COMPANY RESEARCH AND ANALYSIS REPORT

Scala, Inc.

4845

Tokyo Stock Exchange First Section

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FISCO Ltd. Analyst
Yuzuru Sato

FISCO
FISCO Ltd.
http://www.fisco.co.jp

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Summary

Earnings to continue to increase from the growth of SaaS/ASP services in the CRM area and the effects of M&A

Scala, Inc. <4845> (hereafter, also "the Company") is a leading provider of website search services, FAQ services, and other services for corporate websites. It continues to develop its businesses and achieve sustainable growth, centered on SaaS/ASP* services, which are a business model with recurring income. It also actively conducts 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%), which is 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 of Leoconnect, Inc. (ownership ratio: 66.0%), which carries out customer support consulting via call centers operated by the HIKARI TSUSHIN INC. <9435> Group, in March 2018. The Company has adopted International Financial Reporting Standards (IFRS) accounting.

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

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

In the FY6/18 consolidated results based on non-GAAP standards that exclude temporary earnings, sales and profits increased by double digits, with sales revenue growing 20.3% year on year (YoY) to ¥12,829mn and operating profit rising 11.3% to ¥1,546mn. In the SaaS/ASP business, the Company made progress in cross sales to existing customers and the acquisition of new customers, mainly for the mainstay services, and sales revenue increased 11.9% to ¥3,141mn and operating profit rose 41.2% (non-GAAP standard) to ¥559mn, which drove the results as a whole. Profits declined slightly for Softbrain's business, including due to the impact of a delay in projects for e-Sales Manager. But at plube, which was newly made a subsidiary, sales revenue was ¥547mn because of the strong sales of trading cards, while Leoconnect recorded net sales of ¥856mn and operating profit of ¥7mn, and these results were also factors behind the higher sales and profits.

2. Forecasts double-digit increases in sales and profits for FY6/19

The outlook for the FY6/19 results is for the double-digit increases in sales and profits to continue, with sales revenue to rise 20.4% YoY to ¥15,450mn and operating profit to grow 18.3% to ¥1,830mn. The SaaS/ASP business will continue to achieve high growth from the strengthening of the corporate CRM department and the increased investment in IT to improve operational efficiency, while Softbrain's results are expected to be double-digit increases in sales and profits. Leoconnect's full fiscal year contribution to results will also be a factor behind the higher sales and profits.

3. Synergies with Leoconnect are expected

In terms of developments in the future, the focus will be on synergies with Leoconnect. This is because while Leoconnect previously only carried out a management consulting business for the customer support centers of the HIKARI TSUSHIN Group and its operating margin was low, at around 1%, its sales are expected to increase and profitability improve through synergies with the Company. It is considered that in the future, it will be possible to raise its operating margin to a level of around 10%. Since FY6/19, the Company has been sequentially introducing telephone-related services, such as IVR (interactive voice response) services, to the customer support centers to which Leoconnect provides consulting (24 centers nationwide), and the strategy is to improve productivity (reduce the number of responses by operators) at the same time as developing new customers and thereby increase earnings. It will strengthen services for foreigners from who demand is rising, such as due to the increase in the number of overseas visitors to Japan, through a collaboration with Inbound Tech Inc. Specifically, it is planning to provide FAQ translation services and multilingual support services, which are expected to contribute to earnings in the future.

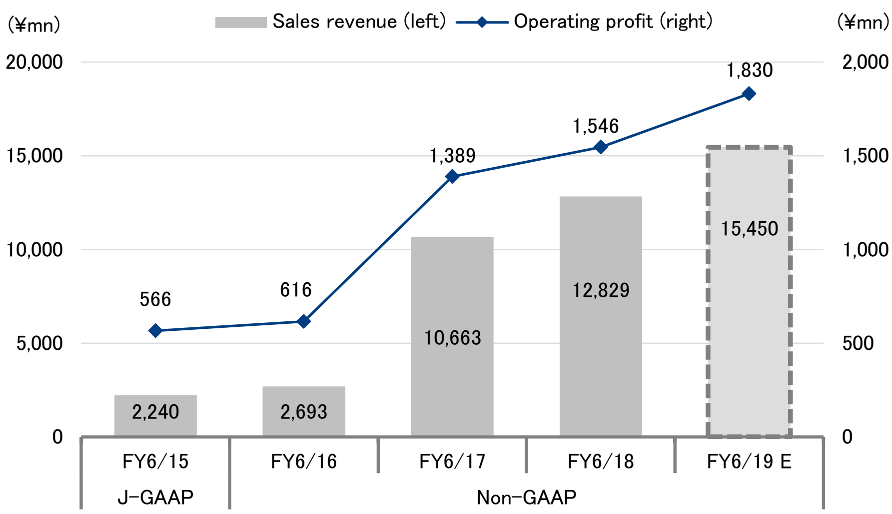
4. Will continue to increase dividends, assuming earnings growth

