COMPANY RESEARCH AND ANALYSIS REPORT

Scala, Inc.

4845

Tokyo Stock Exchange First Section

26-Apr.-2018

FISCO Ltd. Analyst

Yuzuru Sato

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

While progressing a growth strategy utilizing M&A, the outlook for FY6/18 is double-digit increases in sales and profits based on non-GAAP standards that exclude temporary earnings

Scala, Inc. <4845> (hereafter, also “the Company”) is a leading provider of website search services, FAQ services, 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 services related to the Internet of Things (IoT) and big data. It leverages contracts with customers from direct sales to reflect their needs in development activities and has steadily expanded its service lineup to achieve steady growth. The Company is actively utilizing M&A to expand its business area, and in July 2016, it made a subsidiary of Softbrain Co., Ltd. <4779> (percentage of voting rights: 50.23%), a major sales support software company. It also made subsidiaries of plube Co., Ltd. (ownership ratio: 100%), an EC website management company, in August 2017 and Leoconnect, Inc. (ownership ratio: 66.0%), which carries out customer support consulting via call centers operated by HIKARI TSUSHIN, INC. <9435>, in March 2018. From FY6/16, the Company adopted IFRS accounting.

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

1. Sales and profits increased in FY6/18 1H based on non-GAAP standards

In FY6/18 1H (July-December 2017) consolidated results based on non-GAAP standards that exclude temporary earnings, sales revenue increased 10.7% year on year (YoY) to ¥5,854mn and operating profit rose 12.2% to ¥822mn. This was because despite a decline in profits in the businesses of Softbrain, which include SFA and field marketing, the SaaS/ASP business performed strongly and achieved double-digit increases in sales and profits. In addition to the steady rise in the number of contracts for main services, such as i-search and i-ask, development of the Big Data processing and management system of Driving! (a safe-driving support service for individuals provided by Sompo Japan Nipponkoa Insurance Inc.) contributed to earnings. plube, which was made a subsidiary in August 2017, recorded sales revenue of ¥225mn and operating profit of ¥26mn.

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

The outlook for FY6/18 consolidated results based on non-GAAP standards is for sales revenue to increase 21.0% YoY to ¥12,900mn and operating profit to grow 15.1% to ¥1,600mn. Due to the lowering of expectations for Softbrain’s results within the initial forecasts (sales revenue of ¥12,600mn and operating profit of ¥1,710mn), the operating profit forecast has been slightly downwardly revised, but this will be covered by the strong performance of the SaaS/ASP business. In addition, Leoconnect, which was made a subsidiary in March 2018, is expected to contribute sales revenue of ¥900mn.

We encourage readers to review our complete legal statement on “Disclaimer” page.

3. Focusing on expanding the sales of new services and collaborating with Leoconnect

The Company is focusing on expanding the sales of new services, which include i-gift (a digital gift service) and i-livechat (a web chat system) to further accumulate stock earnings. Also, by making Leoconnect a subsidiary, it will expand sales by introducing the Company's IVR (interactive voice response) and other service into call centers of the HIKARI TSUSHIN Group. The two companies will also jointly develop new services with high added value that combine the telephone and the web. Leoconnect is also targeting earnings growth through developing customers other than those in the HIKARI TSUSHIN Group.

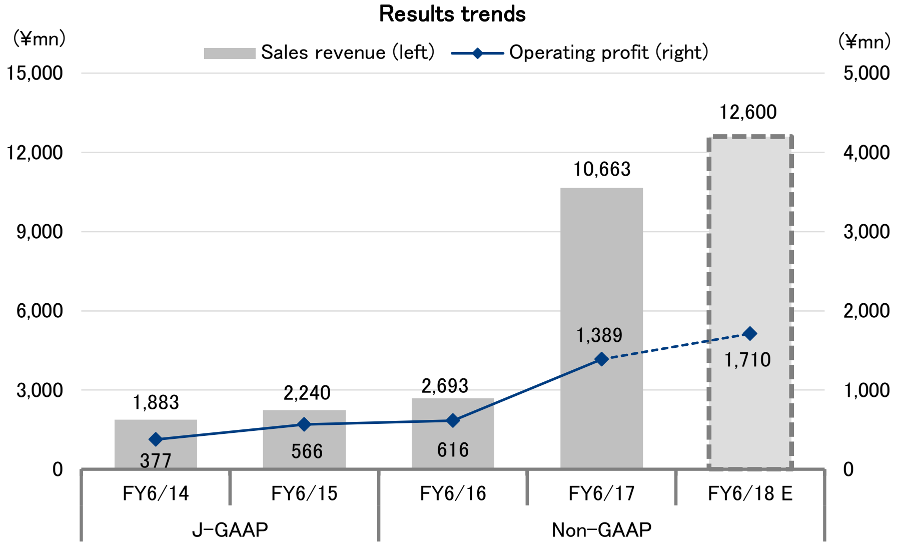
4. Will continue to increase dividends, assuming earnings growth

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
- Aiming for earnings growth through expanding sales of new services, including i-gift and i-livechat, and collaborating with Leoconnect
- Targeting further growth through developing new business areas, while steadily implementing an M&A strategy

Results trends



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

We encourage readers to review our complete legal statement on "Disclaimer" page.

