

Scala, Inc.

4845

Tokyo Stock Exchange First Section

17-Oct.-2019

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FISCO Ltd.

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

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Summary

Medium-term management plan aims for sales revenue of ¥500bn in 10 years

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*1 businesses, which are a business model with recurring (stock-type) 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>, which is a major sales support software company. It also made subsidiaries of plube Co., Ltd., an EC website management company, in August 2017; of Leoconnect, Inc., which provides customer support consulting to call centers operated by the HIKARI TSUSHIN <9435> Group, in March 2018; and of Connect Agency Inc., which provides a Cloud PBX service*2, in November 2018. The Company has adopted International Financial Reporting Standards (IFRS) accounting.

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

*2 An IP phone service with a service design that generates call fees every second. Compared to the usual, three-minute fees, this service offers a cost benefit for companies that make a lot of calls that last a very short time, such as outbound calls.

1. Overview of FY6/19 results

FY6/19 consolidated results were strong, as sales revenue increased 33.4% year on year (YoY) to ¥17,112mn and operating profit rose 39.2% to ¥2,153mn. Both results exceeded the Company’s forecasts (sales revenue of ¥16,600mn and operating profit of ¥2,000mn). Higher sales and profits were achieved in all the business segments, especially in the mainstay SaaS/ASP business and Softbrain’s SFA business. In addition to the emergence of synergies (acquiring new customers, etc.) in conjunction with making HIKARI TSUSHIN Group’s Leoconnect and Connect Agency subsidiaries in 2018, in the SFA business demand for e-Sales Manager, a tool to improve sales productivity, was strong, as companies energized their efforts at workstyle targeting reforms.

2. Outlook for FY6/20

The Company is not disclosing results forecasts for FY6/20 due to the large impact of new businesses which the Company will focus on going forward. However, for existing businesses alone, the Company is forecasting sales revenue to increase 16.9% YoY to ¥20,000mn and operating profit to increase 11.4% YoY to ¥2,400mn. In the SaaS/ASP business, double-digit growth in sales revenue is expected to continue, due to the build-up of fixed monthly revenue for i-ask and other services, as well as the new introduction and cross-selling of new services such as the Web-chat system i-livechat, the web chat bot system i-assist (virtual assistance), and the digital gift service i-gift. In addition, contributions to profits are expected from the planned introduction of a cloud-based core system which the Company is newly developing in the customer support business. Elsewhere, the Company is forecasting continued growth in Softbrain’s SFA business and field marketing business.

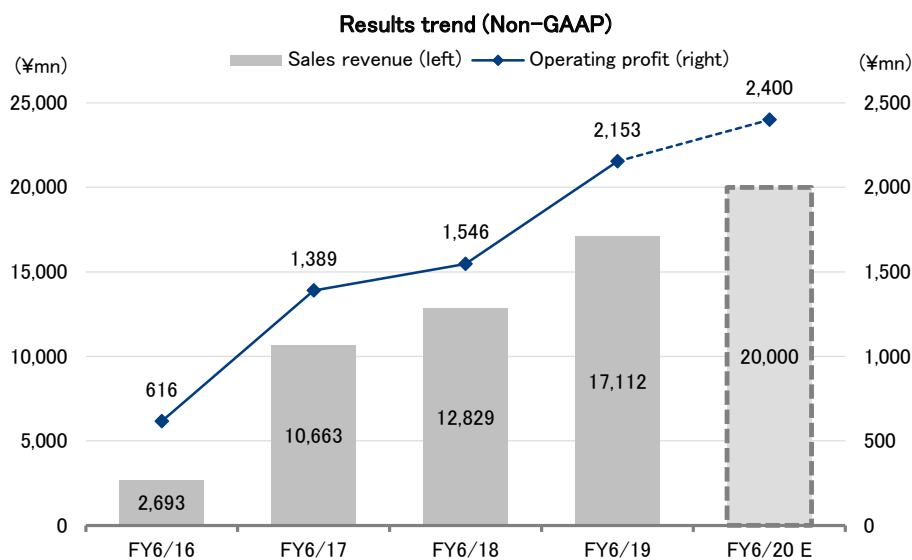
Summary

3. Medium-term management plan

In August 2019, the Company announced a new medium-term management plan. The plan calls for the Company to fully utilize people, knowledge, assets, and other external resources in the Company’s three capabilities (the capability to determine real issues, the capability to discover hidden value of resources, and the capability to maximize value by proposing and executing optimal combination of issues and resources) and to implement these capabilities into the three segments of the Value Creation Support Business, the IT/AI/IoT-related Business, and the Social Issue-solving Business. Numerical targets include sales revenue of ¥100bn and operating profit of ¥10bn by FY6/25 and sales revenue of ¥500bn and operating profit of ¥50bn by FY6/30. In the Value Creation Support Business, due to the fact that management consulting know-how is necessary, the business will be grown by newly establishing Scala Partners and building a network of external partners (specialists). The money needed to expand the business will come from borrowings, the issuance of corporate bonds, as well as the creation of funds.

Key Points

- The SaaS/ASP services in the CRM field is its core business and it is expanding business domain through an M&A strategy
- Results forecasts for FY6/20 are not disclosed, but the outlook is for continued double-digit growth in revenue and profit in existing businesses
- The Company’s medium-term management plan targets revenue of ¥500bn and operating profit of ¥50bn in FY6/30



Note: FY6/20 results forecasts have not been disclosed
 Source: Prepared by FISCO from the Company's financial results and medium-term management plan

■ Company profile

The SaaS/ASP services in the CRM field is its core business and it is expanding business domain 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.

* 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.

In 2000, the Company determined that it needed to change its business structure to continue growing amid the migration of corporate information systems from mainframes to distributed processing (client/servers), and it started expanding its business through M&As utilizing funds obtained from its IPO in 2001. 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.

The Company made subsidiaries of Softbrain (ownership ratio based on voting rights as of the end of June 2019: 50.2%), a major sales support software company, in July 2016; plube (ownership ratio: 100.0%), an EC website management company, 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, and Connect Agency, which provides a cloud PBX service to companies and call centers making outbound calls for such customers as the HIKARI TSUSHIN Group, in November 2018.