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 FY6/19, it plans to pay a dividend per share of ¥24, up ¥4 YoY, for the 10th 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

- Double-digit increases in sales and profits in the SaaS/ASP business due to the rise in sales per customer from cross sales and the growth in IoT- and big data-related sales
- The outlook is for double-digit increases in sales and profits in FY6/19 also, mainly from the SaaS/ASP business
- Aiming for double-digit growth while working to expand services in the CRM area

Results trends



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

Company profile

The corporate cloud service in the CRM field 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) and it is currently listed on the TSE First Section.

* 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 expanding its business 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 other firms in the Internet domain as subsidiaries one after another. The Company is steadily expanding its SaaS/ASP business, which is a business model with recurring income, 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 2018: 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.

To conduct more flexible management, the Company switched to a holding company organization in 2004 and currently has 10 consolidated subsidiaries. In FY6/16, it changed its accounting standards to IFRS to disclose its results.

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, Scala Services 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

Main affiliates

Consolidated subsidiary	Ownership ratio (%)	Main business
Scala Communications Inc.	100.0	SaaS/ASP services and software development, sales, and maintenance
Scala Services Inc.	100.0	Solution services for business processes relating to communication between corporations and individuals
plube Co., Ltd.	100.0	EC site management
Softbrain Co., Ltd.	50.2	Development, sales, and consulting service to support the introduction of sales support software
Leoconnect, Inc.	66.0	Customer support consulting relating to call center management

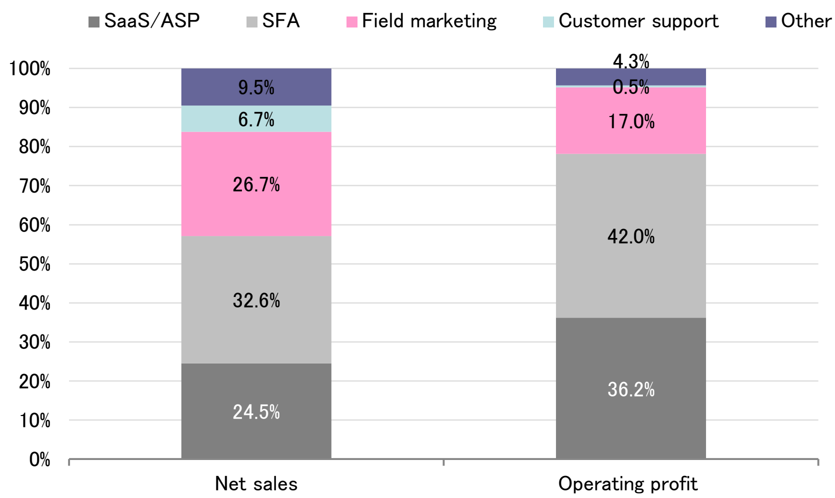
Source: Prepared by FISCO from the Company's business briefing materials

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 divides and discloses information on its businesses into its 4 mainstay businesses: The SaaS/ASP business, which provides IT services that contribute to improving operational efficiency in the corporate CRM area; the Softbrain Group's SFA business (the e-Sales Manager-related business); the field marketing business; and Leoconnect's customer support business, and also the other businesses (Softbrain's systems development and publishing business and plube's EC business). In FY6/18, the percentages of total sales by business were 24.5% from the SaaS/ASP business, 32.6% from the SFA business, 26.7% from the field marketing business, 6.7% from the customer support business, and 9.5% from the other businesses. In the percentages of segment profit to total profit, the SaaS/ASP business provided 36.2%, the SFA business 42.0%, and the field marketing business 17.0%, so these 3 business provided approximately 95% of the total.

Composition by segment (FY6/18)



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

(1) 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.

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' dashboard cameras, 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. 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 dashboard cameras 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, and 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	Web chatbot system
	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
Customer support business	Contact centers	Customer support consulting

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

(2) Softbrain Group's businesses

The Softbrain Group's businesses can be divided into the SFA 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. As of the end of June 2018, the Company has approximately 84,000 registered staff nationwide who cover more than 160,000 stores, including convenience stores and drugstores, 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 systems development business and publishing business are included in the other businesses segment. But they are small scale in terms sales and profits, and their impact on earnings is negligible.

(3) Customer support business

This is the business of Leoconnect, which was made a subsidiary in March 2018. It provides consulting services for the management of the inbound call centers (24 centers nationwide), from accepting enquiries about customer companies' services and products through to the follow-ups after the responses. Previously, its customers were the members of the HIKARI TSUSHIN Group. But on joining the Company's Group, it has strengthened its IT services and is aiming to develop from providing conventional, problem solving-type call centers to proposal-type, inbound call centers, while at the same time its policy is to develop new customers from outside of the HIKARI TSUSHIN Group.

