i-livechat, i-assist, and a social gift service

Results trends



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

Company profile

The corporate cloud service is its core business and it is expanding business scale through an M&A strategy

1. History

A recently retired Representative Director and Chairman Kenzo Tamura, and a recently retired Director Hideki Shimazu founded the Company in December 1991 with an initial start as a sales distributor of database systems. It realized significant growth in 1999 by inheriting support services, including customers, for the Model 204* mainframe database management system license from Mitsui Knowledge Industry Co., Ltd. In May 2001, it was listed on the Osaka Securities Exchange's NASDAQ Japan market (now TSE's JASDAQ; it is currently listed on the TSE First Section).

* DBMS developed by US-based Computer Corporation of America and Sirius Software (now, Rocket Software), whose major customers in Japan have included Bank of Japan <8301> and Tokyo Electric Power Company Holdings, Incorporated <9501>. Demand for it ceased due to changes in the market environment, and the service was ended in the fall of 2016.

The Company determined that it needed to change its business structure to continue growth amid migration by corporate information systems from mainframes to small-scale open servers, and it started acquiring information service firms through M&As utilizing funds obtained from the IPO. It began with the purchase of PatentManager, a patent management software business from Interscience in 2003, and then acquired Dbecs Co., Ltd. with the aim of entering the CRM field, Vodamedia Inc. with the goal of entering the interactive voice response (IVR) field, the news distribution service provider NewsWatch Inc., the website developer TriAx Corp., and others as subsidiaries. The Company is steadily expanding its SaaS/ASP business as its core operations and bolstering its recruitment of system engineers to enhance its own service development capabilities. More recently, by March 2017 it acquired a stake in Softbrain Co., Ltd., a leading supplier of SFA/CRM software (as of June 30, 2017, it owned 50.23% of its voting rights) and made it a consolidated subsidiary.

The Company switched to a holding company organization in 2004 to conduct more flexible management. In December 2016, it changed its trade name from Fusion Partners Co. to Scala, Inc. to strengthen its brand power, and at the same time the consolidated subsidiary Digi-Ana Communications Inc. became Scala Communications Inc. Also, in October 2016, it unified the trade names of its subsidiaries (except for the Softbrain Group), including the newly established Scala Services Inc., which is responsible for the solutions business. The Company currently has 9 consolidated subsidiaries, including the Softbrain Group (6 companies).

History

Date	Major event
December 1991	Founded Database Communications (now, Scala, Inc.)
January 1999	Formed sales distribution contracts for the Japanese market with US-based Computer Corporation of America and Sirius and started Model 204 support
May 2001	Listed on the Osaka Securities Exchange's NASDAQ Japan market (now, TSE JASDAQ (Standard))
April 2003	Acquired Interscience's patent management software (product name: PatentManager) with the aim of entering the intellectual property system field
October 2003	Acquired Dbecs Co., Ltd. as a subsidiary to enter the CRM field
April 2004	Acquired Vodamedia Inc. as a subsidiary with the aim of entering the IVR (interactive voice response) field
September 2004	Renamed as Fusion Partners Co. in the transition to a holding company structure and established Database Communications (now, PAREL, Inc.) as a new company and transferred its business
June 2006	Merged subsidiaries Vodamedia and Dbecs and changed the company name to Digi-Ana Communications Inc. (now, Scala Communications Inc.)
November 2010	Acquired NewsWatch Inc. as a subsidiary
April 2012	Merged subsidiaries Digi-Ana Communications and NewsWatch (now, Scala Communications Inc.)
May 2014	Listing transferred to the TSE Second Section
December 2014	Shares elevated to the TSE First Section
November 2015	Acquired TriAx Corp. as a subsidiary
January 2016	Renamed subsidiary Database Communications as PAREL, Inc.
July 2016	Acquired Softbrain Co., Ltd. as a subsidiary
December 2016	Changed trade name to Scala, Inc.
December 2016	Merged the subsidiaries Digi-Ana Communications and TriAx Corp. and changed the trade name to Scala Communications Inc.