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

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Company profile

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
November 2018	Acquired Connect Agency Inc. as a subsidiary
November 2018	Established Scala Next, Inc.
December 2018	Established the Scala Next, Inc., Mandalay branch (Myanmar)

Source: Prepared by FISCO from the Company's website

Main affiliates

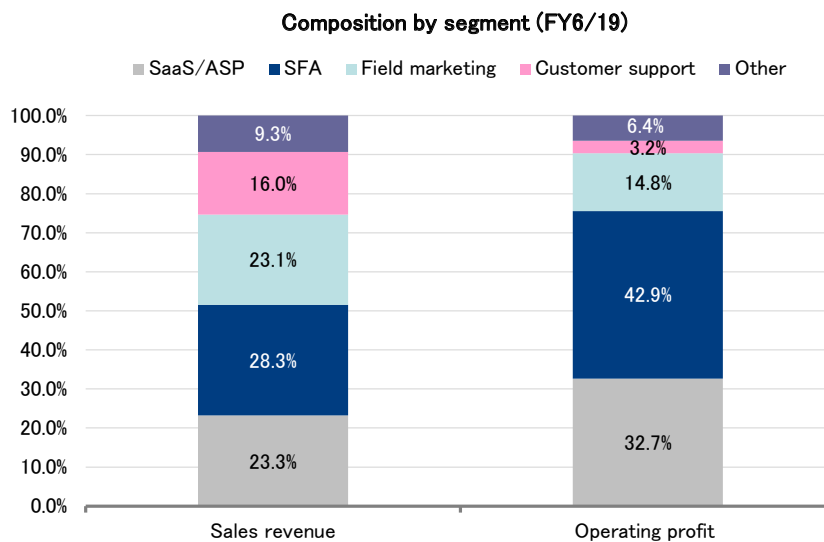
Consolidated subsidiary	Ownership ratio (%)	Main business
Scala Communications Inc.	100.0	SaaS/ASP services and software development, sales, and maintenance
Scala Next	100.0	Development and operations of services for the SaaS/ASP services the Scala Group provides, as well as planning and development of new businesses
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
Connect Agency	51.0	Cloud PBX service

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 field marketing business; and Leoconnect's customer support business, and also the other businesses (Softbrain Group's systems development and publishing business and plube's EC business). In FY6/19, the percentages of total sales by business were 23.3% from the SaaS/ASP business, 28.3% from the SFA business, 23.1% from the field marketing business, 16.0% from the customer support business, and 9.3% from the other businesses. In the percentages of segment profit to total profit, the SaaS/ASP business provided 32.7%, the SFA business 42.9%, and the field marketing business 14.8%, so these 3 businesses provided approximately 90% of the total.



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

(1) SaaS/ASP business

The main services in SaaS/ASP 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 400 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 200 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.

Company profile

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 includes the Cloud PBX service provided by Connect Agency, which was made a subsidiary in October 2018.

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 Sampo 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 driving 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."

Description of the SaaS/ASP business services

Type	Description	Product name
Site assistance service	Site internal search engine	i-search
	Link-loss detection system	i-linkcheck
	Site print service	i-print
	Related link display service	i-linkplus
CMS service	FAQ system	i-ask
	Product site management system	i-catalog
	Progress management and approval system	i-flow
CRM service	Web chatbot system	i-assist
	Web chat system	i-livechat
	Digital gift service	i-gift
Telephone-system service	24-hour, 365-day automated voice response	SaaS-type IVR
News distribution service	Corporate news Monitoring important business information	Corporate news
Data management	Latest patent management system	PatentManager6
	Contract operations management system	GripManager
Site operations business	Search portal site	Fresheye
IoT, Big Data	Processing and management of Big Data	Safe driving analysis
SFA business	SFA/CRM software	e-Sales Manager
Field marketing business	Market research, store field activities	Field activities, market research, etc.
EC	Operations for the online buying and selling of trading cards and related products	Online card shop
Customer support business	Customer support consulting	Contact centers

Source: Company material

Company profile

(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 5,000 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 2019, the Company has approximately 90,000 registered staff nationwide who cover more than 180,000 stores, including convenience stores and drugstores, and it is deploying this business on the largest scale within Japan. Recently, field activities have expanded to encompass the B-to-B domain (sales agent) and not just B-to-C.

The systems development business and publishing business are included in the other businesses segment. But even for both businesses combined, their annual sales have trended around ¥700mn to ¥800mn and operating profit has been in the range of tens of millions of yen, so 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) for customers including the HIKARI TSUSHIN Group and its agencies, from accepting enquiries about customer companies' services and products through to the follow-ups after the responses. For the time being, it is improving productivity by introducing its services, such as i-livechat and i-assist, into call centers, and it is jointly working with Scala Communications on developing a new core system reflecting customers' needs, and this core system is expected to be completed in FY6/20. Going forward, it plans to develop support services not only for the HIKARI TSUSHIN Group but also for the Company's customers.

(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 for buying and selling battle-type trading cards. The site has a high name recognition in the gaming industry and is influential to the extent that it is used as a reference indicator for the pricing of used cards, and it is known as the industry's No. 1 EC shop. Many of the purchases on the site are made by overseas users, and starting in FY6/20 users will be able to purchase from 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 the extensive lineup of services developed in this manner differentiates it from its competitors. The ability to propose multiple services in packages enables the Company to satisfy diverse customer needs, and this cross-selling helps to raise the average price per customer, boost customer satisfaction, as well as prevent cancellations. The Company has done business 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 high 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

In the FY6/19 results, sales and profits increased by double digits and exceeded the Company forecasts

1. Summary of FY6/19 results

In the FY6/19 consolidated results, sales revenue increased 33.4% YoY to ¥17,112mn, operating profit rose 39.2% to ¥2,153mn, pretax profit grew 39.1% to ¥2,137mn, and net income attributable to owners of the parent increased 33.8% to ¥946mn. So sales and profits increased by double digits, and moreover every result exceeded the Company forecasts.