(4) Other businesses

The other businesses include Softbrain's systems development business and the publishing business. They also include plube's EC business, which manages "yuyu-tei," an EC website to buy and sell battle-type trading cards. The site has a high name recognition in the game industry and is influential to the extent that it is used as a reference indicator for the pricing of used cards, and many of the purchases on it are made by overseas users.

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 of 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 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.

The features of the SaaS/ASP business are that monthly billing revenue accounts for approximately 70% of sales revenue and its recurring income business model, in which monthly revenue is accumulated in accordance with the number of service contracts. 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.

Results trends

Double-digit increases in sales and profits in FY6/18 based on non-GAAP standards

1. Summary of FY6/18 results

For the FY6/18 consolidated results according to non-GAAP standards that exclude temporary earnings and costs, sales and profits increased by double digits, with sales revenue rising 20.3% to ¥12,829mn, operating profit climbing 11.3% to 1,546mn, pretax profit growing 11.1% to ¥1,535mn, and net income attributable to owners of the parent increasing 28.0% to ¥707mn. Results in Softbrain's SFA business were slightly less than forecast due to the effects of the delay in the occurrence of projects and upfront investment, but they steadily grew for the other businesses. Within them, sales and profits increased by double digits for the mainstay SaaS/ASP business, which drove the results as a whole.

Looking at the effects of the M&A, plube, which was made a subsidiary in August 2017, recorded sales revenue of ¥547mn, while Leoconnect, which was made a subsidiary in March 2018, achieved sales revenue of ¥856mn and operating profit of ¥7mn, and both contributed to the higher sales and profits. The IFRS results for FY6/17 included ¥2,633mn as a gain on the staged acquisition of Softbrain shares* at the operating profit stage.

* 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 consolidated results

(¥mn)

	IFRS			Non-GAAP				
	FY6/17	FY6/18		FY6/17	FY6/18			
	Results	Results	YoY	Results	Company target	Results	YoY	vs target
Sales revenue	10,663	12,829	20.3%	10,663	12,900	12,829	20.3%	-0.5%
Cost of sales	6,184	7,744	25.2%	-	-	-	-	-
SG&A expenses	3,372	3,531	4.7%	-	-	-	-	-
Other earnings and costs	2,630	-5	-	-	-	-	-	-
Operating profit	3,736	1,546	-58.6%	1,389	1,600	1,546	11.3%	-3.3%
Pretax profit	3,728	1,535	-58.8%	1,381	1,600	1,535	11.1%	-4.0%
Net income attributable to owners of the parent	2,987	707	-76.3%	552	680	707	28.0%	4.0%

* Non-GAAP indicators are reference indicators for judging the constant management performance of a company using values from which nonrecurring income and expenses items and other adjustment items have been excluded.
Source: Prepared by FISCO from the Company's financial results

Double-digit increases in sales and profits in the SaaS/ASP business due to the rise in sales per customer from cross sales and the growth in IoT- and big data-related sales

2. Trends by business segment

(1) SaaS/ASP business

In the SaaS/ASP business, sales revenue increased 11.9% YoY to ¥3,141mn and non-GAAP standard operating profit rose 41.2% to ¥559mn. Looking by type of sales revenue, monthly and usage-based billing revenue steadily grew, up 9.5% to ¥2,201mn, due to the progress made in spreading cross sales among existing customers and in acquiring new customers. One-time sales revenue also increased for the first time in 2 fiscal periods, up 17.8% to ¥939mn. This was from the contribution of orders for development projects to add to and enhance the functions relating to the safe driving support services for individuals provided by Sompo Japan Nipponkoa Insurance.