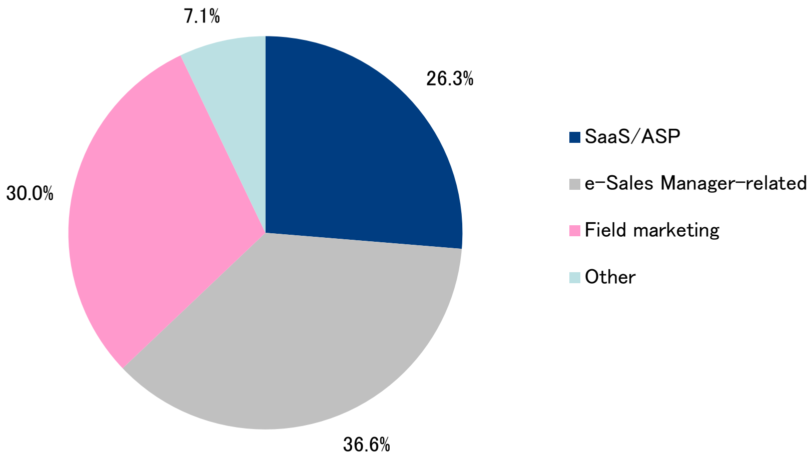
Source: Prepared by FISCO from the Company's website

Has the leading shares in the domestic market, including for i-search, a website internal search service, and i-ask, a FAQ service

2. Business description

The Company's mainstay businesses can be broadly dividend into its existing business of SaaS/ASP services, which enhance convenience for visitors to corporate websites, and the Softbrain Group's businesses (e-Sales Manager-related business, field marketing business, and other businesses). In terms of their respective percentages of total sales in FY6/17, the SaaS/ASP business provided 26.3%, the e-Sales Manager-related business 36.6%, and the field marketing business 30.0%, so these 3 businesses provide more than 90% of total sales.

Sales composition (FY6/17)



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

(1) The SaaS/ASP business

The Company provides SaaS/ASP services as its core businesses. The main services are the i-search website search service, the i-ask FAQ service, the interactive voice response (IVR) service, and the news distribution service.

The i-search service was launched in 2007, and it currently holds the leading market share at around 15% with more than 360 customers, particularly large enterprises. While the Company has over 10 competitors, its i-search service offers better visibility by displaying images in search results and provides effective guidance to users. The average usage fee per month is ¥100,000 to ¥150,000.

The Company launched the i-ask service in around 2008 and it is used by about 160 companies, mainly in the financial and insurance industries. This service lets users resolve issues on their own by listing frequently asked questions and related answers on their corporate sites. It helps to lower costs by reducing accesses to call centers and can also improve customer satisfaction. The Company holds a roughly 15% market share, ranked second after OKWAVE <3808>. The average usage fee per month is ¥200,000 to ¥300,000.

IVR is a system for voice-based automated responses at corporate phone help desks, and the Company's service stands out for being provided in the SaaS format. Companies previously incurred large investment costs for IVR, including the need to install a PBX (private branch exchange) system. However, the SaaS format enables them to access the service inexpensively and to use it during limited periods, such as campaigns.

Other than these businesses, the Company also provides various other services, including a news distribution service for corporations, and a service for the planning, development, production, maintenance, and management of websites according to customer needs, and one of its features is that it has a rich service lineup and it does not rely upon a specific service. It also develops systems and provides services related to the IoT and Big Data as customized development projects. Examples of this are Smiling Road, which is a safe driving assistance service sold by Sompo Japan Nipponkoa Insurance Inc. (for corporations)*1, and "Portable Smiling Road," which is a smartphone app (for individuals)*2. In these services, Big Data, such as driving-related data sent from the users' drive recorders, is received by the server of Scala Communications, and is operated and managed by the web system developed by the Company.

*1 A service that contributes to the promotion of continuous safe driving and accident prevention by providing through a website or smartphone app various functions to facilitate safe driving, starting with the processing of driving data collected from drive recorders utilizing IoT technologies. It also includes the provision of diving data for drivers and administrators for analysis, granting points to drivers rated highly in the driving evaluation system, and enabling them to apply for prizes.

*2 A service that contributes to the promotion of safe driving and accident prevention. It does so by using a smartphone app to provide various functions, including for "peace of mind," by reporting accidents with a single push of a button should the driver be in an accident, for "safety," by being useful for accident prevention including through driving analysis and the provision of information in real time, and GPS for "convenience,".