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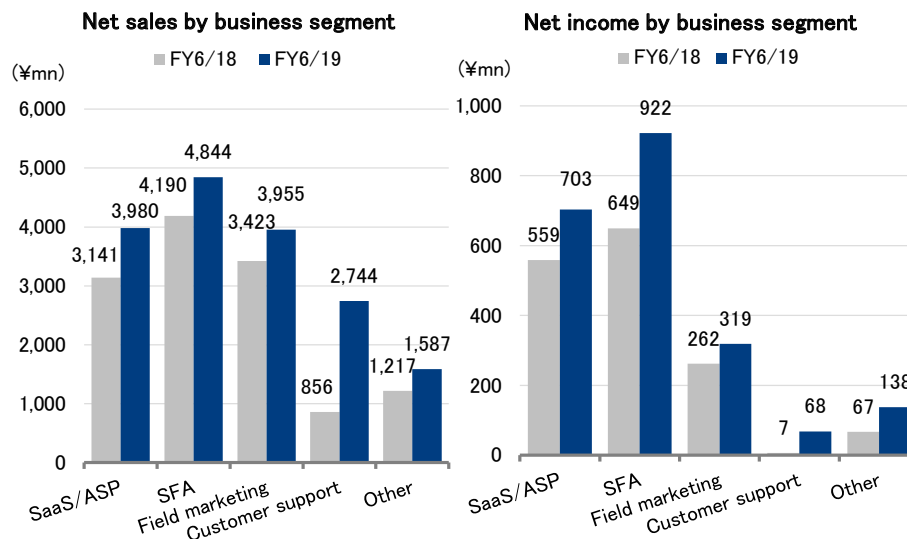
Results trends

Both sales revenue and operating profit increased in all business segments. With respect to the M&A effects, Leoconnect (customer service business), which was brought into the Group in FY6/18 3Q, and Connect Agency (SaaS/ASP business), which was brought into the Group From FY6/19 2Q, together appear to have boosted the Company's sales revenue by over ¥2.0bn and its operating profit by just under ¥100mn, and existing businesses alone posted double-digit growth in both sales revenue and operating profit. Due to the increase in subsidiaries, the cost of sales ratio increased 3.4 percentage points YoY, but the operating margin rose 0.5 percentage points YoY to 12.6% due to the impact of higher sales. The growth in net income attributable to owners of the parent was lower than that for pretax profit. The reason for this was that net income attributable to non-controlling interests increased 44.5% YoY to ¥511mn, due to the increase in profit for Softbrain Group and other non-100% subsidiaries.

FY6/19 consolidated results

	FY6/18			FY6/19			
	Results	vs. sales	Company target	Results	vs. sales	YoY	vs target
Sales revenue	12,829	-	16,600	17,112	-	33.4%	3.1%
Cost of sales	7,744	60.4%	-	10,913	63.8%	40.9%	-
SG&A expenses	3,531	27.5%	-	4,082	23.9%	15.6%	-
Operating profit	1,546	12.1%	2,000	2,153	12.6%	39.2%	7.7%
Pretax profit	1,535	12.0%	1,990	2,137	12.5%	39.1%	7.4%
Net income attributable to owners of the parent	707	5.5%	890	946	5.5%	33.8%	6.3%

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



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

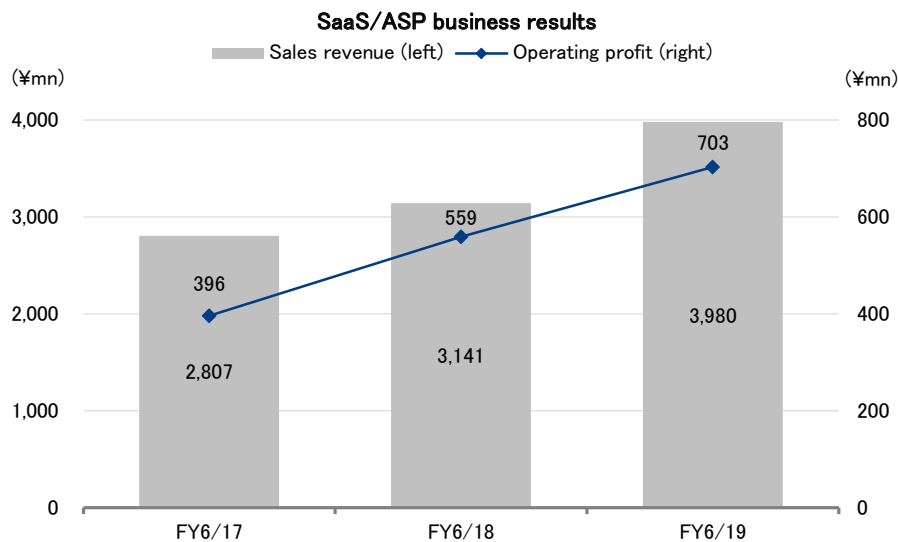
Results trends

The mainstay SaaS/ASP business and SFA business both posted double-digit growth in sales revenue and operating profit