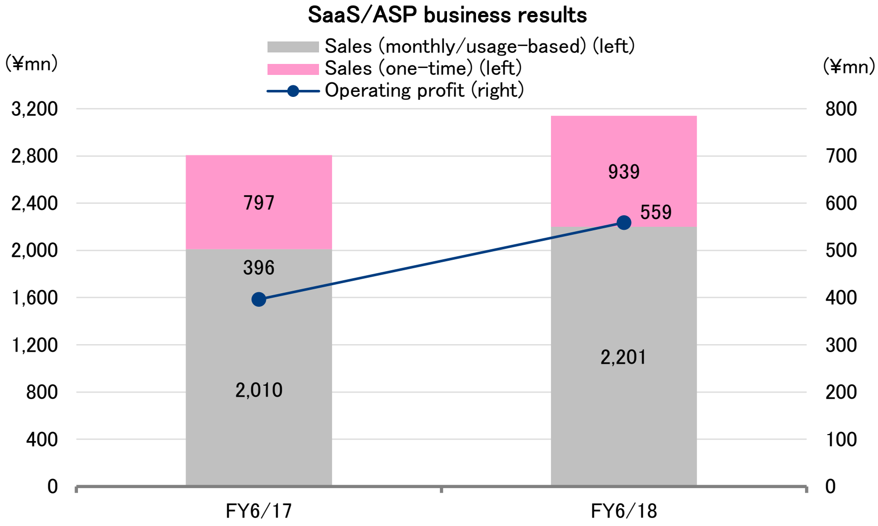
By service, sales revenue increased for the mainstay services, up 11.8% YoY to ¥457mn for i-search and up 26.3% to ¥450mn for i-ask, and both performed strongly. Also, in the i series, the new i-gift service (a store visit-type product exchange digital gift service)*1 was newly introduced by five companies, including SAISON AUTOMOBILE AND FIRE INSURANCE COMPANY, LIMITED, while i-assist (a web chatbot system)*2 was introduced by 3 companies, such as The Shizuoka Bank, Ltd. <8355>, and the Company is steadily accumulating results for new services.

*1 i-gift is a digital gift service 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.
*2 i-assist is a chatbot system that utilizes AI. Its monthly usage fees start from ¥200,000.

Sales revenue for IoT- and big data-related increased greatly, up 44.5% to ¥487mn. This was mainly due to the development of a big data processing and management system relating to Driving!*, which is Sompo Japan Nipponkoa Insurance's safe driving support service, and also the recording of monthly operations and management revenue following the start of this service from January 2018. Other than this, sales were strong for telephone system service, including IVR, increasing 3.8% to ¥273mn, and for the news distribution service, rising 2.2% to ¥430mn.

* It is a service that fully supports a safe and secure car life by providing security when driving through the installation of a dedicated dashboard camera 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 factors causing operating profit to change, the cost-increase factors were that outsourcing costs rose ¥110mn and personnel costs climbed ¥60mn. But these increases were covered by the effects of the higher sales, mainly of the i series, so the operating margin rose from 14.1% in FY6/17 to 17.8%.



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

Sales by service

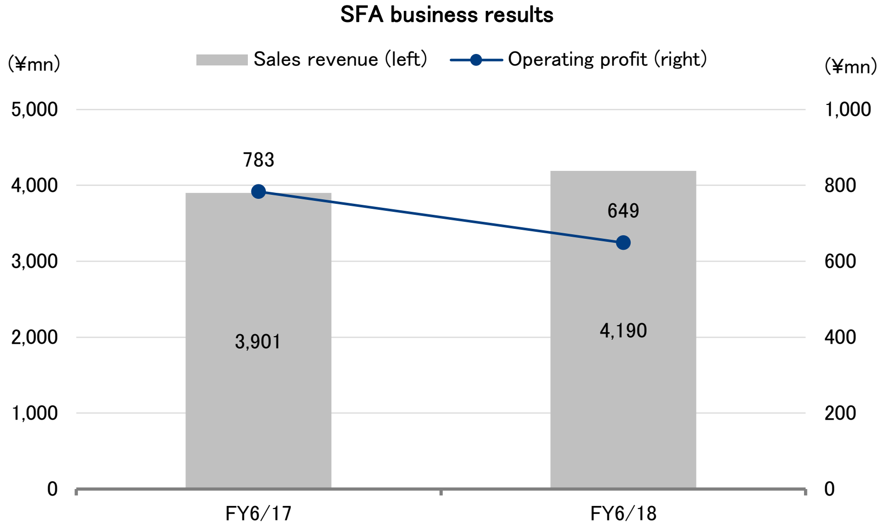
(¥mn)

	FY6/17	FY6/18	YoY
i-search	409	457	11.8%
i-ask	356	450	26.3%
i-entry	104	101	-2.8%
Web services	426	467	9.5%
Services related to IoT/big data	337	487	44.5%
Telephone system service	263	273	3.8%
News distribution service	421	430	2.2%
Other	488	473	-3.1%
Total	2,807	3,141	11.9%