Company profile

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

1. History

The Company was founded 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 the TSE's JASDAQ; it is currently listed on the TSE First Section).

* DBMS was developed by US-based Computer Corporation of America and Sirius Software (now, Rocket Software). Major customers were large companies in Japan like as Bank of Japan <8301> and Tokyo Electric Power Company Holdings, Inc. <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 growing amid the migration of corporate information systems from mainframes to small-scale open servers, and it started acquiring information service firms through M&As utilizing funds obtained from its 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 IVR field, the news distribution service provider NewsWatch Inc., the website developer TriAx Corp., and others as subsidiaries one after another. 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.

Recently, the Company made subsidiaries of Softbrain (ownership ratio based on voting rights as of the end of June 2017: 50.23%), a major sales support software company, in July 2016; plube (ownership ratio: 100.0%), an EC website management company that conducts trading of battle game trading cards, in August 2017 in order to enter the EC business; and Leoconnect (ownership ratio: 66.0%), which uses 24 call centers to provide customer support consulting for the brands and products of the HIKARI TSUSHIN Group, in March 2018.

The Company switched to a holding company organization in 2004 to conduct more flexible management, and in FY6/16, it changed its accounting standards to IFRS to disclose its results.

We encourage readers to review our complete legal statement on "Disclaimer" page.

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.
August 2017	Acquired plube Co., Ltd. as a subsidiary
March 2018	Acquired Leoconnect, Inc. as a subsidiary

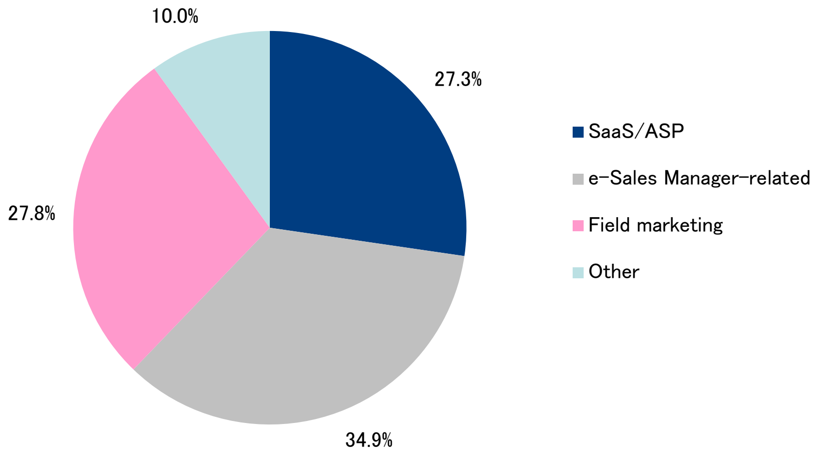
Source: Prepared by FISCO from the Company's website

Holds the leading share in the domestic market, including for i-search (an internal website search service) and i-ask (an 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 users to corporate websites, and the Softbrain Group's SFA business (sales innovation business), field marketing business, and other businesses. Other businesses also now include the EC business of plube, which was made a subsidiary in August 2017. The percentages of total sales by business in FY6/18 1H were 27.3% from the SaaS/ASP business, 34.9% from the SFA business, and 27.8% from the field marketing business, so these three businesses provide 90% of total sales.

Sales composition (FY6/18 1H)



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 business. The main services are the i-search website search service, i-ask FAQ service, IVR service, and 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 ¥100,000-150,000.

The Company launched the i-ask service 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 improve customer satisfaction. The Company holds a roughly 15% market share, ranked second after OKWAVE <3808>. The average usage fee per month is ¥200,000-300,000.

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 use it during limited periods, such as campaigns.

We encourage readers to review our complete legal statement on "Disclaimer" page.

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 IoT and big data as customized development projects. Examples of this are Smiling Road, a safe-driving assistance service (for corporations)*1 sold by Sompo Japan Nipponkoa Insurance, and Portable Smiling Road, 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 Inc. 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. It does so by using a website or smartphone app to provide various functions to facilitate safe driving, for example, processing of driving data collected from drive recorders utilizing IoT technologies, providing safe diving analysis for drivers and administrators, 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 for "peace of mind," reporting accidents with a single push of a button should the driver be in an accident for "safety," 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
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-assist	Virtual assistance
	i-livechat	Web chat system
	i-gift	Digital gift service
Telephone-system service	SaaS-type IVR	24-hour, 365-day automated voice response
News distribution service	Corporate news	Monitoring important business information
Data management	PatentManager6	Latest patent management system
	GripManager	Contract operations 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
EC	Online card shop	Operations for the online buying and selling of trading cards and related products

Source: Prepared by FISCO from Company materials

(2) The Softbrain Group's businesses and other businesses

The Softbrain Group's businesses can be divided into the SFA business (e-Sales Manager-related business), field marketing business, and other businesses. The SFA 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. e-Sales Manager has an excellent reputation as being No. 1 for usability. It is the industry-leading product from domestic SFA vendors, and has been introduced by a total of more than 4,500 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 74,000 registered staff nationwide who cover more than 140,000 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 the Softbrain Group's systems development and publishing businesses, and plube's EC business, which was added in August 2017. They contribute around 10% of total sales.