2. Trends by business segment

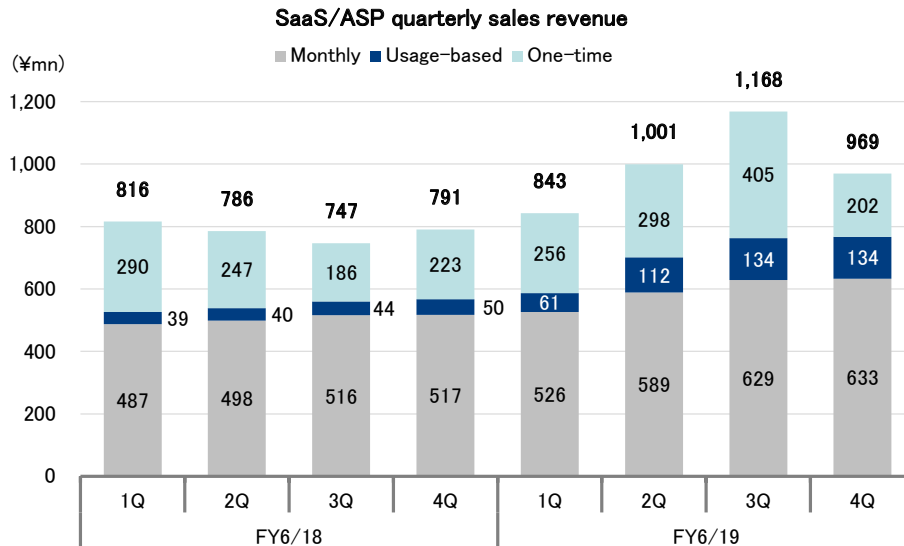
(1) SaaS/ASP business

In the SaaS/ASP business, sales revenue increased 26.7% YoY to ¥3,980mn and operating profit rose 25.6% to ¥703mn, which were record highs for both once again. Looking at sales revenue by type, all types of sales revenue increased considerably. Monthly billing revenue increased 17.8% to ¥2,377mn due to the penetration of cross sales among existing customers and the progress made in acquiring new customers, while usage-based billing revenue rose 154.9% to ¥441mn in conjunction with the addition of Connect Agency's sales from 2Q. One-time sales revenue grew 22.7% to ¥1,161mn due to the new introduction of a PIM (Product Information Management) system that enables centralized management of product information to Sanyo Electric <6516>. Connect Agency's results have been included in consolidated results since November 2018, and this seems to have added ¥300-400mn in net sales and somewhere around ¥30mn in profit.



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

Results trends



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

By service, while sales generally increased for all services, the i-ask service in particular saw an increase in sales due to progress in cultivating new customers. Also, i-gift*1, which was released as a new service in 2017, as well as i-assist*2 and i-livechat*3 were steadily introduced, primarily in financial institutions. Synergies are also starting to emerge through joint proposals with Leoconnect, such as the service introductions into Haluene Co., Ltd., Hi-Bit Inc., as well as service introductions into Last One Mile Co., Ltd. and other HIKARI TSUSHIN Group companies and their agencies.

*1 i-gift is a digital gift service in which digital gifts (electronic messages with IDs such as QR codes) that are exchangeable for products are sent to customers through SMS or e-mail when companies are conducting sales promotion campaigns and gift campaigns for new products. Customers who received a digital gift can bring it to a store 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.

*3 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.

The main new customers for SaaS/ASP business services

Type	Product name	Description	Customers
Site assistance service	i-search	Site internal search engine	OSAKA PALCOOP, NISHIMATSUYA CHAIN Co., Ltd., Haluene Co., Ltd.
CMS service	i-ask	FAQ system	SUMITOMO LIFE INSURANCE COMPANY, DX Antenna Co., Ltd. LIFENET INSURANCE COMPANY, The Nanto Bank, Ltd., ORIX Credit Corporation, SymEnergy Inc., E.design Insurance Co.,Ltd., Sanrio Company, Ltd., JFR CARD Co., Ltd., HASEKO Corporation, DIAMOND, Inc., UNIMAT LIFE CORPORATION, Haluene Co., Ltd., Maxsupport, Fene Co., Ltd., Salespartner Inc., Hi-Bit Inc., hi-ho Inc.
CRM service	i-assist	Virtual assistance	The Nishi-Nippon City Bank, Ltd., Daiwa Securities Co. Ltd., The Gunma Bank, Ltd., Hi-Bit Inc., Last One Mile Co., Ltd., AXCELL
	i-livechat	Web chat system	Sony Assurance Inc.
	i-gift	Digital gift service	MONEY PARTNERS CO., LTD, SAISON AUTOMOBILE&FIRE INSURANCE CO., LTD.
Telephone system service	SaaS-type IVR	Automated voice response service	R-bies, INC.

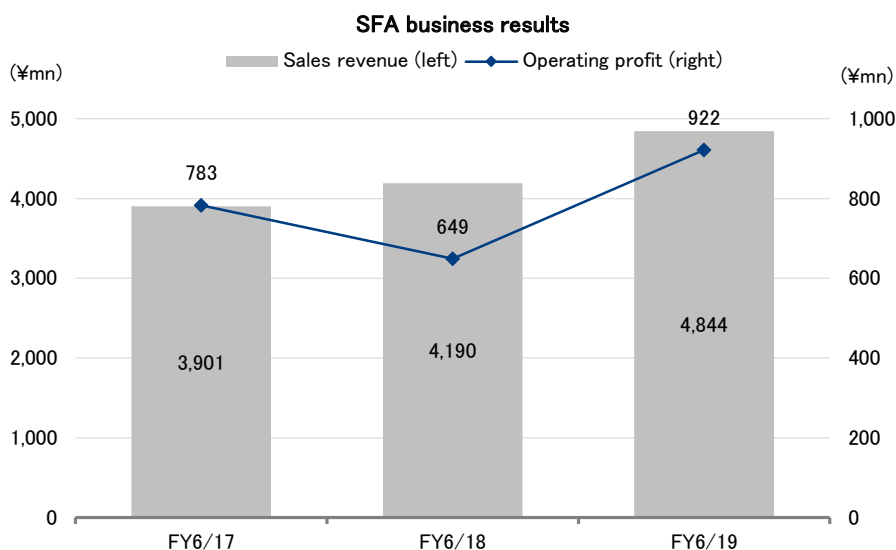
Note: Red text indicates collaborative projects with Leoconnect.

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

Results trends

(2) SFA business

In the SFA business, sales revenue increased 15.6% YoY to ¥4,844mn and operating profit rose 42.2% to ¥922mn, which were new record highs. As more companies implement workstyle reform measures to deal with the increasingly severe personnel shortages, there has been an increase in the number of companies using SFA tools in order to improve sales productivity. Sales of e-Sales Manager, which has been rated No. 1 for ease of use, were strong, particularly for the cloud service. The profit margin also rose by 3.5 percentage points YoY to 19.0%, as the effects of the higher sales of e-Sales Manager absorbed the increases in personnel costs and development costs.