Service content

Type	Product name	Description
Site assistance service	i-search	Site internal search engine
	i-linkcheck	Link-loss detection system
	i-print	Site print service
	i-linkplus	Related link display service
	i-assist	Virtual assistance
CMS service	i-ask	FAQ system
	i-catalog	Product site management system
	i-learning	e-learning service
	i-flow	Progress management and approval system
	LaCoon	Web system building platform
CRM service	i-entry	Comprehensive questionnaire CRM service
	dbecs	High-performance web mailer
	i-livechat	Web chat system
Telephone-system service	SaaS-type IVR	24-hour, 365-day automated voice response
News distribution service	Corporate news	Monitoring important business information
Intellectual property management solutions	PatentManager6	Latest patent management system
Site operations business	Fresheye	Search portal site
IoT, Big Data	Safe driving analysis	Processing and management of Big Data
SFA service	e-Sales Manager	SFA/CRM software
Field marketing business	Field activities, market research, etc.	Market research, store field activities

Source: Prepared by FISCO from Company materials

(2) The Softbrain Group's businesses

The Softbrain Group's businesses can be divided into the e-Sales Manager-related business, the field marketing business, and other businesses. The e-Sales Manager-related business is mainly the development and sales of "e-Sales Manager," which is SFA/CRM software, but also includes a consulting service to solve sales issues, skills training, and a service to support the introduction of smart devices into companies.

The field marketing business is mainly for consumer goods manufacturers, and involves conducting field activities, market research, and other activities in stores utilizing registered staff, who are mainly housewives aged in their 30s to 50s. The Company has approximately 66,000 registered staff nationwide who cover more than 120,000 stores, and it is deploying this business on the largest scale within Japan. It is also developing businesses for the dispatch and referral of retailer quality counselors who conduct field activities.

The other businesses include a systems development business and publishing business, but they are of small scale and their impact on overall earnings is negligible.

Aims to differentiate itself from competitors by increasing convenience through developments from the customer's perspective and providing a rich service menu

3. The Company's strengths

One of the Company's strengths in the SaaS/ASP business is that it develops services from the customer's perspective. It handles most its business as direct sales and 80% of sales revenue is from direct salesforces. It improves service functions and develops new services by listening closely to customer needs and feeding this information back to its development team, and its development policy is to meet 100% of customer requests. The Company developed its core i-search and i-ask services thanks to this approach of meeting customer requests and its services are characterized specially by their ease of use, and this has also enabled it to make smooth progress in rolling out sales to other customers.

Another strength is that its extensive lineup of services developed in this manner differentiates it from its competitors. While many competitors offer SaaS/ASP services for corporate websites, most of these companies only supply standalone services and few can provide multiple services as the Company does. The ability to propose multiple services as a package enables it to meet diverse customer needs, and this helps to raise the average price per customer and customer satisfaction. It has a track record of transactions with over 1,000 companies, including 400 listed companies.

A feature of the SaaS/ASP business is that monthly billing revenue accounts for approximately 70% of the sales revenue and it has established a stable, stock-type earnings base. The Company's basic policy is to avoid usage-based billing as much as possible and to provide services only from fixed monthly billing. Also, the main services are maintaining a high level of profitability, with the gross profit margins at around 80% (the margin is lower for the news distribution service, at around 70%, because of the costs of purchasing content). A reason for this is that the Company initially develops services as customized services according to customer needs, and then develops them horizontally as general services, which enables it to keep down development costs.

Results trends

Significant increases in sales and profits in FY6/17 following the consolidation of Softbrain as a subsidiary

1. Summary of the FY6/17 results

In the FY6/17 consolidated results (based on IFRS), both sales and profits grew significantly, with sales revenue increasing 295.8% YoY to ¥10,663mn, operating profit rising 505.7% to ¥3,736mn, pretax profit climbing 211.7% to ¥3,728mn, and net income attributable to the owners of the parent increasing 260.7% to ¥2,987mn. In addition to the consolidation of Softbrain in FY6/17, the main factor behind the improved results was the recording in operating profit of a gain* of ¥2,633mn relating to the staged acquisition of Softbrain shares.