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

(2) SFA business

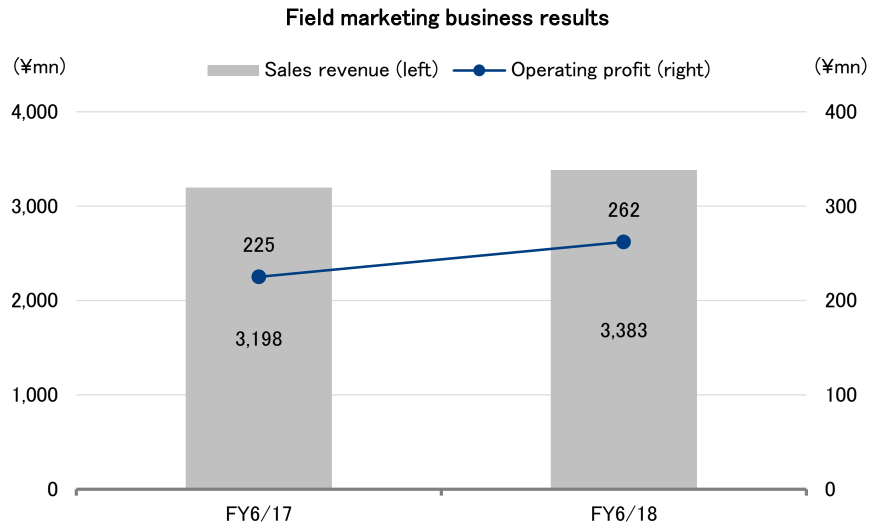
In the SFA business, sales revenue increased 7.4% YoY to ¥4,190mn, while operating profit decreased 17.1% to ¥649mn. Sales of e-Sales Manager, which is sales support software that contributes to improving productivity in sales departments, trended steadily, particularly for the cloud type. But the reason why profits declined was that costs increased, such as personnel costs and relocation-related costs, including to more actively invest in human resources toward realizing growth and to move the head office. It was the only business that failed to achieve the Company forecasts, but this was mainly because of the occurrence of delay in two comparatively large-scale, on-premise projects for e-Sales Manager, and also the pushing forward of the investment in human resources (the recruitment target for 2018 was achieved in half a year), and at the present time, orders received continue to trend steadily.



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

(3) Field marketing business

In the field marketing business, sales revenue increased 7.0% YoY to ¥3,423mn and operating profit rose 16.5% to ¥262mn. Results slumped in 1H of the fiscal period due to the decline in orders for spot projects. But on entering 2018, the Company made progress in acquiring new customers through the effects of the review of the sales organization and making independent a special department for acquiring new customers. As a result, orders for short-term spot projects rapidly recovered and doubled compared to in the same period in the previous fiscal year. In addition, lump-sum contracts for field activities from the main existing customers steadily increased, and therefore sales and profits rose for the full fiscal year.



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

(4) Customer support business

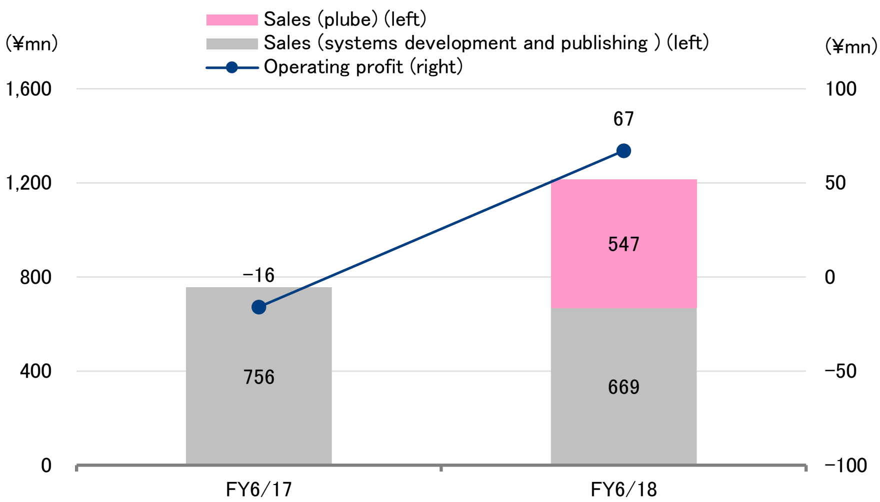
Leoconnect, which conducts a customer support consulting business to provide a one-stop service to solve various problems within call center management, entered the scope of consolidation from March 2018. Therefore, it recorded four months' worth of results, of sales revenue of ¥856mn and operating profit of ¥7mn.

(5) Other businesses

In the other businesses, sales revenue increased 60.9% YoY to ¥1,217mn and operating profit was ¥67mn (compared to a loss of ¥16mn in the previous fiscal year). Looking at the breakdown of sales revenue, in the systems development business, it declined 25.9% to ¥369mn alongside the reduction in the scale of existing projects, but in the publishing business, it increased 16.5% to ¥300mn due to the recovery of book sales.

In the EC business of plube, which entered the scope of consolidation from August 2017, sales revenue was ¥547mn due to the strong sales of battle game trading cards.