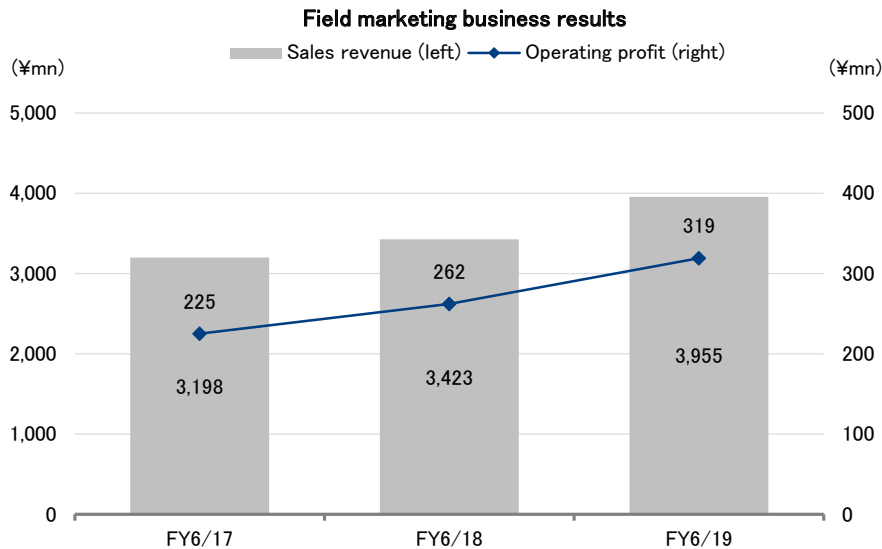


Source: Prepared by FISCO from the Company's results briefing materials

(3) Field marketing business

In the field marketing business, sales revenue increased 15.6% YoY to ¥3,955mn, and operating profit rose 21.8% to ¥319mn. The main reasons for the higher sales and profits were that orders for spot projects, such as store construction, increased due to the change to the sales organization structure and from the effects of focusing on new customer acquisition, as well as strong performance in lump-sum contract projects for field activities for existing customers. In terms of new initiatives, progress is being made on carrying out third-party sales services in the B-to-B field, and orders received have gradually begun to increase.

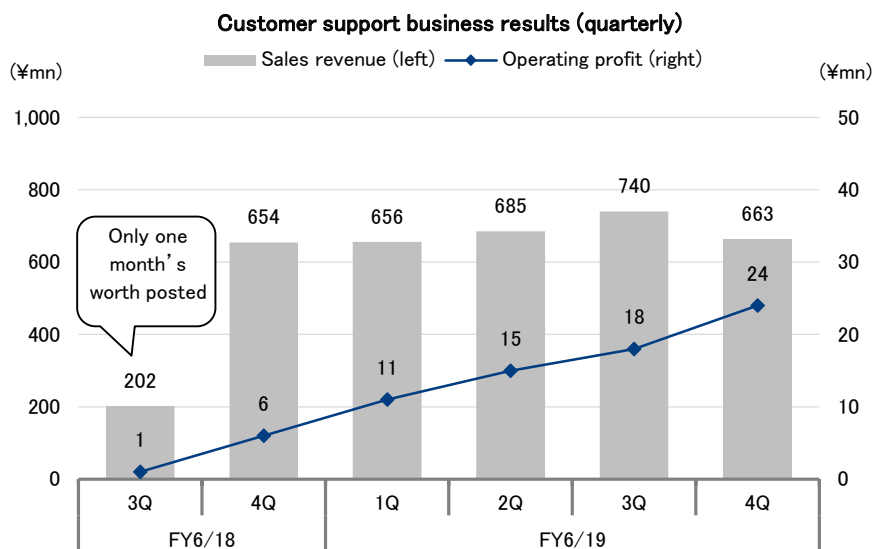
Results trends



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

(4) Customer support business

Sales revenue increased 220.3% YoY to ¥2,744mn and operating profit increased 770.4% to ¥68mn. Because this business segment was included in consolidated results since FY6/18 3Q, steady progress is being made on initiatives utilizing Group synergies, although no comparisons can be made for the period in question. In addition to handling inbound call center operations from HIKARI TSUSHIN Group companies, the Company contracts in customer consulting operations for a leading new energy company and a large telecommunications company, as well as customer support operations for a customer that uses Scala Communications' service (SaaS/ASP business). The profit margin was a low 2.5%, but progress is currently being made on the joint development of a core system with Scala Communications, and the Company will work to increase the profit margin by enhancing productivity and cultivating new clients, among other efforts.

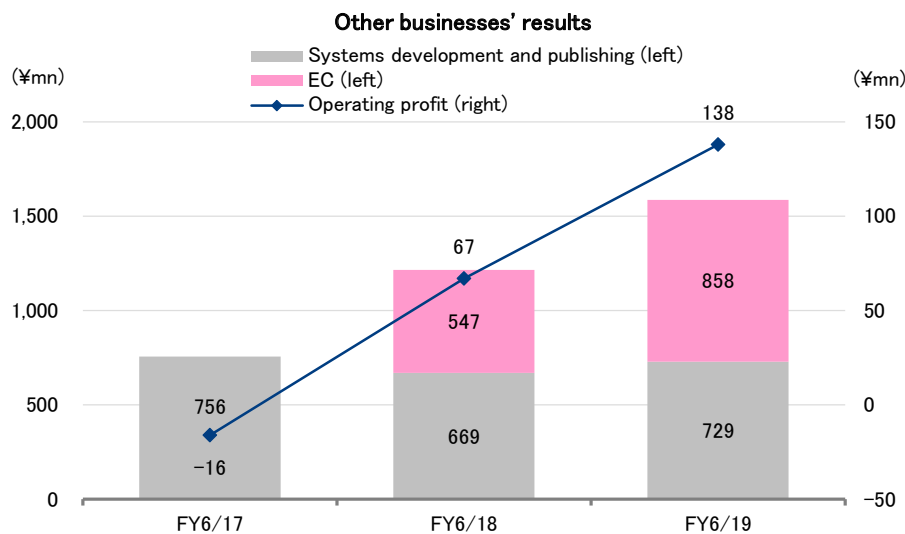


Source: Prepared by FISCO from the Company's results briefing materials

Results trends

(5) Other businesses

In other businesses, sales revenue increased 30.4% YoY to ¥1,587mn and operating profit rose 106.5% to ¥138mn. Looking at the breakdown of sales revenue, in the EC business sales jumped 56.8% YoY to ¥858mn due to vigorous buying and selling of trading cards. Meanwhile, in the systems development and publishing business, sales revenue increased 9.0% YoY to ¥729mn as a result of increased revenue in the systems development business. Profit increased due to the improvement in profit in the systems development and publishing business, while profit in the EC business was also solid.