* The gain on the difference between the market value of the relevant subsidiary at the time it entered the scope of consolidation and the acquisition cost of the shares

Looking at the non-GAAP standards results, which exclude one-off earnings and expenses items, operating profit increased 125.2% YoY to ¥1,389mn, pretax profit rose 106.8% to ¥1,381mn, and net income attributable to the owners of the parent climbed 19.2% to ¥552mn. Next, looking at the main extraordinary earnings and expenses items, in FY6/16, there was a gain of ¥527mn (non-operating profit) on the sale of investment securities that was recorded as financial earnings, and in FY6/17 there were items recorded in other earnings and expenses, of a gain relating to the staged acquisition of Softbrain shares, a retirement allowance for the founder and co-founder, a lump-sum payment on the retirement of employees, and M&A brokerage fees. There is a gap between the profit increase rate of net income and net income attributable to the owners of the parent, but this is due to the deduction of Softbrain's non-controlling interest income of ¥394mn (same for IFRS standards also).

The effects on the results of Softbrain being made a consolidated subsidiary were to increase sales and profits, raising sales revenue by ¥7,856mn and operating profit by ¥992mn. Compared to the Company forecasts, sales revenue was basically as expected, but profits were slightly below the forecasts. This was mainly because in the SaaS/ASP business, in-house resources were focused on the development of new services with high added value, and therefore outsourcing expenses for large projects that will provide one-time revenue increased more than anticipated.

FY6/17 consolidated results

(\mn)

	IFRS standards							Non-GAAP indicators*2			
	FY6/16		FY6/17					FY6/16		FY6/17	
	Result	YoY	Company target	Result	YoY	vs target		Result	YoY	Result	YoY
Sales revenue	2,693	20.4%	10,600	10,663	295.8%	0.6%		2,693	20.4%	10,663	295.8%
Operating profit	616	14.0%	4,100	3,736	505.7%	-8.9%		616	14.0%	1,389	125.2%
Pretax profit	1,196	116.2%	4,100	3,728	211.7%	-9.0%		668	20.8%	1,381	106.8%
Net income*1	828	128.9%	3,180	2,987	260.7%	-6.0%		463	28.0%	552	19.2%

*1 Net income (net income attributable to the owners of the parent)
*2 Non-GAAP indicators are reference indicators for judging the constant management performance of a company using values from which non-recurring income and expenses items and other adjustment items have been excluded.
Source: Prepared by FISCO from the Company's financial results

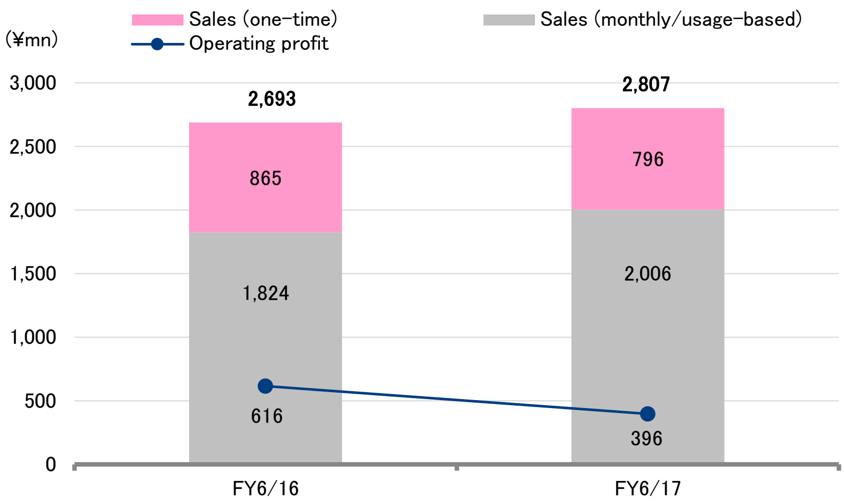
While sales are steadily increasing in the SaaS/ASP business, profits declined temporarily due to higher outsourcing expenses and personnel expenses

2. Trends by business segment

(1) The SaaS/ASP business

In the SaaS/ASP business, sales rose but profits fell, with sales revenue increasing 4.2% YoY to ¥2,807mn, but operating profit decreasing 82.1% to ¥110mn. Based on non-GAAP standards, operating profit declined 35.7% to ¥396mn. Looking by type of revenue, monthly billing and usage-based billing revenue steadily increased due to the rise in the number of service contracts, up 9.9% YoY to ¥2,006mn. Conversely, one-time revenue decreased 8.0% to ¥796mn, as the development of the service for Sompo Japan Nipponkoa Insurance Inc. entered its closing phase.