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 expanding sales to new 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 cross-selling 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 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 customized to customer needs, and then develops them horizontally as general services, which enables it to keep development costs down.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Results trends

Sales and profits increased in FY6/18 1H based on non-GAAP standards

1. Summary of FY6/18 1H results

In FY6/18 1H consolidated results based on non-GAAP standards that exclude temporary earnings and costs, sales revenue increased 10.7% YoY to ¥5,854mn, operating profit rose 12.2% to ¥822mn, pretax profit climbed 11.8% to ¥815mn, and net income attributable to owners of the parent increased 20.0% to ¥372mn, for double-digit increases in sales and profits. The positive results were mainly because while Softbrain Group's results were slightly lower than expected, the SaaS/ASP business performed strongly, and there were also the additions of sales revenue of ¥225mn and operating profit of ¥26mn from plube entering the scope of consolidation in August 2017. FY6/17 1H IFRS results included a gain of ¥2,633mn relating to the step acquisitions of Softbrain's shares* under operating profit.

* 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

FY6/18 1H consolidated results

(¥mn)

	FY6/17 1H			FY6/18 1H				
	Results (IFRS)	Results (Non-GAAP)	Ratio to sales	Company target	Results (Non-GAAP)	Ratio to sales	YoY	vs target
Sales revenue	5,286	5,286	-	6,000	5,854	-	10.7%	-2.4%
Operating profit	3,366	733	13.9%	830	822	14.0%	12.2%	-0.9%
Pretax profit	3,363	730	13.8%	830	815	13.9%	11.8%	-1.7%
Net income attributable to owners of the parent	2,943	310	5.9%	540	372	6.4%	20.0%	-31.1%

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

The SaaS/ASP business is performing strongly, but growth has temporarily stalled in the SFA and field marketing businesses

2. Trends by business segment

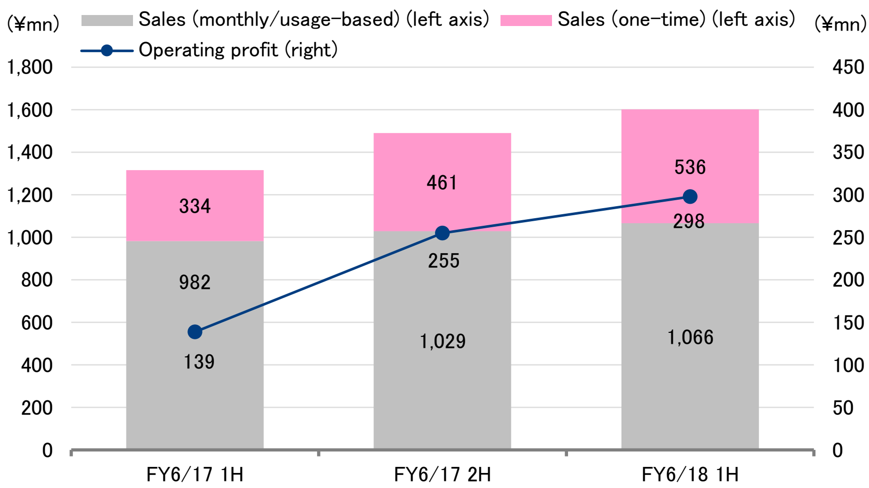
(1) SaaS/ASP business

In the SaaS/ASP business, sales revenue increased 21.7% YoY to ¥1,602mn, and operating profit based on non-GAAP standards rose 113.6% to ¥298mn. Looking by type of sales revenue, the number of contracts for the various services for monthly and usage-based billing revenue steadily increased, up 8.6% to ¥1,066mn. One-time sales revenue also grew greatly, up 60.5% to ¥536mn, from the contribution of the development of the Driving! Big Data processing and management system*, a safe-driving support service for individuals provided by Sompo Japan Nipponkoa Insurance.

* It is a service that fully supports a safe and secure car life by providing security when driving through the installation of a dedicated drive recorder with communication functions equipped with the Safe Driving Support Function. After driving, the Safe Driving Diagnosis and Visual Function Training features allow users to self-maintain driving skills. Also, should an accident occur, the service provides an Accident Report Function and Accident Scene Emergency Assistance Service.