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

Interest-bearing debt increased, but the net cash equilibrium maintained a healthy financial condition

3. Financial condition and business indicators

Looking at the financial condition at the end of FY6/19, total assets were up ¥2,461mn on the end of the previous fiscal year to ¥18,694mn. Breaking down the main change factors, in current assets, cash and cash equivalents increased ¥1,443mn and operating receivables and other receivables rose ¥411mn, while in non-current assets, goodwill increased ¥404mn.

Total liabilities increased ¥1,498mn from the end of the previous fiscal year to ¥9,086mn. The main factor was interest-bearing debt increased by ¥1,185mn. Total equity increased ¥962mn from the end of the previous fiscal year to ¥9,608mn, with the main factors being the recording of net income attributable to owners of the parent of ¥946mn, net income attributable to non-controlling interests of ¥511mn, and dividend payments of ¥372mn with the decline in retained earnings.

Results trends

Looking at the business indicators, the ratio of equity attributable to the owners of the parent declined by 2.2 PP, from 39.7% at the end of the previous fiscal year to 37.5%. Mainly due to the increase in interest bearing debt, the interest-bearing debt ratio rose from 74.3% at the end of the previous fiscal year to 85.3. But since net cash (cash and cash equivalents – interest-bearing debt) is being kept at the equilibrium level, it can be judged that the Company is maintaining its financial soundness. However, goodwill accounts for approximately 33% (¥6,192mn) 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 currently Softbrain's results are trending stably, and at FISCO, we think the possibility of this risk materializing is extremely low.

Consolidated balance sheet

	(¥mn)				
	FY6/16	FY6/17	FY6/18	FY6/19	Change
Current assets	5,470	7,167	8,120	10,165	2,045
(Cash and cash equivalents)	5,060	4,999	4,950	6,393	1,443
Non-current assets	4,160	7,774	8,112	8,529	416
(Goodwill)	477	5,684	5,787	6,192	404
Total assets	9,631	14,941	16,233	18,694	2,461
Total liabilities	5,720	7,021	7,587	9,086	1,498
(Interest-bearing debt)	3,300	4,768	4,793	5,978	1,185
Total equity	3,910	7,919	8,645	9,608	962
(attributable to non-controlling interests)	-	1,934	2,196	2,597	401
Indicators					
(Stability)					
Ownership ratio attributable to owners of the parent	40.6%	40.1%	39.7%	37.5%	-2.2pt
Interest-bearing debt ratio	84.4%	79.7%	74.3%	85.3%	11.0pt
(Profitability)					
ROE	28.1%	60.4%	11.4%	14.1%	2.7pt
ROA	18.2%	30.4%	9.9%	12.2%	2.3pt
Operating margin	22.9%	35.4%	12.1%	12.6%	0.5pt

Note: Based on IFRS

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

■ Outlook

Outlook for FY6/20 results are not disclosed, but existing businesses are expected to continue to post double-digit growth in sales revenue and operating profit

1. Outlook for FY6/20

In its medium-term management plan, the Company made it clear that it will be engaging in new businesses from FY6/20. However, because these new businesses will have a large impact on results, the Company has decided not to disclose results forecasts for FY6/20. Still, for its existing businesses, the Company is expecting sales revenue to increase 16.9% YoY to ¥20,000mn, and forecasting operating profit to rise ¥11.4% to ¥2,400mn, with both sales revenue and operating profit expected to increase in all business segments.

Outlook

(1) SaaS/ASP business

In the SaaS/ASP business, the Company aims to achieve a double-digit increase in both sales and profit. It will continue to focus on sales in its flagship i-series service, the IVR+SMS service which simplifies guidance from phone to Web services, and Web service which constructs customized Web systems based on companies' needs, as it looks to build up monthly fixed revenue, as well as focus on expanding introductions of new services like i-livechat, i-assist, and i-gift and engaging in cross sales. The Company will continue to cultivate customers in the HIKARI TSUSHIN Group and its agencies through joint proposals with Leoconnect. There are 200-300 companies in the HIKARI TSUSHIN Group, and if companies in which it has not invested, such as agencies, are included, this number increases to several thousand companies. This pool of companies represents the Company's promising potential customers. In addition, as a new initiative, the Company will focus energy on a service whereby it will make proposals as a set with comprehensive value creation advisory incorporating AI-based natural language analysis, and with understanding from senior management, provide design, introduction, and operation of AI/IoT in a one-stop manner.

(2) SFA business

In the SFA business, sales revenue and operating profit are expected to increase 10-20%. With the implementation of the Act on the Arrangement of Related Acts to Promote Work Style Reform in April 2019, limits on overtime hours were established for large companies, and limits will go into effect for SMEs from April 2020. SMEs face more severe personnel shortages than large companies, and therefore demand for e-Sales Manager, which helps companies increase sales productivity, is expected to further increase going forward. Softbrain started selling e-Sales Manager Remix MS, which is a self-serve version intended for SMEs, from 2018. Softbrain has been gathering user needs to improve the UI and revise functions. The final form is almost ready, and Softbrain plans to expand sales in earnest from 2020. Close attention will be paid to sales trends.

(3) Field marketing business

In the field marketing business, sales and profit are expected to increase 10-20% YoY. Consumer goods manufacturers, the key customers, are increasingly outsourcing sales promotion operations due to a shortage of personnel. This shortage of human resources is particularly serious in regional cities and other such places, and this would seem to provide a tailwind for the Company, which has built a network of approximately 90,000 field staff across the country. Concerning B-to-B third-party sales services, there has been an increase in new projects, such as introducing cashless payment systems in stores and lodging facilities, and this is expected to contribute to an increase in profits going forward.

As a new service, collecting consumer receipt information and adding additional information, such as the purchase reason, to create a database, and developing a POB (Point of Buy) business to sell to companies. Currently, POS information data is in widespread use, but as additional data, for example on the purchase reason and consumer attributes, is still unclear, it seems possible for the Company to profit from this by adding this type of additional information. In terms of scale, the goal is to build a collection system that collects three million receipts per month, and the plan is to build up a business base by working with companies possessing member bases to expand the network. In the near term, the target is to collect one million receipts by the end of 2019.