SaaS/ASP business results



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

Looking by service at the YoY changes in sales revenue, sales increased ¥53mn for the “i-series” servicies, mainly for i-search and i-ask. They also rose ¥54mn for the news distribution service, ¥23mn for IVR, and ¥13mn for web services. Conversely, support services for the mainframe DBMS “Model 204” came to an end in the fall of 2016, which had the effect of decreasing sales by ¥30mn. Looking at the growth rates, i-ask and IVR, each performed strongly alongside the rise in their number of contracts, up 10.2% and 9.6% respectively, while sales from the news distribution service also increased 14.7% due to the increase in contracts for the “e-market” service that has a high unit price.

Sales by service

(\mn)

	FY6/15	FY6/16	FY6/17	YoY
i-search	400	403	409	1.5%
i-ask	304	323	356	10.2%
i-entry	112	104	104	0.0%
Web services	412	750	763	1.7%
News distribution service	336	367	421	14.7%
IVR	257	240	263	9.6%
Other	416	506	488	-3.6%
Total	2,237	2,693	2,807	4.2%

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

Looking at the factors causing operating profit to change, the increase factors were ¥113mn from the higher sales revenue and ¥11mn from the absence of an extraordinary loss recorded in the previous fiscal year (office relocation expenses). Conversely, the decrease factors were ¥144mn from the increase in labor expenses, outsourcing expenses, rent, news article usage fees, and other expenses, and ¥93mn from the rise in personnel expenses (SG&A expenses), including for the recruitment of new graduates and to raise wages. The operating margin fell from 22.9% in FY6/16 to 14.1% in FY6/17. The profit margin fell mainly because in-house development resources were devoted to the development of new, high value-added services, and therefore outsourcing expenses rose for development projects that will provide one-time revenue. Another reason was because of an increase in the percentage of total sales provided by the news distribution service, which has a relatively low profit margin.

(2) The e-Sales Manager-related business

In the e-Sales Manager-related business, sales revenue was ¥3,901mn and operating profit was ¥783mn. Looking at the YoY changes for your reference, we see that results trended strongly, with sales revenue increasing 23.3% and operating profit rising 134.4% (in the previous fiscal year, non-consolidated and Japanese GAAP). The main factors were that sales of "e-Sales Manager," which is a tool that contributes to the improved productivity of sales departments, performed well following the acquisition of large-scale projects, and also the steady increase in sales for the consulting service and skills training to maximize the benefits of introducing this tool.

(3) The field marketing business

In the field marketing business, sales revenue was ¥3,198mn and operating profit was ¥225mn. Looking at the YoY changes for your reference, sales increased but profits deceased, with sales revenue rising 8.4% but operating profit falling 40.9% (in the previous fiscal year, non-consolidated and Japanese GAAP). The trend among consumer goods manufacturers to outsource field activity operations in stores is continuing, and the stock business, which includes lump-sum contracts for field activities, trended stably. Nevertheless, profit fell mainly because the Company has been actively investing in strengthening its sales structure toward further growth and also to create a new market under the new business concept of "field crowdsourcing."

(4) Other businesses

In other businesses, sales revenue was ¥756mn and the operating loss was ¥16mn. Looking at the sales revenue breakdown, it was ¥551mn in the system development business and ¥258mn in the publishing business. Profits slightly worsened YoY due to higher personnel expenses and production cost.

Is maintaining financial soundness on the increase in total assets following the consolidation of Softbrain as a subsidiary

3. Financial condition and business indicators

Looking at the financial condition at the end of June 2017, total assets were up ¥5,310mn on the end of the previous fiscal year to ¥14,941mn, which was mainly due to the consolidation of Softbrain as a subsidiary. In current assets, business receivables and other receivables rose ¥1,465mn. In non-current assets, goodwill increased ¥5,207mn following the consolidation of Softbrain as a subsidiary, but investment accounted for under the equity method declined ¥2,800mn. Intangible assets also increased \883mn.

Total liabilities were up ¥1,300mn on the end of the previous fiscal year to ¥7,021mn. The main change factor was that interest-bearing debt increased ¥1,468mn. Softbrain's interest-bearing debt at the end of June 2017 was ¥268mn, so most of the interest-bearing debt is from the Company's procurement. Meanwhile, total equity was up ¥4,009mn on the end of the previous fiscal year to ¥7,919mn. The main change factors were the recording of net income attributable to the owners of the parent of ¥2,987mn, which became ¥2,014mn from the increase in non-controlling interest following Softbrain being made a subsidiary, while the capital surplus decreased ¥699mn following the acquisition of additional Softbrain shares.