Looking at the YoY growth in sales revenue by service, sales were positive for the mainstay i series, with i-search up 15.7% and i-ask up 16.6%, while a track record of introductions is also starting to appear for the new services of i-gift and the chatbot system. Companies are steadily introducing i-gift, which is intended for property insurance companies. For web services also, orders for website production increased, up 11.4%. Sales of services related to IoT and big data grew greatly, up 133.6%, mainly due to the development of the Driving! Big Data safe-driving support service. Operations of the Driving! Big Data service were launched in January 2018, and from 3Q, its monthly billing will be recorded in operations management revenue. Other than these, sales of IVR and other telephone system services and the news distribution service performed steadily, increasing 3.1% and 1.9%, respectively. The Model 204 service ended in the fall of 2016, and the effect of the end of this service was a decline in sales revenue of ¥47mn.

SaaS/ASP business results



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

Results trends

Sales by service

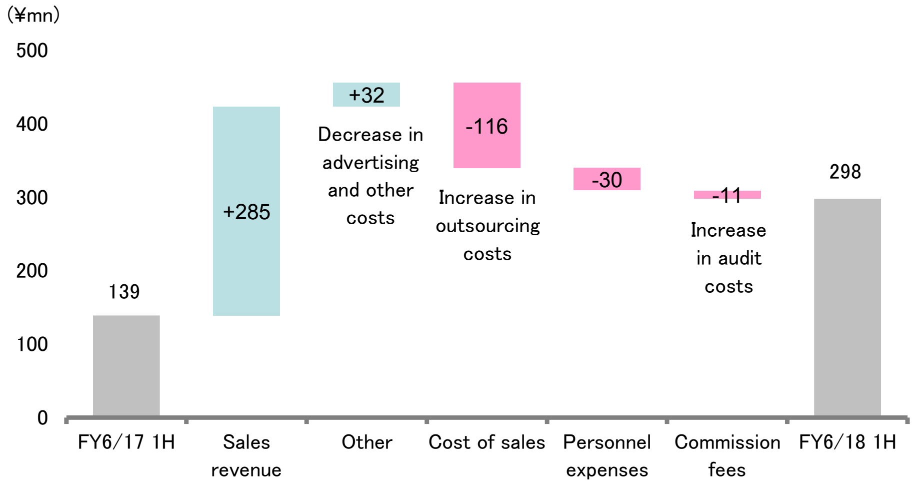
(¥mn)

	FY6/17 1H	FY6/18 1H	Change	YoY
i-search	191	221	30	15.7%
i-ask	175	204	29	16.6%
i-entry	51	48	-3	-5.9%
Web services	185	206	21	11.4%
Services related to IoT/big data	137	320	183	133.6%
Telephone system service	131	135	4	3.1%
News distribution service	206	210	4	1.9%
Other	237	255	18	7.6%
Total	1,317	1,602	285	21.6%

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

Looking at the factors causing operating profit to change, those causing an increase were the higher sales revenue of ¥285mn and the effects of cost reductions, including ¥32mn in advertising costs, while those causing a decrease were rises in outsourcing costs of ¥116mn, personnel costs within SG&A expenses of ¥30mn, and audit costs of ¥11mn. Due to the effects of the higher sales, the operating margin rose greatly, from 10.6% in the previous fiscal year to 18.7%.

Factors affecting operating profit in the SaaS/ASP business results



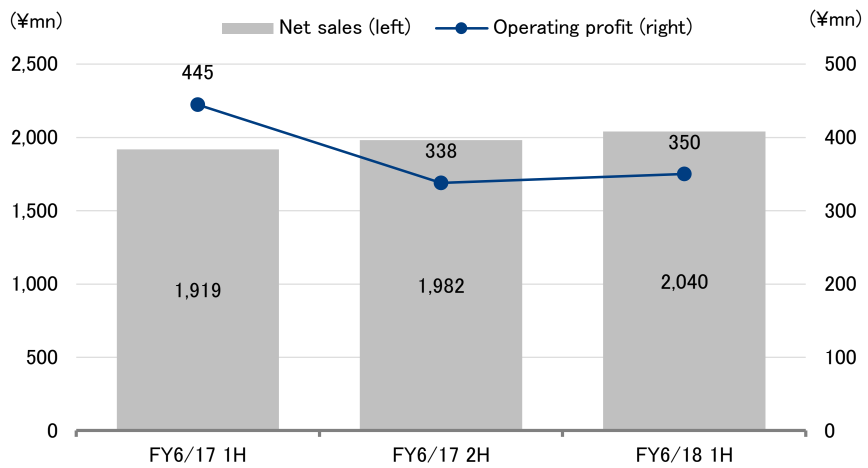
Source: Prepared by FISCO from the Company's results briefing materials

(2) SFA business

In the SFA business, sales revenue increased 6.3% YoY to ¥2,040mn and operating profit decreased 21.3% to ¥350mn. Results were strong due to the acquisition of large projects for e-Sales Manager, which is the mainstay product, while they also trended steadily for consulting focusing on sales problems and skills training. However, operating profit declined due to active investment in developing e-Sales Manager toward realizing medium- to long-term growth.

We encourage readers to review our complete legal statement on "Disclaimer" page.