Other businesses' results



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

Equity ratio of 39.7%, sustained financial soundness

3. Financial condition and business indicators

Looking at the financial condition at the end of FY6/18, total assets were up ¥1,291mn on the end of the previous fiscal year to ¥16,233mn. The main change factors were that in current assets, there were increases in operating receivables and other receivables of ¥1,005mn and in inventories of ¥79mn. In non-current assets, goodwill rose ¥103mn and other long-term financial assets increased ¥166mn.

Total liabilities increased ¥566mn from the end of the previous fiscal year to ¥7,587mn. The main factors were that operating debt and other payables increased ¥353mn and income taxes payable increased ¥43mn. Total equity increased ¥725mn from the end of the previous fiscal year to ¥8,645mn, with the main factors being the recording of net income attributable to owners of the parent of ¥707mn, net income attributable to non-controlling interests of ¥354mn, and dividend payments of ¥320mn.

Looking at the business indicators, the equity ratio was basically unchanged, declining slightly from 40.1% at the end of the previous fiscal year to 39.7%, while the interest-bearing debt ratio fell from 79.7% to 74.3%. This was mainly because while interest-bearing debt was at about the same level as at the end of the previous fiscal year, shareholders' equity increased. While there is room for the equity ratio to improve even further, net cash (cash and deposits – interest-bearing debt) is being kept at the equilibrium level, so it can be judged that the Company is maintaining a sound financial condition. However, goodwill accounts for approximately 36% (¥5,787mn) 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 due to it requiring impairment treatment. But 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.

Statement of consolidated financial position and business indicators

(¥mn)

	End-FY6/16	End-FY6/17	End-FY6/18	Change
Current assets	5,470	7,167	8,120	953
(Cash and cash equivalents)	5,060	4,999	4,950	-48
Non-current assets	4,160	7,774	8,112	338
(Goodwill)	477	5,684	5,787	103
Total assets	9,631	14,941	16,233	1,291
Total liabilities	5,720	7,021	7,587	566
(Interest-bearing debt)	3,300	4,768	4,793	25
Total equity	3,910	7,919	8,645	725
(attributable to non-controlling interests)	-	1,934	2,196	261
Indicators				
(Stability)				
Equity ratio (shareholders' equity ÷ total assets)	40.6%	40.1%	39.7%	
Interest-bearing debt ratio (interest-bearing debt ÷ shareholders' equity)	84.4%	79.7%	74.3%	
(Profitability)				
ROE	28.1%	60.4%	11.4%	
ROA	18.2%	30.4%	9.9%	
Operating margin	22.9%	35.0%	12.1%	

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

Outlook

Outlook is for the double-digit increases in sales and profits to continue in FY6/19, mainly from the SaaS/ASP business

1. Outlook for FY6/19

The outlook for FY6/19 is for the double-digit increases in sales and profits to continue, with sales revenue to rise 20.4% YoY to ¥15,450mn, operating profit to grow 18.3% to ¥1,830mn, pretax profit to climb 18.5% to ¥1,820mn, and net income attributable to owners of the parent to increase 16.0% to ¥820mn. The SaaS/ASP business and the field marketing business are expected to grow, while the SFA business is set to return to a growth track, with sales and profits to increase by double digits. Leoconnect's recording of results for the full fiscal year will also contribute to sales revenue. In 1H, the Company will conduct upfront investment in development costs and to invest in human resources, so the profit-increase rate will slow down to single digit. But from 2H onwards, the forecast is for the profit-increase rate to rise, including due to the effects of the higher sales and the improved profitability of Leoconnect.

Outlook for FY6/19 consolidated earnings

(¥mn)

	FY6/18		FY6/19			
	Full year	YoY*	1H forecast	YoY	Full-year forecast	YoY
Sales revenue	12,829	20.3%	7,480	27.8%	15,450	20.4%
Operating profit	1,546	11.3%	860	4.6%	1,830	18.3%
Pretax profit	1,535	11.1%	850	4.2%	1,820	18.5%
Net income attributable to owners of the parent	707	28.0%	390	4.8%	820	16.0%
Earnings per share (¥)	41.88		23.10		48.50	

* Comparisons with non-GAAP indicators
Source: Prepared by FISCO from the Company's financial results

Synergies expected with the SaaS/ASP business and the customer support business

2. Outlook by business segment

(1) SaaS/ASP business

The outlook for the SaaS/ASP business is for sales and profits to increase by around 15% YoY. The Company will continue to work on acquiring cross sales for the i series and new customers, aiming to accumulate monthly-billing earnings. One-time sales are also expected to increase from the contribution to sales of new development projects.