Looking at the business indicators, the equity ratio was 39.5% due to the increase in interest-bearing debt as a result of the proactive M&A strategy, and it has trended downward for the past few years. But the interest-bearing debt ratio is at a level of below 100%, at 80.7%, and in addition net cash (cash and deposits minus interesting-bearing debt) is also basically at the equilibrium level, so it can be judged that the Company is maintaining its financial soundness. However, goodwill accounts for approximately 38% (¥5,684mn) of total assets, and it is necessary to be aware that there is the risk that its financial condition could worsen should the earnings of Softbrain, which provides the majority of this goodwill, deteriorate and it is required to treat as impairment. Currently, Softbrain's results are trending stably, and at FISCO we think the possibility of this risk being materialized is extremely low. The Company has expressed its intention to gradually reduce the level of interest-bearing debt in the future.

Statement of consolidated financial position and business indicators

(\mn)

	End-FY6/15	End-FY6/16	End-FY6/17	Change
Current assets	1,843	5,470	7,167	1,696
(Cash and deposits)	1,430	5,060	4,999	-61
Non-current assets	1,686	4,160	7,774	3,613
(Goodwill)	224	477	5,684	5,207
Total assets	3,529	9,631	14,941	5,310
(Interest-bearing debt)	350	3,300	4,768	1,468
Total liabilities	1,534	5,720	7,021	1,300
Total equity	1,994	3,910	7,919	4,009
Business indicators				
Equity ratio (shareholders' equity ÷ total assets)	56.5%	40.6%	39.5%	
Interest-bearing debt ratio (interest-bearing debt ÷ shareholders' equity)	17.5%	84.4%	80.7%	

*Based on IFRS
Source: Prepared by FISCO from the Company's financial results

Outlook

The forecasts for the FY6/18 consolidated earnings are double-digit increases in sales and profits, based on non-GAAP standards

1. Outlook for FY6/18

Looking at FY6/18 in a comparison using non-GAAP standards, the forecasts are for double-digit increases in sales and profits, for sales revenue to increase 18.2% YoY to ¥12,600mn, operating profit to rise 23.1% to ¥1,710mn, pretax profit to climb 23.7% to ¥1,710mn, and net income attributable to the owners of the parent to grow 30.3% to ¥720mn. For Softbrain, with the assumption that the higher sales and profits will continue, in the existing SaaS/ASP business, sales and profits are expected to rise by double digits.

In the SaaS/ASP business, the forecast is that sales of the main services, including i-ask and IVR, will increase by around 15%. In addition, the Company plans to launch multiple new services during the fiscal period, and these new services will add to earnings. In terms of profits, the increase in outsourcing expenses, which was a factor decreasing profits in the previous fiscal year, will come to an end. In SG&A expenses, the rise in personnel expenses, partly due to the retirement of executives, will be kept down to slight increases only, and therefore the profit margin is expected to improve from the effects of the higher sales. Taking into account of the acquisition of an EC site used for buying and selling trading cards for a competition-type game with the objective of entering into the EC business, the operating margin of the SaaS/ASP business will be around 15% (14.1% in the previous fiscal year). Annual sales revenue from this EC site will be ¥400mn to ¥500mn and it will be around the break-even point for operating profit, so it will add to sales revenue in its first fiscal year. In profits, the Company is aiming to raise its operating margin to around 5% to 10% at an early stage through conducting business management.

Outlook for the FY6/18 consolidated earnings

(\mn)

	FY6/17 results		FY6/18 forecasts	
	IFRS	Non-GAAP	IFRS/Non-GAAP	YoY*2
Sales revenue	10,663	10,663	12,600	18.2%
Operating profit	3,736	1,389	1,710	23.1%
Pretax profit	3,728	1,381	1,710	23.7%
Net income*1	2,987	552	720	30.3%
Earnings per share	177.52	32.82	42.64	

*1 The net income (net income attributable to the owners of the parent)
*2 The growth rate YoY for FY6/18 are a comparison with non-GAAP indicators
Source: Prepared by FISCO from the Company's financial results

Will launch new services one after another, including i-livechat, i-assist, and a social gift service

2. Overview of new services

The new services that the Company is developing and will provide include i-livechat (web chat system) and i-assist (virtual assistance). It is also developing and will manage a social gift service.