SFA business results

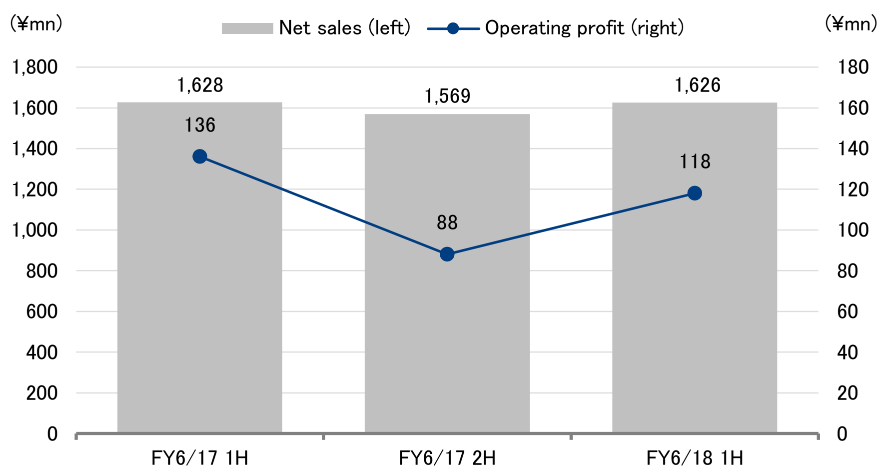


Source: Prepared by FISCO from the Company's results briefing materials

(3) Field marketing business

In the field marketing business, sales revenue decreased 0.2% YoY to ¥1,626mn and operating profit declined 13.3% to ¥118mn. Results of the stock-type businesses, which include lump-sum contracts for field activities and the dispatch business, trended at around the same level YoY, and the reason for the decline in sales was the reduction in short-term spot proposals, such as for store surveys. Profits declined as a result of active investment in strengthening the sales structure toward realizing further growth and the creation of a new market based on the new business concept of "field crowdsourcing." However, sales and profits both increased compared to FY6/17 2H.

Field marketing business results



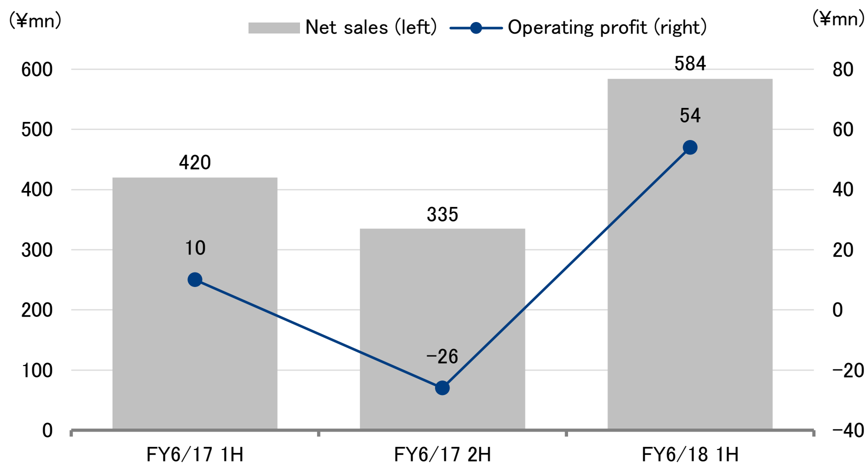
Source: Prepared by FISCO from the Company's results briefing materials

We encourage readers to review our complete legal statement on "Disclaimer" page.

(4) Other businesses

In the other businesses, sales revenue increased 39.0% YoY to ¥584mn and operating profit rose 429.5% to ¥54mn. The increase factors were the recovery of book sales in the publishing business, and also the additions of sales revenue of ¥225mn and operating profit of ¥26mn following plube, which is an EC website management company, entering the scope of consolidation.

Other businesses' results



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

Keeping the equity ratio in the 40% range and maintaining financial soundness

3. Financial condition and business indicators

Looking at the financial condition at the end FY6/18 1H, total assets increased ¥719mn from the end of the previous fiscal year to ¥15,660mn. The main factors were that, in current assets, cash and deposits increased ¥109mn and operating receivables and other receivables rose ¥394mn. Also, in non-current assets, deferred tax assets deceased ¥101mn, while there were increases in other long-term financial assets of ¥143mn, property, plant and equipment of ¥62mn, goodwill of ¥74mn, and intangible assets of ¥51mn.