Outlook

(4) Customer support business

In the customer support business, the Company is forecasting flat sales revenue but higher operating profit due to higher profit margin. The Company will aim for an increase in productivity and enhance profitability by continuing to handle inbound call center operations for customers of HIKARI TSUSHIN Group companies and advancing the introduction of the various SaaS/ASP services (IVR+SMS, i-assist, etc.) for the Company's call centers. The Company also plans to work on contracting customer support operations for customer companies using SaaS/ASP services. Furthermore, the Company is currently working with Scala Communications to develop a cloud-based core system reflecting customer needs, and there are already plans in place for the system to be introduced at multiple companies, which is expected to contribute to FY6/20 results. Going forward, the Company plans to focus on the development and provision of new services that improve operational efficiency while utilizing AI/IoT technology, and aims to achieve an operating margin of 10% in the future.

(5) Other businesses

The EC business is expected to continue to post double-digit growth in FY6/20. In order to further grow the EC site "yuyutei," in addition to starting to develop a smartphone app version, users also began being able to purchase trading cards from overseas. Going forward, the Company aims to expand its business as the EC site where the most trading card game users gather, while expanding the number of game titles handled and providing timely game tips. Plube has built all the processes necessary for the operation of EC sites such as logistics, systems, sales, purchases, and marketing internally, and the Company plans to leverage plube's know-how as it develops the Group's EC business going forward.

Meanwhile, with respect to the systems development and publishing business, there are no plans to aggressively expand the business within the Softbrain Group, so results are expected to be on par with the previous year.

The newly-formulated medium-term management plan targets sales revenue of ¥500bn and operating profit of ¥50bn in FY6/30

2. Mid-term management plan

In August 2019, the Company announced its medium-term management plan that runs until 2030. As results continue to grow steadily and stabilize, including the financial base, the plan redefines the management philosophy targeting further growth to raise employee motivation and drive growth.

(1) New Management Philosophy
a) Vision (Aim): Contribute to the happiness and prosperity of all mankind

The Company will achieve its management vision by realizing a society overflowing with value. Specifically, the Company will aim to discover people who recognize value and deliver this to them at the right time, as well as continue to create things that exceed existing value and promote a cycle that gives birth to new value and technology.

The Company is touting Scala Co-creating Shared Value (SCSV), which entails spreading its philosophy of balancing business and social contribution around the world through "co-creation," and has indicated its plan to develop business together with companies that possess the same philosophy.

Outlook

b) Mission (Role to Play): Become an ideal company for the world

In addition to direct social contributions in the IT business domain, the Company will contribute indirectly to people's happiness in a variety of domains, both in Japan and the rest of the world. The Company aims to discover hidden value using its unique mechanisms, and accelerate the speed of development around the world, as well as create the necessary communication tools and services, striving to become the world's top business with this new business model using IT.

c) Value (Values and Action Guidelines): Provide unlimited possibilities for those who continue to challenge anything

As values and action guidelines for employees in order for them to achieve goals, the Company has established the four key phrases of "realize your dream," "fair and square," "don't give up," and "raise one another up."

The Company's strategy is to strive for growth by building and expanding a value creation platform to realize a society full of value including communication promotion and making value visible utilizing IT/AI/IoT technology, human resources including external resources, knowledge held by companies and individuals, and capital from investment funds, etc.

(2) Basic Strategy

As the basic strategy in the medium-term management plan, the Company has sorted its own capabilities as "determining real issues," "discovering hidden value of resources," and "maximizing value by proposing and executing optimal combinations of issues and resources," and has included plans and will develop businesses for each capability. In particular, the Company plans to focus on fields related to AI/IoT which are based on existing businesses and fields related to SDGs* (Sustainable Development Goals).

* Sustainable Development Goals (SDGs): As a follow-up to the Millennium Development Goals (MDGs) adopted in 2001, the SDGs are goals of the international community between 2016 and 2030 included in the 2030 Agenda for Sustainable Development adopted at the UN Summit in September 2015. The SDGs comprise 17 goals and 169 targets in order to achieve a sustainable world, and pledge "to leave no one behind."

Mid-term management plan

Basic Strategy

- Aim for dramatic growth with three capabilities

Capabilities	Future Strategy
1) Determine real issues	Expand targets not only to Japanese, but also to global companies, governments, municipalities, and NPOs. Widen scope of activities to sales and management consulting and media platform domains.
2) Discover hidden value of resources	Utilize internal and external resources as well as AI/IoT technology, and provide "people, assets, capital and knowledge" involved in solving problems.
3) Maximize value by proposing and executing optimal combinations of issues and resources	Expand the scope of activities to operation of AI-based matching platform and investor relations support to maximize corporate value, not only for customers and the Scala Group, but for all related stakeholders, and provide various solutions.

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

(3) Numerical management targets

The Company is targeting sales revenue of ¥100bn and operating profit of ¥10bn in FY6/25, and sales revenue of ¥500bn and operating profit of ¥50bn in FY6/30. In FY6/19, sales revenue was ¥17.1bn and operating profit was ¥2.1bn, so the Company is considering carrying out new businesses in addition to existing businesses as well as expanding the business area to overseas as well as in Japan. Business segments are classified into each capability.

Outlook

Initiatives and Sales Revenue Targets by Segment

Capability	Segment involved	Initiatives	Sales revenue target	
			FY6/25	FY6/30
1) Determine real issues	Value creation support business	<ul style="list-style-type: none"> Value creation comprehensive advisory (consulting) Engagement fund Launch CVC Investor communications support 	¥30bn	¥180bn
2) Discover hidden value of resources	IT/AI/IoT-related business	<ul style="list-style-type: none"> Proposal-type solutions AI/IoT introduction support Development of IT/AI/IoT engineers Matching with venture companies Development of communication tools for the knowledge-creation cycle 	¥60bn	¥220bn
3) Maximize value by proposing and executing optimal combinations of issues and resources	Social-issue solving business	<ul style="list-style-type: none"> Health and education in developing countries Business targeting environmental issues Business related to regional revitalization 	¥10bn	¥100bn

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

a) Value creation support business

The value creation support business includes comprehensive advisory of value creation (consulting), engagement funds*, corporate venture capital (CVC), and investor communications support services. A high level of expertise is required for this business, so the Company will conclude contracts with external partners to carry out the business. Scala Partners Co., Ltd., the subsidiary that will actually engage in this business, was established in July 2019 (ownership ratio: 100%), and partner agreements have been concluded with around 10 specialists.