(1) i-livechat

i-livechat is a service that enables the operator, such as in a customer support center, to guide the user to solve the problem he or she is facing through a real-time chat on their question or concern. By linking i-search and i-ask and checking those contest it also becomes possible for the operator to respond while confirming the user's contents on the chat-response screen. There have been many inquiries for this service and a major credit card company has already decided to introduce it in February 2017, and the number of contracts is expected to increase in the future. It is anticipated that it will be mainly introduced into call centers, with the minimum monthly-billed usage fee expected to be from ¥150,000 to ¥200,000.

In terms of other web chat systems, "Zopim Chat," from Zendesk in the U.S., has already been introduced by more than 40,000 companies worldwide (it was launched in Japan in 2012). Within Japan, "Chamo" from Chamo Co., Ltd has been introduced by more than 2,500 companies, so the Company is a latecomer. But the Company plans to expand its market share as it is making progress in enhancing functions that offer high levels of convenience as well as able to link i-search, i-ask, and other services.

(2) i-assist

i-assist is a customer assistance service that uses the language processing engine developed originally by the Company to understand the content of text-based inquiries from users and provide automated text-based responses. Features of its functions include a site concierge function that determines the page that the user is currently viewing and guides him or her to related pages, and a function to analyze the web content of customer companies and automatically collect words for which assistance can be provided. It also has a dictionary function that enables an expansion in the words that can be responded to. For the companies introducing it, this service will automatically respond to inquiries from users, which will not only lead to cost reductions at call centers and for web staff, but will also contribute to improving levels of customer satisfaction because their inquiries will be responded promptly.

A similar service is being provided by several other companies, including Oracle Corporation Japan <4716>, but there are customers strongly calling for a service that is highly convenient, and the Company is presently developing a service that meets such needs and easier to use. It has received inquiries from dozens of companies, mainly i-ask users, and can expect annual sales in the region of tens of millions of yen, assuming the monthly-billed usage fees will be from ¥150,000 to ¥200,000. The Company aims to complete development in 2017 and launch the service from the beginning of 2018.

(3) A social gift service

As one of its future growth strategies, the Company is developing services for the B-to-C domain. Among them, in FY6/18 it will launch a new social gift service. Social gift is the generic name for a service that can send gifts to another person using SNS. In addition to its use between individuals, in the last few years there has been a rapid increase in cases of its use by companies as part of their sales promotion measures.

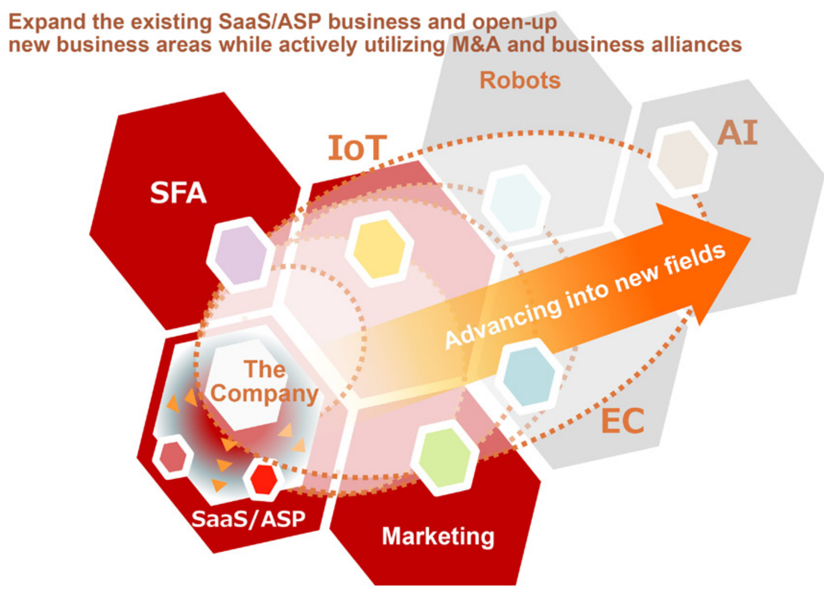
The Company has received inquiries from two insurance companies and will start providing them with services (scheduled for August for one company, October for the other). In the insurance industry, as an incentive for potential customers to complete insurance contracts, companies would previously frequently give such customers a gift equivalent to cash, such as a QUO card. But following revisions to the regulations, the granting of such cash-equivalent gifts has been prohibited, and instead these companies have started using social gifts. In terms of the image of the service, a company sends by SMS or by email to an individual a digital gift (an electronic message with a ID, such as a QR code) that can be exchanged for goods at fast food restaurants, convenience stores, or other locations, and the individual who has received the gift takes it to the store or elsewhere and uses it. The Company's sales revenue is from usage-based billing based on the number of IDs issued, so as the number of IDs increases, sales revenue also increases. As the mechanism itself is simple, there are many competitors. Therefore, the key point in order to increase earnings is how to acquire client companies that have a large customer base and that handle many products. The target for sales revenue in FY6/18 is ¥20mn.