Total liabilities increased ¥250mn from the end of the previous fiscal year to ¥7,272mn. The main factors were that interest-bearing debt increased ¥413mn and operating debt and other payables decreased ¥300mn. Also, total equity increased ¥468mn from the end of the previous fiscal year to ¥8,388mn, with the main factors being the recording of net income attributable to owners of the parent of ¥372mn, net income attributable to non-controlling interests of ¥191mn, and dividend payments of ¥150mn.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Looking at the business indicators, the interest-bearing debt ratio rose to 82.7% from 79.7% at the end of the previous fiscal year as a result of the proactive M&A strategy. But the earnings increased by M&A so the equity ratio was 40.0%, almost flat YoY. On the other hand, net cash (cash and deposits minus interesting-bearing debt) was also basically kept on an even keel, so it can be judged that the Company is maintaining its financial soundness. However, goodwill accounts for approximately 37% (¥5,758mn) 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 require impairment treatment. Currently, Softbrain's results are trending stably, and at FISCO, we think the possibility of this risk materializing is extremely low. The Company has expressed its intention to gradually reduce the level of interest-bearing debt in the future.

Consolidated balance sheet

(¥mn)

	FY6/16 year-end	FY6/17 year-end	FY6/18 1H-end	Change
Current assets	5,470	7,167	7,656	488
(Cash and deposits)	5,060	4,999	5,108	109
Non-current assets	4,160	7,774	8,004	230
(Goodwill)	477	5,684	5,758	74
Total assets	9,631	14,941	15,660	719
(Interest-bearing debt)	3,300	4,768	5,181	413
Total liabilities	5,720	7,021	7,272	250
Total equity	3,910	7,919	8,388	468
Management indicators				
Equity ratio (shareholders' equity ÷ total assets)	40.6%	40.1%	40.0%	
Interest-bearing debt ratio (interest-bearing debt ÷ shareholders' equity)	84.4%	79.7%	82.7%	

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

Outlook

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

1. Outlook for FY6/18

In a comparison based on non-GAAP standards, the outlook for FY6/18 results is for sales revenue to increase 21.0% YoY to ¥12,900mn, operating profit to rise 15.1% to ¥1,600mn, pretax profit to grow 15.8% to ¥1,600mn, and net income attributable to owners of the parent to increase 23.1% to ¥680mn, for double-digit increases in sales and profits.

Compared to the initial forecasts, sales revenue will rise ¥300mn, operating profit and pretax profit will decrease ¥110mn, and net income attributable to owners of the parent will fall ¥40mn. The main factor behind sales revenue exceeding the initial forecast is the consolidation of Leoconnect, which was made a subsidiary in March 2018, adding its sales of ¥900mn. On excluding the effect of this, sales revenue will decrease ¥600mn. But this is because in the Softbrain Group's results, sales revenue and profits are both trending slightly below initial expectations. The outlook for the SaaS/ASP business is for results to be basically in line with initial forecasts.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Outlook for FY6/18 consolidated earnings

(¥mn)

	FY6/17		FY6/18		
	IFRS	Non-GAAP	Initial forecast	Revised forecasts	YoY*
Sales revenue	10,663	10,663	12,600	12,900	21.0%
Operating profit	3,736	1,389	1,710	1,600	15.1%
Pretax profit	3,728	1,381	1,710	1,600	15.8%
Net income attributable to owners of the parent	2,987	552	720	680	23.1%
Earnings per share	177.52	32.82	42.64	40.27	

* YoY growth rates for FY6/18 are comparisons with non-GAAP indicators
Source: Prepared by FISCO from the Company's financial results

Looking on a fiscal half-year basis, sales revenue, which was ¥5,854mn in 1H, will grow greatly to ¥7,046mn in 2H, and even when excluding the effects of Leoconnect, sales are expected to increase by around 5.0%. On the other hand, operating profit is forecast to decrease 5.0%, from ¥822mn in 1H to ¥778mn in 2H. Leoconnect is expected to have hardly any effect on profits, but the Company will collaborate with Leoconnect on new measures, including developing new services so the forecasts appear conservative in terms of costs.

The outlook for the SaaS/ASP business is for the double-digit growth to continue through the accumulation of stock earnings, centered as before on the i series. On the other hand, Softbrain's forecasts for FY12/18 1H (January-June 2018) are for strong results, with net sales to increase 9.1% YoY to ¥4,300mn and operating profit to grow 9.7% to ¥480mn. Higher sales and profits are expected in both the SFA and field marketing businesses. Also, compared to 2H in the previous fiscal year (July-December 2017), net sales will increase 4.0% and operating profit will decrease 6.0%, which do not seem incompatible with the basic trend in the Company's consolidated results.

plube's EC business is forecast to contribute around ¥400-500mn in sales for the full fiscal year. It is not anticipated to contribute much to profits at the initial stage, but it is performing steadily, including recording profits of ¥26mn in 1H, so it is expected to contribute to profits for the full fiscal year.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Aiming for earnings growth through expanding sales of new services, including i-gift and i-livechat, and collaborating with Leoconnect