For the i series, a major cosmetics company and major non-life insurance company have decided to introduce i-livechat (a web chat system)*, and in addition, a major cosmetics company and a major financial company have decided to newly introduce i-assist. Including the new introductions of i-gift that were decided in FY6/18, the outlook is that these new services will contribute greatly to sales. Particularly for i-livechat and i-assist, it is possible to re-use the knowledge database of i-ask, which is the Company's mainstay service, so it is proposing cross sales to customers using this service, which is leading to contracts. For i-livechat, its policy is to strengthen sales through a cooperating service with LINE Customer Connect.

* 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 a service that contributes to improving customer satisfaction. It is anticipated that it will be introduced mainly at corporate call centers, with an expected minimum monthly usage fee from ¥200,000.

Other than the above, higher sales are expected to continue in FY6/19 for Sompo Japan Nipponkoa Insurance, for which in the previous fiscal year, sales revenue of approximately ¥600mn was recorded. This is because the Company plans to record sales from development projects for insurance sales systems other than for vehicles.

(2) SFA business

The outlook for the SFA business is also for sales and profits to increase by around 15% YoY. As Softbrain's fiscal year ends in December, in terms of Softbrain's results that correspond to the Company's accounting period (FY6/19), 2H of FY12/18 and 1H of FY12/19 will be reflected in the Company's results. On provisionally calculating the growth rate of the sum of Softbrain's FY12/18 2H forecasts and 50% of the FY12/19 forecasts announced in the medium-term management plan, sales revenue will increase 23% YoY and operating profit will rise 46%. There are slight differences, because the two companies' accounting standards are different. But if Softbrain proceeds as planned, it is possible that they will be factor behind results exceeding the forecasts.

Sales of Softbrain's e-Sales Manager are expected to continue to grow. Currently, in order to expand its customer groups, it has introduced e-Sales Manager Remix MS, which is a self-serve version that is intended for SMEs. It is also developing industry-specific products, and these products are expected to contribute to earnings from FY12/19 onwards.

(3) Field marketing business

In the field marketing business, sales and profits are expected to grow by around 5% YoY. If provisionally calculated in the same way, based on Softbrain's forecasts, sales revenue will increase 1% and operating profit 3%. These are less than the Company forecasts, but this is because the FY12/18 1H results were increases in sales and profits that exceeded the Company forecasts. As orders have been trending steadily since July, at FISCO we think it is fully possible that it will achieve higher sales and profits of around 5%.

(4) Customer support business

In the customer support business, sales revenue of ¥2bn is expected. As the amount in FY6/18 was ¥856mn for 4 months, on simply multiplying this amount by 3, the total for the full fiscal year becomes around ¥2.5bn. But in order to improve the profitability of Leoconnect, the Company plans to acquire customers from outside of the HIKARI TSUSHIN Group. Toward, this, it is aiming to reduce the number of telephone inquiries at call centers and establish a structure to accept new customers. As the solution for this, it is proposing introducing the Company's IVR service into each call center, and it is also proposing the introduction of i-ask on the websites of its customers, which are the HIKARI TSUSHIN Group companies. While other companies' systems have already been introduced into Leoconnect's call centers, the Company's IVR is superior in terms of performance and costs, so the plan is to sequentially replace the other systems with it.

Therefore, it is anticipated that the growth in sales revenue will slow due to the temporary fall in the number of telephone inquiries. However, the plan is to allocate the surplus capacity created from the fall in the number of telephone inquiries to new customers from outside of the HIKARI TSUSHIN Group, and if it is able to smoothly acquire new customers, this can be expected to have a positive effect on earnings. Moreover, the number of introductions of IVR and i-ask will rise, which will also be a factor for sales and profits to increase in the SaaS/ASP business.

Other than these, as new services, the Company will start providing multilingual call center services for foreigners and a service to translate FAQ pages. For the multilingual call centers, it has entered into a business alliance with Inbound Tech, which has a leading track record in Japan in this field, and the Company will utilize its resources to provide high-quality services. It is said that the number of annual overseas visitors to Japan will exceed 30 million in 2018, and this number is expected to rise even higher toward the Tokyo Olympics in 2020. Therefore, it is forecast that needs of companies for such services will also increase in the future. The service to translate FAQ will be in the SaaS/ASP business area, and the Company's strategy is to ascertain market changes in advance to quickly capture potential demand.

In the customer support business, the industry average operating margin is around 10%, so the aim at the present time is to improve profitability up to this level by acquiring new customers in the future. Also, through making Leoconnect a subsidiary, it has become possible to ascertain quickly and in more detail the needs of call center worksites, and synergies can be expected going forward in terms of the development of SaaS/ASP services.

(5) Other businesses

In the other businesses, even within Softbrain, the systems development business and publishing business are not considered to be businesses to be actively expanded, and their results are expected to remain at the same level as in the previous fiscal year. On the other hand, the outlook for the EC business in FY6/19 is for higher sales and profits from the strong sales of battle-type trading cards.