* Engagement funds seek to be investment funds that carry out bilateral dialogue with investee companies to ensure that investee companies' commitments align with those of the fund. When necessary, engagement funds introduce business partners and/or customers, propose M&A deals, and otherwise support the management of investee companies and provide them with advice.

Scala Partners plans to engage in three businesses: the CSV innovation business, which together with client companies will pursue the launch of innovative new businesses that look ahead to the future; the CSV incubation business, which will discover entrepreneurs, support business start-ups, and help develop companies; and the CSV investment business, which will search for possibilities to increase latent company value, nurture businesses through investment, invest, and provide value creation consulting services. In the near term, the six fields of focus will be "food and health, healthcare, education, environment, regional revitalization, and finance." In these six fields, efforts will be focused on working with companies and research institutes involved in these fields, as well as local governments and other entities to utilize AI/IoT technologies to increase corporate value and solve social problems.

In addition, in the investor communications support business, the Company has announced that it will convert J-Phoenix Research Inc. into a wholly-owned subsidiary in September 2019, and this service will be carried out through this company. J-Phoenix Research produces integrated reports and securities analyst reports from the perspective of securities analysts, and provides value creation management advisory services. Sales have recently reached approximately ¥60mn. Going forward, jointly with J-Phoenix Research, the Company will utilize IT/AI/IoT to carry out services that contribute to the enhancement of corporate value. The Company has already started developing an automatic generation system for securities analyst reports using AI.

In this business, the Company is targeting sales revenue of ¥30.0bn in FY6/25 and ¥180.0bn in FY6/30. In the CSV innovation business, the key to growth will be the extent to which large companies can be acquired as customers.

Outlook

b) IT/AI/IoT-related business

The IT/AI/IoT-related business will be an extension of the existing business. For this business, the Company is targeting sales revenue of ¥60bn in FY6/25 and ¥220bn in FY6/30. This comes to an average growth rate of 23% per year over the six years until FY6/25. In its next three-year medium-term management plan starting FY12/21, Softbrain is targeting annual sales growth of 20-30%, and this target seems sufficiently reachable if one considers the growth prospects for the company's SaaS/ASP business and new business development, along with other factors.

Future initiatives include not only the development of SaaS/ASP service proposal-type solutions and support for the introduction of AI /IoT solutions, but also the training of engineers who will serve as the foundation for business expansion, and the development of matching services for large companies and venture companies, as well as new communication tools for the knowledge-creation cycle. In terms of training engineers, in Myanmar, where a branch office was opened in 2018, the Company is currently training about 20 engineers, and plans to expand this to several hundred engineers over the next two to three years.

c) Social Issue-solving business

In the social issue-solving business, the Company will engage in enhancing the health/insurance and education environments in developing countries, and businesses related to environmental problems and regional revitalization. The Company is targeting sales revenue of ¥10bn in FY6/25 and ¥100bn in FY6/30.

With respect to enhancing health/insurance in developing countries, the Company has partially launched a model business at its Myanmar Branch. Since there are few hospitals in Myanmar, and the insurance system is undeveloped, it costs ¥30,000 yen to receive treatment for a common cold, so many people do not go to the hospital and their symptoms worsen. For this reason, we promote health promotion activities from the standpoint of food and are creating a system to collect personal health data via smartphone apps. If such big data can be collected over a wide area, it will become the basis of insurance data and it will be possible to commercialize the insurance business. When the business is commercialized, engagement funds and subsidies from the government will be used to do so, and actual services will be advanced jointly with insurance companies.

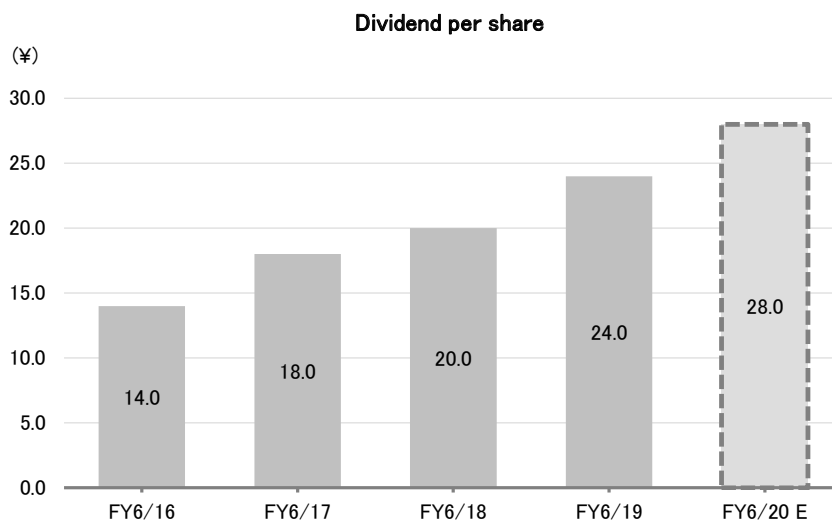
In terms of environmental issues, the Company will establish a comprehensive information platform with an issue database, resources database, and matching advisory function, based on the theory of biotechnology-based resource circulation, and plans to collaborate with related organizations, research institutes, large companies, and other entities to carry out the business.

Also, targeting local cities in Japan and overseas, the Company will collaborate with local governments, regional financial institutions, and SMEs to support local culture succession issues, thereby revitalizing regional areas. The Company does not yet have any detailed plans, but it is assumed that the Company will develop its businesses by establishing a matching platform for human resources, monetization and culture dissemination and building a network of young personnel and a network of local culture successors.

Shareholder return policy

The Company plans to continually increase its dividend going forward

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 FY6/20, the Company plans to increase the dividend per share by ¥4.0 YoY to ¥28.0. This will be the 11th 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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