2. Measures for 2H

(1) Strengthening sales of new services

In 2H, the Company is focusing on expanding sales of new services, including i-gift, i-livechat, and the chatbot system. i-gift is a digital gift service for product exchanges at conventional stores, in which companies conducting sales promotion campaigns for new products or gifts can send customers an SMS or email (electronic message with an ID, such as a QR code) that can be presented at stores to receive a product. As the billing system is a combination of usage-based billing according to the number of IDs issued and fixed monthly billing, the greater the number of IDs issued, the more the Company's sales revenue will increase. As the mechanism itself is simple, there are many competitors. Therefore, the key to increasing earnings is determining how to acquire client companies that have customer bases and handle many products. Up to December 2017, the service had been introduced by three companies, including two insurance companies, and the Company intends to acquire new customers in FY6/18, aiming at sales revenue of ¥20mn.

i-livechat is a web chat service that enables site operators, such as in a customer support center, to guide users in solving problems they may face and addressing their questions or concerns through real-time chat. By linking and checking users' i-search and i-ask history, site operators are able to respond while confirming content on the chat response screen. i-livechat is attracting attention as a service that contributes to improving customer satisfaction. It is anticipated that it will be introduced mainly at call centers, with an expected minimum monthly usage fee between ¥150,000-200,000.

In terms of other web chat systems, Zopim Chat from Zendesk in the U.S. (launched in Japan in 2012) has already been introduced by more than 40,000 companies worldwide. 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 and linking i-search, i-ask, and other services.

The chatbot system is a system that uses proprietary language analysis technology to analyze what site users ask by keyword or natural sentences, and then answers automatically in a chat format. In addition to answering FAQs registered on the management site, it can also answer questions in a conversational style. It was introduced for the first time in December 2017 by Koyo Electric Co., Ltd.* through a joint proposal between IBSystem Co., Ltd. and Toppan Forms Co., Ltd., and it has been favorably received. There have been many inquiries regarding this service from companies' CRM managers aiming to reduce their work load and improve customer satisfaction, and the number of contracts is expected to increase in the future. The service fee is ¥200,000-300,000 per month.

* Changed its company name to SymEnergy, Inc. on April 1, 2018

(2) Collaboration with Leoconnect

HIKARI TSUSHIN Group established Leoconnect on December 1, 2017 with an aim to create customer operations head office and supervise all of its group company's call center operations. Currently, it is using 24 call centers to provide customer support consulting for the HIKARI TSUSHIN Group's brands and products. It has 22 employees. Its strengths include expertise in effectively constructing and proposing customer support operations that cover multiple sales channels and products. It has a track record of outsourcing for 190 brands and services for 456 types of customer service counters.

As background to the Company's objectives in making a subsidiary of Leoconnect is that in the call center industry in the last few years, various services have been launched, such as chatbot services and business consulting utilizing the big data of VOC (voice of customer) data, and therefore business opportunities are expanding. Through its collaboration with Leoconnect, which is knowledgeable of needs at work sites, the Company is aiming to develop new value-added services for call centers and expand earnings from this field. It also has a lineup of customer support-related services, including IVR and i-ask, but it has no track record of introducing them at the call centers of the HIKARI TSUSHIN Group, so sales are expected to increase in the future. On the other hand, Leoconnect has not previously conducted sales activities other than for the companies in the HIKARI TSUSHIN Group, so it also expects to acquire new customers from joining the Company's Group.

If they are able to develop highly competitive new services in the customer support field by integrating Scala's IT development capabilities and Leoconnect's consulting capabilities, the Company's earnings growth can be expected to accelerate.

We encourage readers to review our complete legal statement on “Disclaimer” page.

Medium- to long-term growth strategy

Targeting further growth through developing new business areas, while steadily implementing an M&A strategy

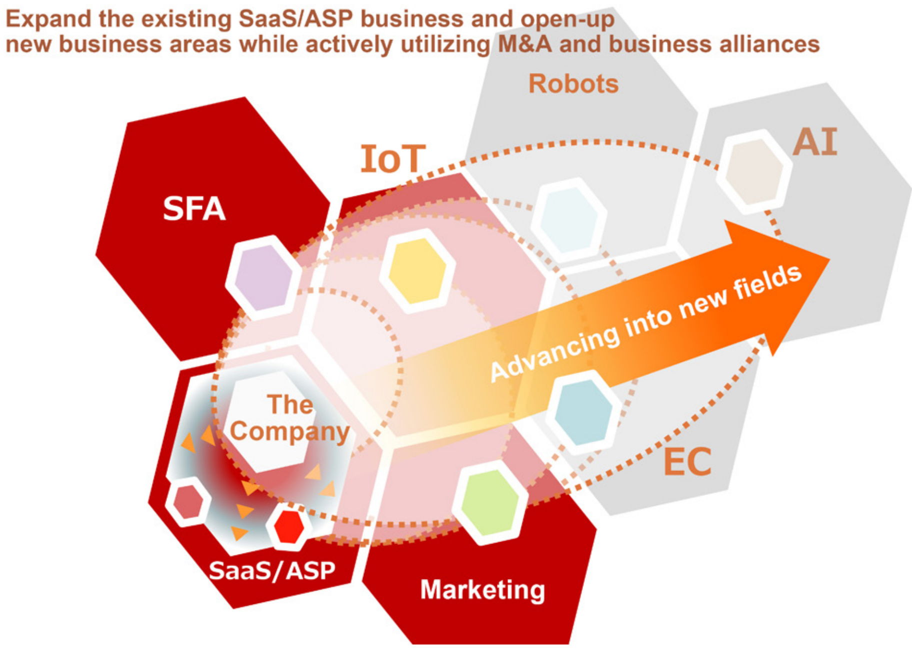
As its medium- to long-term growth strategy, the Company is aiming to realize further growth by stably growing its existing SaaS/ASP business (cloud service), and moreover based on this service, to open up new business areas that facilitate communication between people and between companies (including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