Future direction

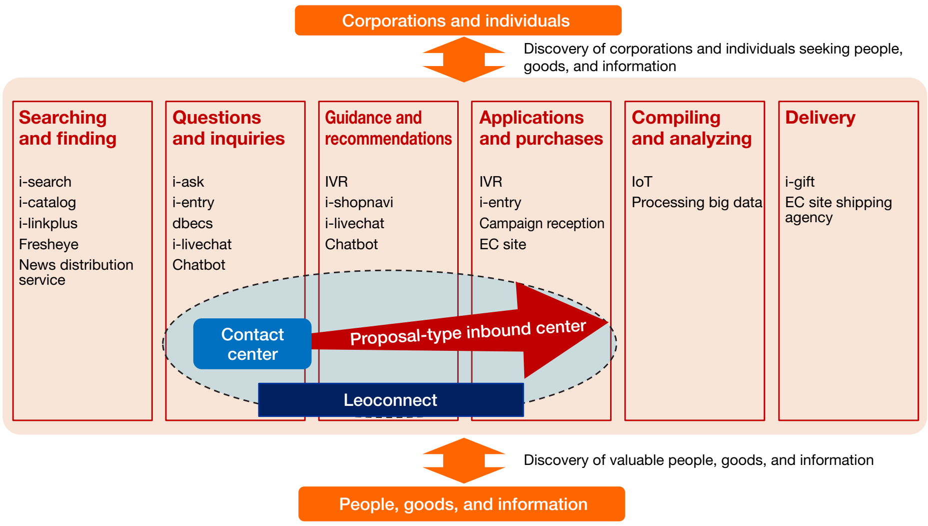
Aiming for double-digit growth while working to enhance services in the CRM area

In terms of its direction for the future, the Company plans to develop a wide range of businesses in the CRM area, which supports communication between corporations and individuals, with the aim of providing the necessary information and goods on the correct timing based on IT services. In addition to the sustainable and stable growth of the existing SaaS/ASP business, its plan is to target double-digit growth by enhancing the synergies with the customer support business acquired through M&A.

In the last two years, the Company has successively and quickly conducted three M&A to acquire Softbrain, plube, and Leoconnect. It is prioritizing the early realization of synergies through collaborating with Leoconnect. Therefore, it seems it will temporarily take a break from conducting M&A, but it is thought that they continue to be one important growth strategy. 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.

Future direction

The Company will develop a wide range of businesses with the aim of providing the necessary information and goods on the correct timing, based on IT services that support communication between corporations and individuals.

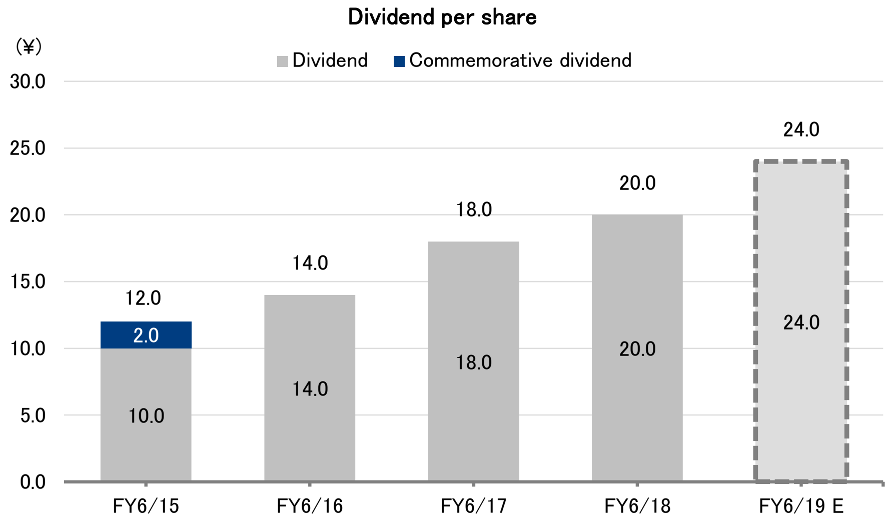


Source: The Company's results briefing materials

Shareholder return policy

Plans to increase the FY6/19 dividend per share by ¥4 YoY to ¥24, for the 10th consecutive fiscal year of higher 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. The standard for the consolidated dividend payout ratio is around 50%, and in FY6/19, the Company plans to increase the dividend per share by ¥4.0 YoY to ¥24.0 (dividend payout ratio, 49.5%). This will be the 10th consecutive fiscal year of higher dividends, and it is also expected to continue to increase the dividend in the future, if earnings 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.

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