The medium- to long-term growth strategy

Aiming for further growth by utilizing M&A to develop into new business fields

As its medium- to long-term growth strategy, the Company is aiming to realize further growth by stably growing its existing SaaS/ASP business (cloud service), and moreover based on this service, to open up new business areas that facilitate communication between people and between companies (including the areas of robots, EC, and AI), while actively utilizing M&A and business alliances.

Future direction



Source: The Company's results briefing materials

The targets for the M&A and business alliances can be summarized into the following four types of companies. The first type are companies with the expertise and technologies to develop new services, the second type are companies with a large customer base that will lead to expansions in market share for the Company's existing services, the third type are companies that will enhance its service lineup and that have expertise and technologies it does not possess and so will contribute to the evolution of its existing services and improved competitiveness, and the fourth type are companies with many excellent engineers who will strengthen its development capabilities.

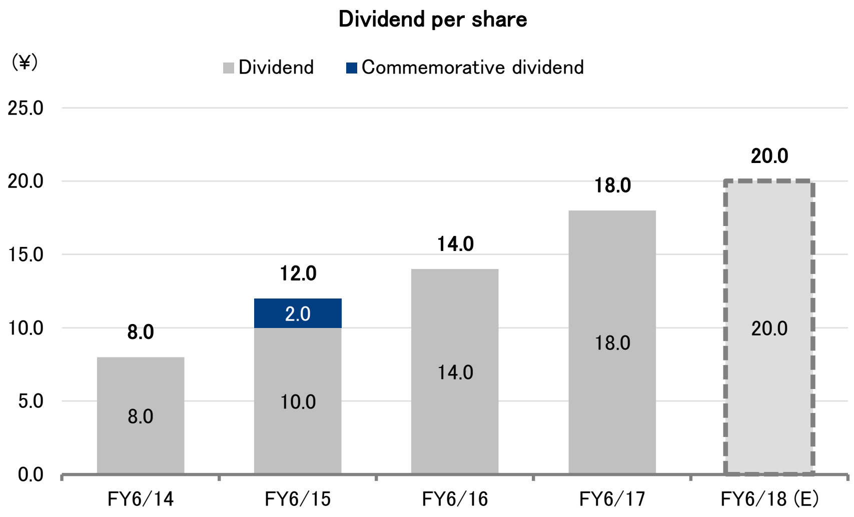
The acquired EC site became consolidated from August 2017 and going forward, the Company is aiming to acquire management expertise toward expanding its EC site management business for the B-to-C market. It is accumulating various expertise from the management of this EC site, including in the inventory management of products, effective shipping methods, and product pricing.

With regards to existing cloud services also, the Company is aiming to realize steady growth by using it mainstay services, such as i-search, i-ask, and IVR, for which it is building the leading market shares in the industry and then raise the unit price per customer by adding other services, while also developing new customers. Although profits temporarily declined in FY6/17 due to increases in expenses, including outsourcing expenses and personnel expenses, the forecast for FY6/18 and onwards is for them to recover and for the Company to once again return to the path of higher sales and profits, including from the effects of launching new services.

Shareholder return policy

Plans to increase the FY6/18 dividend per share by ¥2 YoY to ¥20, and its policy is to continuously increase dividends

The Company's basic policy on returning profits to shareholders is to stably and continuously pay a dividend while also retaining the internal reserves necessary to strengthen its financial structure and to develop its businesses in the future. In FY6/18, it plans to increase the dividend per share by ¥2 YoY to ¥20, for the ninth consecutive fiscal year of higher dividends. It has also indicated its intention to continuously increase dividends in the future, if profits continue to grow.



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

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