The targets for the M&A and business alliances can be summarized into the following four types of companies: 1) companies with the expertise and technologies to develop new services, 2) companies with a large customer base that will lead to expansions in market share for the Company's existing services, 3) companies that will enhance the Company's service lineup and that have expertise and technologies it does not possess and will contribute to the evolution of its existing services and improved competitiveness, and 4) companies with many excellent engineers who will strengthen the Company's development capabilities.

The Company made plube a subsidiary in August 2017 with the aim of absorbing its EC business management expertise. In addition, it made a subsidiary of Leoconnect in March 2018 in order to expand the market shares of its existing services, enhance its service lineup and increase its competitiveness. So it can be said to be steadily implementing an M&A strategy.

It is also expected to achieve sustainable growth in its existing businesses, as it is aiming to raise the unit price per customer through cross-selling its various i series products, and also by working to acquire new customers.

Future direction



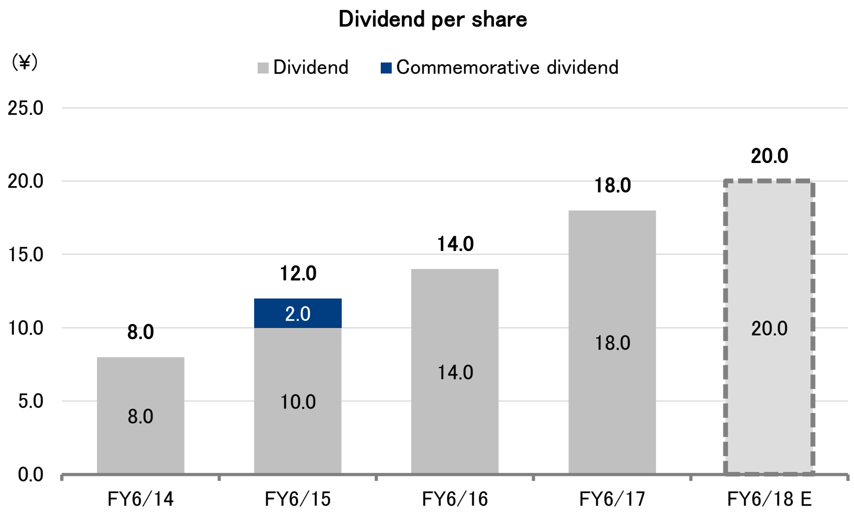
Source: The Company's results briefing materials

We encourage readers to review our complete legal statement on "Disclaimer" page.

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 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

Information security measure

The Company's mainstay business is SaaS/ASP services that utilize the Internet, so information security is one of its most important management issues. In terms of specific measures, all Group companies have been and continue to work to acquire ISO/IEC27001 certification, which is the international standard for information security, and to implement information security measures incorporating a global-standard third-party perspective. They also strive to thoroughly manage the information assets owned by the Group based on an internal management system. They use in-house servers and some private clouds for the information system, while also constructing backup systems.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Disclaimer

FISCO Ltd. (the terms "FISCO", "we", mean FISCO Ltd.) has legal agreements with the Tokyo Stock Exchange, the Osaka Exchange,and Nikkei Inc. as to the usage of stock price and index information. The trademark and value of the "JASDAQ INDEX" are the intellectual properties of the Tokyo Stock Exchange, and therefore all rights to them belong to the Tokyo Stock Exchange.

This report is based on information that we believe to be reliable, but we do not confirm or guarantee its accuracy, timeliness,or completeness, or the value of the securities issued by companies cited in this report. Regardless of purpose,investors should decide how to use this report and take full responsibility for such use. We shall not be liable for any result of its use. We provide this report solely for the purpose of information, not to induce investment or any other action.

This report was prepared at the request of its subject company using information provided by the company in interviews, but the entire content of the report, including suppositions and conclusions, is the result of our analysis. The content of this report is based on information that was current at the time the report was produced, but this information and the content of this report are subject to change without prior notice.

All intellectual property rights to this report, including copyrights to its text and data, are held exclusively by FISCO. Any alteration or processing of the report or duplications of the report, without the express written consent of FISCO, is strictly prohibited. Any transmission, reproduction, distribution or transfer of the report or its duplications is also strictly prohibited.

The final selection of investments and determination of appropriate prices for investment transactions are decisions for the recipients of this report.

FISCO Ltd.